1999

Comment letters on Proposed statement on auditing standards : audit adjustments, reporting on consistency, and service organizations

American Institute of Certified Public Accountants. Auditing Standards Board

A Team AICPA Note

AICPA

DATE: June 29, 1999

TO: Pat Meyer

FROM: Sherry Boothe

SUBJECT: Comment Letters

Attached is copies of the *Audit Adjustment* Comment Letters 1-33. If I receive any more I will send to your attention.

(1)

H.Gregory Mermel
CERTIFIED PUBLIC ACCOUNTANT
2835 N. Sheffield, Suite 311, Chicago, IL 60657-5084
773-525-1778 Fax 773-525-3209

April 30, 1999

Ms. Judith M. Sherinsky
Technical Manager, Audit and Attest Standards
File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

This is in response to the "Audit Adjustment" section of the exposure draft.

This section generally assumes that there is agreement between auditor and client as to whether the amount or presentation of an item constitutes a misstatement. In practice, I find that this is often not the case. My clients tend to be accounting laymen and rely not on the rules but on what they perceive to be common sense. They may insist that their presentation is correct, or that their presentation is clearer and more logical; in either case, they are often difficult to convince of the need to change. If, at this point, I judge the effect of the misstatement to be immaterial, I leave the matter alone rather than waste time convincing the client of the need to change. Virtually all auditors, I am sure, would do the same.

I do not believe that note 5 to the proposed amendment to SAS No. 85 adequately addresses this situation. What it seems to me that we want is for the client to *acknowledge* the auditor's belief that the items are misstatements (whether or not the client agrees) and to *agree* with the auditor's judgment that the items are immaterial. What does stating their reason for believing them not to be misstatements add?

Moreover, this note presupposes that the client believes the presentation to be correct. Not infrequently, clients will agree with us: the presentation is not in accordance with GAAP, but they nevertheless want it their way. The proposed standard leaves us no means of addressing this situation. I am obviously not going to change my auditors' report over an item that I have already judged to be immaterial, and it is not appropriate to ask the client to state in the representation letter something he does not believe to be true (i.e., that the existing presentation is in accordance with GAAP).

I would also like to suggest a clarification. When I first read the exposure draft, I thought that the schedule of uncorrected misstatements had to have specific dollar amounts associated with them, which is not always practical. If one has judged the maximum amount of a misstatement to be immaterial, one need not spend time determining the exact amount. On rereading the draft, I understand that such precise dollar amounts are not required (or, in some cases, any dollar amounts at all where the misstatement involves financial statement disclosure). I believe some rewording or amplification may be needed to prevent such accidental misreadings.

Please let me know if you wish to discuss this.

Yours very truly,

H. Gregory Mermel, C.P.A.

2

Author: ATTESTSR at AICPA3
Date: 5/14/99 3:10 PM
Priority: Normal
Receipt Requested
TO: Judith M. Sherinsky
Subject: Fwd:AICPA Feedback
------------------------------- Message Contents -------------------------------

____________________Forward Header____________________
Subject: AICPA Feedback
Author: MIME:bholtz@dbc-llp.com
Date: 5/13/99 2:33 PM

Thursday, 05/13/99 02:28:31 PM (PST)

From: BRUCE G. HOLTZ
Email: bholtz@dbc-llp.com
Phone: (309) 827-0348
AICPAMember: Yes
Employer: DUNBAR, BREITWEISER & COMPANY LLP
Address1: 202 N. CENTER
Address2: City: BLOOMINGTON
State: IL
Country: USA
Zip: 61701
Comments: to Judith M. Sherinsky, Technical Manager, Audit and Attest
RE: EXPOSURE DRAFT-SAS-AUDIT ADJUSTMENTS

This proposal seems absurd. I thought the whole point of using the concept of materiality was so that we did not have to waste time on the small insignificant matters. Now this proposal is suggesting we give extra special attention to the small/insignificant stuff by putting it in Management Representation letters and bringing it to the attention of the audit committee. I hope this statement doesn't get approved, it seems like a step backwards.

Thank you,
Bruce G. Holtz, CPA

3

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PROFESSIONAL ASSOCIATION

CERTIFIED PUBLIC ACCOUNTANTS

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Anthony M. Funk, CPA

Members of American Institute
and Kansas Society of
Certified Public Accountants

May 6, 1999

Judith M. Sherinsky
Technical Manager
Audit and Attest Standards
File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036

Dear Ms. Sherinsky:

I am writing to comment on one section of the April 22, 1999 exposure draft on a proposed statement on auditing standards relating to audit adjustments, reporting on consistency and service organizations (omnibus statement on auditing standards-1999).

The section that I wish to comment on has to do with audit adjustments. In particular, I have serious concerns about requiring that the management representation letter include a summary of uncorrected misstatements and that client management will be required to acknowledge that it considers these to be immaterial. First of all, a requirement to report implies a requirement to discover. However, AU 312.04-.05 states that an auditor has no responsibility to plan and perform an engagement in order to obtain a reasonable assurance that immaterial misstatements will be discovered. Secondly, materiality is a construction of the auditor, not client management. How can we ask client management to make representations to us about a value for which they took no part in determining and may have only a limited understanding of at best?

Furthermore, I believe that the additional requirement of reporting immaterial uncorrected misstatements to the audit committee or equivalent will significantly blur the idea of what is material and thereby potentially cause impairment to the whole concept of reasonable assurance. The blurring of the idea of materiality will occur because it will open the auditor up to second guessing about his or her decision to classify a misstatement as material or not. Also, how do we explain to a client that we are reporting immaterial uncorrected misstatements when theoretically these misstatements should not influence the judgment of the financial statement reader; that materiality may change during the audit or that it may be both quantitative and qualitative? The impairment of the concept of reasonable assurance could occur because the reporting of immaterial misstatements might lead the client and other financial statement users to infer a level of precision (absolute assurance) in the audit process that is not there.

My recommendation is to entirely remove the audit adjustments section from the adopted omnibus statement on auditing standards-1999 due the fatal flaws in its content. Thank you for your attention.

Cordially,

Thomas E. Singleton, CPA

May 6.doc

4

Author: MIME:rosenfie@gateway.net at INTERNET
Date: 5/19/99 7:06 PM
Priority: Normal
TO: Judith M. Sherinsky at AICPA3
CC: Barbara Vigilante at AICPA2
Subject: Proposed SAS on Audit Adjustments
------------------------------ Message Contents ------------------------------

Please do not require auditors to send a summary of immaterial audit adjustments to their clients.

We have spent a great deal of time & effort educating small firms (and their clients) to the concept of materiality. To now require them to focus on the list is a step backward.

I would also like to know the problem that caused the AICPA to consider this proposal. Is this really a "big 5" client problem? I have never, in over 30 years, had a small firm audit client refuse to post a J/E.

If we must pursue this course, lets just require the client to furnish the auditors with a post closing trial balance- something I always considered a requirement.

I have no problem with addressing the adjustments in the engagement and representation letters.

5

McCarthy, Hargrave & Co.

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May 21, 1999

Judith M. Sherinsky, Technical Manager
Audit and Attest Standards
File 3509
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Judith:

This letter is being written in response to the Proposed Statement on Auditing Standards, "Audit Adjustments, Reporting on Consistency, and Service Organizations" dated April 22, 1999.

With respect to part one, Audit Adjustments, paragraph two requires a summary of the uncorrected misstatements be included in the representation letter or in an attachment thereto. Is it possible to have management state in the letter of representation that all adjustments proposed by the auditor have been made to the financial statements except for any entries that might be clearly inconsequential? The reason I suggest this is that in my twenty-five years of auditing experience, including my nine years of recent experience conducting peer reviews, it seems that accounting firms dealing with small entities usually make all the adjustments that they find as a result of either audit, review or work on compiled financial statements. In all my years of experience, I have never encountered a situation where a client refused to make the adjustments we were proposing to the financial statements. I have the feeling that this proposed standard is directed at much larger organizations that may be publicly held. In any event, it seems to me that a positive statement by management in the letter of representation would eliminate the need for the auditor to attached a list, which would require additional precious time, to summarize inconsequential adjustments to financial statements.

You might also want to consider whether this proposed standard should also apply to review engagements. As you know, a letter of representation is required on a review engagement and such a requirement, I believe, would be beneficial.

Sincerely yours,

Dan McCarthy

Daniel F. McCarthy, CPA

/hb

COMMENT LETTER #6

June 4, 1999

Ms. Judith M. Sherinsky
Technical Manager, Audit and Attest Standards
File 3509
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Judith:

I agree with the general intent of the Exposure Draft on Auditing Standards concerning audit adjustments. I do believe it is a positive change to include a statement in the engagement letter highlighting that management is responsible for correcting material misstatements and for affirming that uncorrected misstatements are immaterial. I further agree that a general statement to that effect will enhance the management representation letter. However, I disagree with the proposal to include a summary or listing of each immaterial item.

In our practice, we certainly make our client staff aware of any errors we discover, even if they are immaterial. Following professional literature, we only report these errors to the person responsible for them, not necessarily any higher levels as would be required for material errors or any inappropriate activity. I believe that having to include a list of individually immaterial items in the management representation letter, which should come from those persons having ultimate responsibility for the financial statements, is inappropriate. That is asking senior management to become too involved with immaterial items.

I further believe that the representation letter should be prepared by management. A requirement that a list of auditor findings be included in management's letter would diminish the effectiveness of the letter. This is because, in my experience, management tends to consider any schedules that were prepared by the auditors to be theirs, and I believe that as a profession we want the management representation letter to a product of the client.

Lastly, a list of immaterial errors noted during an audit is not likely to be all-inclusive. In other words, the list will include only those items coming to our attention during our testing. Because of the inherent nature of sampling, the errors we discover should be representative, but will not likely be complete. I believe that including such a list will give the appearance of being complete, and that subsequent discovery by management of other immaterial errors could cause management to improperly question the effectiveness of the audit.

These are my personal views. In order to let you know on what I base these opinions, I will list my relevant experiences. I am a partner in a 23 person local CPA firm. I have been a CPA in public practice for over 20 years. I am a former member of the AICPA Credit Unions Committee, and have served on the Maryland Association of CPAs Auditing Standards, Accounting Standards, and Professional Ethics Committees. I chaired the MACPA Auditing Standards Committee for two years.

Thank you for the opportunity to share my opinions with you.

Sincerely,

James A. Higbee, CPA

MACPA

(7)

June 1, 1999

Judith M. Sherinsky, Technical Manager
Audit and Attest Standards; File 3509
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

The Audit and Attest Standards Committee of the Maryland Association of Certified Public Accountants reviewed the exposure draft, *Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards—1999)* dated April 22, 1999. We have the following comments:

Part 1 Audit Adjustments

The committee noted that every financial statement misstatement is not necessarily brought to the attention of management in the form of proposed adjustments. Frequently there are items identified in the course of the audit that are clearly de minimus and those items are not considered as potential audit adjustments. The committee felt it was important to make this distinction in order to avoid presenting management with a long list of insignificant items. Clearly these types of inconsequential items would not have a significant effect on the entity's financial reporting process and the committee did not feel the need to bring them to the attention of the audit committee.

In general the committee felt this amendment makes sense in the SEC environment. However, this may not have any benefit for the small practitioners and their clients that do not practice in this environment. This issue may have been more appropriately dealt with as a Practice Alert. The real issue may be revisiting SAS 47, *Audit Risk and Materiality in Conducting an Audit.*

One of the requirements of SAS 61 is to bring to the audit committee's attention matters that may have a significant effect on the entity's financial reporting process. The committee questioned the purpose of bringing immaterial items to their attention unless the misstatements are deemed to be pervasive or intentional. Otherwise, the committee felt it was not necessary to do so.

Part 2 Consistency

In light of the proposed elimination of the pooling of interests method of accounting for business combinations, the committee felt this amendment was not necessary.

If addressed, the committee questioned why changing from the cost to the equity method would not be a consistency issue.

Part 3 Service Organizations

The committee agreed with this amendment.

We appreciate the opportunity to respond to the exposure draft.

Sincerely yours,

James L. Layton

James L. Layton, CPA
Chairman

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(8)

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June 4, 1999

Judith M Sherinsky, Technical Manager
American Institute of Certified Public Accountants
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New York, New York 10036-8775

Dear Ms. Sherinsky:

The following are my personal comments on the April 22, 1999 Proposed Statement on Auditing Standards -- *Audit Adjustments, Reporting on Consistency, and Service Organizations*. I will only comment on the issue regarding audit adjustments. To provide you with a little perspective on my view, I have considerable Big Six (now Five) experience in the practice of auditing, have served on my state society's auditing standards committee for several years (including as chair) and presently serve as the audit manager for the CPA firm noted above.

While I see no harm in issuing the proposal, it seems more of a token gesture to give the appearance that the profession is responding to concerns voiced by Arthur Levitt and the SEC than a meaningful attempt to address any underlying weaknesses. This entire issue is the result of concerns voiced by Mr. Levitt after several high profile cases, such as W. R. Grace, brought to light the apparent misuse of judgment regarding materiality -- a misuse by both management and the auditors. Furthermore, it is clear that the proposal is nothing more than a copying of the requirements adopted by the Big Five Audit Materiality Task Force.

I must say that I am disappointed that the Auditing Standards Board would merely "adopt" what the Big Five have agreed among themselves to be appropriate. For non-SEC registrants, with no audit committees, simply including a reference to passed adjustments in the engagement and representation letters seems of little significance -- but certainly would not hurt anything (however, I can see where small CPA firms with a few passed adjustments will be overlooking including a schedule of same (particularly if they relate to minor errors as opposed to intentional misstatements) with a representation letter, only to get "pinged" by peer review).

I feel a better approach would be for the SECPS to issue a Practice Alert or some other type of guidance. Also, I think the real issue is to provide guidance to auditors on how to use judgment in issues involving materiality that may well involve a need to revisit SAS No. 47. After all, regardless of how strongly client management objects, in the end it is the auditors who make the final decision to issue a "clean" opinion. It is time that we 'fess up to needing more robust audit procedures in place -- think about it, if management can be relied upon to police itself, there never would have been a need for audits. To reiterate, the real issue is not whether we, as a profession, can shame client management into passing on fewer proposed adjustments but whether we are doing our job. Maybe the POB's recent initiative to look into audit effectiveness can be expanded to address this issue (if it's not already).

However, if the proposal is going to be issued, I suggest that it be made clear that passed adjustments that are clearly inconsequential[1] not be required to be communicated under SAS No. 61. Also, I think it would be prudent to consider only requiring passed adjustments that in the auditors judgment are or may be of an intentional or pervasive nature be required to be communicated under SAS No. 61 (after all, the apparent concern being expressed by the SEC is with respect to intentional misstatements and not isolated bookkeeping errors).

Finally, rather than add a paragraph 10 (after AU sec 380.09) for "immaterial uncorrected misstatements" which seems a little contradictory given the use of the term "significant" in paragraph 9, it may be less confusing/contradictory to simply insert parenthetically the term "including immaterial uncorrected misstatements" after the word "adjustments" in the first sentence of paragraph 9. This way, auditor judgment is still involved and allows everyone to focus on the more serious misstatements that are intentional and/or pervasive in nature.

Very truly yours,

Daniel R. Sandstrom

[1] This is consistent with the "Big Five Audit Materiality Task Force Status Report and Initial Recommendations."

#9

State of Wisconsin \ LEGISLATIVE AUDIT BUREAU

JANICE MUELLER
STATE AUDITOR

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131 WEST WILSON STREET
MADISON, WISCONSIN 53703
(608) 266-2818
FAX (608) 267-0410

June 2, 1999

Judith M. Sherinsky
Technical Manager
Audit and Attest Standards, File 3509
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

We appreciate the opportunity to respond to the exposure draft of the proposed statement on standards for audit adjustments, reporting on consistency, and service organizations. Overall, we believe the draft provides necessary clarification and guidance to the auditor in the prescribed areas. We do not have any comment on the proposed changes to the standards on reporting on consistency; however, we do have a few suggestions on the changes proposed for audit adjustments and service organizations.

Audit Adjustments

We support changes that would encourage auditees to record proposed adjustments or to acknowledge their decision in determining them to be immaterial. However, we believe the proposed changes need to be clarified to allow for auditor discretion to communicate immaterial misstatements informally, rather than to present them formally in the representation letter or in communication with the audit committee. For example, we frequently bring minor errors to the attention of our auditees in an attempt to suggest control or procedural improvements, rather than to suggest the auditee make adjustments to its financial records for relatively insignificant amounts. It is unclear as to whether the proposed change would encompass these types of insignificant misstatements.

Service Organizations

Overall, we found the proposed changes to the auditing standard on service organizations clarified what information the auditor needs when auditing the financial statements of an entity that uses a service organization. We strongly agree with changing the title to service organizations, because we believe there is frequently too much emphasis on determining whether a "SAS 70 report" is available, rather than ensuring auditors have adequately considered the service organization's controls. Further, we believe the changes to paragraph 3 of AU Section 324 provides additional guidance for determining the applicability of this standard to the audit. However, further examples of service organizations and how they are used would be helpful, especially in relation to paragraph 3, item d. In our own audits, we have difficulty determining the applicability of this standard to areas such as the use of external investment managers or the use of claims processing organizations for benefit programs. We believe additional clarification in this area, through the use of examples, may assist auditors in determining the applicability of the standard to the various types of service organizations.

Additionally, we have some concerns about the removal of paragraph 8 of AU Section 324, which provided examples that were useful for determining the significance of the service organization to the audit. We believe the proposed change provides less guidance to the auditor in determining what factors should be analyzed in deciding the significance of the service organization's controls.

We appreciate the opportunity to respond. If you have any questions about our comments, feel free to contact Carolyn Stittleburg at (608) 266-2818, who coordinated our response.

Sincerely,

Janice Mueller

Janice Mueller
State Auditor

JM:jb

#10

505 Church Avenue
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June 13, 1999

Phone 425-353-2048
FAX 425-261-1329
E-mail charlspa@msn.com

Judith M. Sherinsky, Technical Manager
Audit and Attest Standards
File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft, Proposed Statement on Auditing Standards, Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards—1999) April 22, 1999

Supplement to my prior letter dated May 24, 1999

Differences In Estimate

The Exposure Draft is directed at management's responsibility for financial statements and disposition of misstatements brought to its attention. It does not specifically address what are often called differences in estimate. Auditors have always had to deal with differences between their estimates and their clients' estimates, determining whether the differences were so great as to require adjustment. When an accrual or valuation reserve is appropriate, the difficulty is often in determining what the amount should be.

With the written formalities between the auditor and his client, suggested by the Exposure Draft, it may be awkward to deal, in writing, with differences in estimate. It seems like the only solution is to require the auditor to include, in writing, a description of these differences to management and the audit committee so they will have the same oversight and responsibility to determine whether any adjustment is appropriate.

In the case of differences in estimate, as compared to outright misstatements, these differences may become more important and more difficult to deal with than outright misstatements. It may result in non finance management and the audit committee having to get involved in evaluating the judgmental information supporting some estimates, followed by an affirmative written representation to the auditors.

In my experience, differences in estimate are more prevalent in "earnings management" than amounts/accounts that are total misstatements. I believe it is imperative that the changes to Auditing Standards that arise from this Exposure Draft address this area and not leave it open for auditors and management to deal with, without guidance.

Part of the possible solution to the above matters will depend on how the other areas of my May 24 letter are addressed.

Again, I would be happy to discuss any of the matters in this or my prior letter with you. It is difficult to cover all the issues in a short letter as there are so many variables. A group discussion and brainstorming sessions would probably be a better way to arrive at a revised Exposure Draft. I would be happy to participate in such discussions.

Sincerely,

Charles A. Pancerzewski

Charles A. Pancerzewski, CPA

505 Church Avenue
Mukilteo, WA 98275-1517
June 13, 1999

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Judith M. Sherinsky, Technical Manager
Audit and Attest Standards
File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft, Proposed Statement on Auditing Standards, Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards—1999) April 22, 1999

Supplement to my prior letter dated May 24, 1999

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Sincerely,
Charles A. Pancerzewski

Charles A. Pancerzewski, CPA

#11

ARTHUR ANDERSEN

June 14, 1999

Arthur Andersen LLP

225 Franklin Street
Boston MA 02110-2812
617 330 4000

Ms. Judith M. Sherinsky
Technical Manager
Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
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Re: File 3509

Dear Ms. Sherinsky:

We are pleased to submit our comments on the proposed auditing standard, "Omnibus Statement on Auditing Standards--1999" (the ED). Our comments on the content and substance of the ED are presented below.

Overall Comments

We strongly support the timely issuance of this proposed auditing standard. We believe the objectives of the ED, to encourage audit clients to record financial statement adjustments proposed by the auditor in an audit of financial statements, to clarify which changes in the reporting entity require a consistency explanatory paragraph in the auditor's report, and to help auditors determine the kind of information they need about a service organization when they are auditing the financial statements of an entity that uses a service organization to process transactions, are necessary and appropriate.

In particular, the correction of known misstatements by management is critical to investors' and analysts' confidence in the financial reporting process, as well as the continued well-being of U.S. financial markets. Therefore, the establishment of a standard that requires specific auditor actions that will further encourage audit clients to record proposed audit adjustments is warranted. Our comments with respect to this area of the proposed standard (included under Part 1 below) revolve around providing further clarity to help management and the auditor implement the guidance in this section of proposed standard.

The proposed amendment of AU section 420 to conform the language in the auditing standards with the guidance in the accounting literature, as well as to clarify that certain instances resulting in changes in reporting entity do not warrant a consistency explanatory paragraph, is appropriate. We have no further comments on this section of the proposed standard.

Lastly, we support the proposed amendment to AU section 324 to state that it is applicable when an entity obtains services from another organization that are part of the entity's information system and to provide guidance to help auditors determine whether services are part of the information system. Our comments with respect to this area of the proposed standard (included under Part 3 below) are focused on providing clarification and guidance (1) as to when a service organization's services are part of an entity's information system, (2) about the factors that impact on the significance of the service organization's controls to the user organization, and (3) as to how the presence of these factors should be considered by auditors in planning and executing their audits.

ARTHUR
ANDERSEN

Principal Comments

Part 1:

Applicability to Latest Period Presented

- We believe that the amendment should clarify that the acknowledgment by management that it has considered the financial statement misstatements brought to its attention by the auditor and has concluded that any uncorrected misstatements are not material, both individually and in the aggregate, to the financial statements taken as a whole (along with the required summary of uncorrected misstatements) applies only to the latest period presented, i.e., since the general representation letter otherwise covers all periods presented.

Summary of Misstatements – Paragraph 5 (AU section 333.06, paragraph g)

- We believe that the requirement for attaching a summary of misstatements to the general representation letter should also state that this summary is to include sufficient information to provide management a basis for concluding that any uncorrected financial statement misstatements are individually and collectively immaterial.

  We suggest inserting the following at the end of paragraph g: *This summary should include sufficient information to enable management to conclude that the effects of any uncorrected financial statement misstatements are individually and collectively immaterial.*

Disagreements with Management– Paragraph 5 (AU section 333.06, paragraph g, footnote 5)

- We believe there is a need to cross-reference the information in the proposed footnote 5 to the existing guidance in AU 380 with respect to communicating disagreements with management to the audit committee.

  We suggest inserting the following at the end of footnote 5: *See AU sec. 380.11.*

Definition of Misstatement

- We believe that there is a need for more clarity with respect to the definition of misstatement, specifically as relates to the effect of proposed audit adjustments carried over from prior years on the current year financial statements. Additionally, there is a need to provide further guidance as to qualitative factors that the auditor should consider in assessing the materiality of proposed audit adjustments.

  We suggest that the Materiality Task Force, in its continuing activities, undertake a project subsequent to the finalization of the proposed standard to:

1. provide more guidance on the definition of misstatement, specifically as relates to the effect of proposed audit adjustments carried over from prior years on the current year financial statements, and

2. develop a list of qualitative factors that the auditor should consider in his/her assessment of materiality.

Part 3:

Service Organizations – Paragraph 11 (AU section 324.03 and 324. 06-.08)

- We believe there is a need for more clarity with respect to the guidance provided as to when a service organization's services are part of an entity's information system. For instance, must all three of the factors in 3b (accounting records, supporting information and specific accounts) be affected by the service organization's services before this criterion is met or not? Additionally, does the accounting process have to be affected by the service organization's services *all the way* "from the initiation of the transactions to their inclusion in the financial statements" before the criterion in 3c is met or not? In essence, what does "affect" mean in this context?

  We suggest replacing the last sentence of paragraph 3 and paragraphs 3a through 3d with the following:

  A service organization's services are part of an entity's information system if they include:

  a. initiation of transactions, or
  b. part or all of the accounting processing of transactions from their initiation to their inclusion in the financial statements.

- We believe that the significance of the controls of the service organization to those of the user organization depends primarily, not solely, on the nature of the services provided by the service organization. For example, the extent to which the user organization, when practicable, implements controls of its own versus places reliance on the controls of the service organization also bears on the significance of the service organization's controls.

  We suggest rewording paragraph 6 to acknowledge this as follows:

  When a user organization uses a service organization, transactions that affect the user organization's financial statements are subjected to controls that are, at least in part, physically and operationally separate from the user organization. The significance of the controls of the service organization to those of the user organization ***primarily*** *depend upon the nature and materiality of the transactions the service organization initiates and/or* *processes for the user organization, and the degree of reliance placed by the user organization on the service organization's controls. For example, when the user organization initiates transactions and the service organization executes and handles the accounting processing of those transactions, there may be a high degree of interaction between the organizations' activities. In these circumstances, it may be practicable for the user organization to implement effective controls for those transactions to the extent the user organization elects to do so.*

- We believe there is a need to strengthen the linkage between paragraphs .06, .07 and .08 to provide auditors with more guidance as to the how the presence of the factors included in paragraph .06 should be considered in planning and executing their audits.

  We suggest rewording the second sentence of paragraph 7 to provide for this as follows:

  This understanding may encompass controls placed in operation by (a) the entity and (b) service organizations whose services are part of the entity's information system when those controls are deemed to be significant to those of the user organization (see paragraph .06).

  We also suggest rewording the first sentence of paragraph 8 to provide for this as follows:

  Information about the services provided by a service organization that are part of the user organization's information system and the significance of the controls of the service organization to those of the user organization may be available from a wide variety of sources, such as...

Very truly yours,

Arthur Andersen LLP

#12

GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

June 16, 1999

Ms. Judith M. Sherinsky
Technical Manager
Audit and Attest Standards, File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

This letter presents the U.S. General Accounting Office's comments on the Proposed Statement on Auditing Standards *Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards – 1999).* We are limiting our comments to the proposed revisions that address audit adjustments and service organizations.

The proposed amendments regarding auditing adjustments are intended to encourage audit clients to record financial statements adjustments proposed by auditors. The auditor in establishing an understanding with the client regarding the services to be performed would be required to inform management of its responsibility for adjusting the financial statements to correct material misstatements and for affirming to the auditor in management's representation letter that the effects of any uncorrected misstatements are immaterial. The auditor would be required to inform the audit committee about uncorrected misstatements that were brought to management's attention.

We support presenting all misstatements of the financial statements to the client as proposed audit adjustments. We do offer several suggestions to clarify and expand the proposed standards concerning audit adjustments. First, our experience has shown that generally there are those government agencies that "book" all adjustments and those that do not make adjustments that are immaterial to the financial statements. The proposed communications with the client and the audit committee, and management representations, provide additional incentive for management to adjust the financial statements for immaterial amounts. We suggest that when the Auditing Standards Board issues the proposed revisions, the Board announce its intent to informally monitor the effectiveness of the standards. This could further help induce some clients to adjust their financial statements for immaterial amounts.

Second, Statement on Auditing Standards (SAS) No. 47 does not require the auditor to bring all misstatements to management's attention. We suggest that SAS 47 be amended to require the auditor to present all misstatements to management, except for those that are clearly inconsequential. Today's computerized information systems facilitate making adjustments to the financial statements. If the client does not correct the misstatements, the auditor should consider management's reasons for not adjusting the financial statements and whether those reasons might be overcome in planning next year's audit, such as the timing of presenting the proposed adjustments to management. Also, regardless of whether management corrects the misstatements, the auditor should consider whether there are underlying internal control weaknesses that management should address to preclude the need for such adjustments in the future. We suggest the proposed revision include these instructions for the auditor.

Third, this is a good opportunity to clarify evaluation of sampling results for misstatements. AU 350.30 states that projected misstatement results for all audit sampling applications and all known misstatements from nonsampling applications should be considered in evaluating whether the financial statements may be materially misstated. In practice, the results of sampling yield several measures of estimated error, including a projected misstatement and upper and lower limits of misstatement. We suggest that AU 350.30 be modified to require the auditor when communicating misstatements to management, and to the audit committee in the case of uncorrected misstatements, to present each of the above measures. We suggest that AU 350 indicate that management should normally adjust for the projected misstatement, unless the difference between the lower and upper limit is material. In that case, additional sampling or other tests would be necessary to resolve whether a particular point in the range of estimated error rather than the projected misstatement is the more likely error that should be used to adjust the financial statements.

Finally, the proposed revision adds to the list of matters that should be addressed in a representation letter the "immateriality, both individually and in the aggregate, of the effects of any uncorrected financial statement misstatements brought to management's attention by the auditor during the current engagement." AU 312.38 states: "Even though the aggregate effect of likely misstatements on the financial statements may be immaterial, the auditor should recognize that an accumulation of immaterial misstatements in the balance sheet could contribute to material misstatement of future financial statements." We suggest adding a cross reference to AU 312.38 to ensure that the effects of prior period misstatements, for which the client did not adjust its records, are considered in evaluating the individual and aggregate effects of misstatements on the financial statements.

Regarding the proposed amendments to SAS No. 70, *Reports on the Processing of Transactions by Service Organizations*, we support the clarifications to help auditors determine whether services from another organization are part of the entity's information system and for evaluating the effects of those transactions on the user organization's financial statements in planning the audit. In planning the audit and in considering the significance of the transactions processed by a service organization, the proposed revision to SAS No. 70 deletes language contained in AU 324.07 requiring the auditor to obtain knowledge about the design of controls relevant to the audit of financial statements and whether they have been placed in operation by the entity. The proposed revised language of AU 324.07 states that the auditor's understanding of internal control sufficient to plan the audit "may encompass controls" placed in operation by the entity and by service organizations whose services are part of the entity's information system. We assume that applying the phrase "may encompass controls" is dependent upon the nature and materiality of the transactions the service organization processes for the user entity. To avoid any misunderstanding when transactions are material, we suggest that the auditor's responsibility to obtain an understanding of the design of the controls related to those transactions and whether they have been placed in operation by the entity and the service organization be specifically stated as it now is in SAS No. 70, AU 324.07. Service organizations are a significant component of many business operations and the auditor's responsibilities should be clear to preclude unwarranted audit risk.

Overall, the proposal helps to better address the difficult issue of materiality. We encourage the Board to continue to address this issue to provide guidance to the auditor for evaluating the effects of misstatements to the financial statements. We appreciate the opportunity to offer our comments on this proposal. Please call me at (202) 512-9406 if you have any questions or comments.

Sincerely yours,

Robert W. Gramling

Robert W. Gramling
Director, Corporate Audits
and Standards

#13

Massachusetts Society of Certified Public Accountants, Inc.

Educational Foundation

105 Chauncy Street • Boston, Massachusetts 02111

June 18, 1999

Ms. Judith M. Sherinsky
Technical Manager
Audit and Attest Standards, File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky,

The Accounting Principles and Auditing Procedures Committee is the senior technical committee of the Massachusetts Society of Certified Public Accountants. The Committee consists of over thirty members who are affiliated with public accounting firms of various size, from sole proprietorships to international "big five" firms, as well as both industry and academia. The Committee has reviewed and discussed the Omnibus Statement on Auditing Standards – 1999. The views expressed in this comment letter are solely those of the Committee and do not reflect the views of the organizations which the Committee members are affiliated.

We have the following suggestions:

Part 1: Audit Adjustments
We agree with the proposed change for item 1 regarding the engagement letter.

In response to item 2, the proposed change to the Statement on Auditing Standards No. 85, Management Representations, we disagree with the addition in its entirety. The auditor is responsible for issuing an opinion that the financial statements are in conformity with generally accepted accounting principles, in all material respects. Adding management representation that uncorrected financial statement misstatements are immaterial does not aid in reducing misunderstandings between the auditor and management, as is the purpose of the standard. Accordingly, we believe a summary of uncorrected misstatements would not be appropriate.

We strongly object to the proposed change regarding informing the audit committee of uncorrected misstatements. Item 3 (paragraphs 7 & 10), is board involvement on what we would consider a management role; if auditors agree with management that the adjustment are immaterial, we do not believe board oversight is needed. We communicate disagreements with management directly to the board now and we believe that would include disputes over proposed adjustments and modified opinions if a material adjustment was not booked.

We did discuss whether the proposed audit committee communication be recommended but not required or maybe required for public registrants only.

Part 2: Reporting on Consistency
We agree with the proposed changes.

Part 3: Service Organizations
By eliminating paragraph 8, are we saying the nature and materiality are the (only) primary factors in determining significance (paragraph 6) and those items listed in the original paragraph 8 are no longer to be considered? If not, we are eliminating guidance instead of adding clarity, which we believe is the proposed purpose as stated under item 4.

We appreciate the opportunity to present our comments and thank you for your consideration.

Sincerely,

Jacob Azar, CPA, Chairman
Accounting Principles and Auditing Procedures Committee
Massachusetts Society of Certified Public Accountants

#14

PROPOSED STATEMENT ON AUDITING STANDARDS:

AUDIT ADJUSTMENTS, REPORTING ON CONSISTENCY, AND SERVVICE ORGANIZATIONS (OMNIBUS STATEMENT ON AUDITING STANDARDS -- 1999)

APRIL 22, 1999

File 3509

Part 1: AUDIT ADJUSTMENTS

Since it is the professional judgment of the external auditor to determine what represents a material misstatement in the financial statement, should not any comment about adjustments reinforce that responsibility? Therefore, should the auditor's role be explicit, not implied?

While not well written, possibly the following will indicate what I have in mind:

> Management is responsible for adjusting the financial statements based on the auditor's assessment of required adjustments to correct material misstatements in the financial statements. Furthermore, management is to affirm that it is in agreement with the auditors that uncorrected misstatements identified by the auditor and judged by the auditor to be immaterial are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

The expectation gap persists. Most of my students have some acquaintanceship with external auditors in their jobs. A comment I hear far too frequent for comfort is: "Oh, it is clear that our outside auditors are there to give us what we want."

The statement re audit adjustments as now stated will appear contradictory to my students who have learned the responsibility of the auditor in SAS No. 82. . . "to assess the risk of material misstatement due to fraud. . . " (316.12). Careful reading of AU312 gives students the impression that materiality is determined by the auditor; it is the auditor's professional judgment. And, in the end, it is the auditor's judgment about what is material that is to prevail.

I realize that the auditor's report should reflect management's insufficient response to making recommended adjustments. But, given the current perceptions of auditors, stronger, more explicit language is required, I would say. A statement such as the one here must stand on its own, even if in context there is no ambiguity.

Immaterial Uncorrected Misstatements

Is not the audit committee interested in what the auditor's judgment is?

10. The auditor should inform the audit committee about
    (a) misstatements that the auditor judged to be immaterial
    (b) bringing such misstatements to management's attention
    (c) management's judgment about the misstatements
    (d) management's decision about correcting such misstatements

Is it the position of the Board that if management corrects immaterial misstatements no comment is required? Would it be an incentive to enhance the discipline of the total accounting process to report to the Board that management did book immaterial adjustments?

(In reading the early publications for employees at J. C. Penney's, I found an interesting letter (1917) in which Mr. Penney reported that the external auditors had offered no adjustments to their financial statements! In this day of full disclosure, I find that employees -- even in the accounting function -- don't know the nature and extent of adjustment recommended by the external auditors.)

Mary Ellen Oliverio
Department of Accounting
Pace University
Pace Plaza
New York, NY 10038

212 346 1819
moliverio@pace.edu

#15

STATE OF SOUTH DAKOTA
DEPARTMENT OF LEGISLATIVE AUDIT

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MAURICE C. CHRISTIANSEN, CPA
AUDITOR GENERAL

June 16, 1999

Judith M. Sherinsky, Technical Manager
Audit and Attest Standards, File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Thank-you for the opportunity to review and respond to the exposure draft of the proposed Statement on Audit Standards titles *Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards – 1999).*

Our comments follow:

CONSIDERATIONS FOR A RESPONSE TO THE AICPA REGARDING THE 04-22-99 EXPOSURE DRAFT ON AUDIT ADJUSTMENTS, REPORTING ON CONSISTENCY, AND SERVICE ORGANIZATIONS

PART 1, AUDIT ADJUSTMENTS

One of the significant professional judgments an auditor makes is the level at which an item of misstatement is or is not material.

We generally agree that an auditor should bring to management's attention any errors that are detected during the course of an audit. Current auditing standards provide guidance for an auditor when management fails or refuses to correct material misstatements. However, we disagree with a requirement to report all immaterial misstatements to the audit committee, or its equivalent.

Historically, the role of an audit committee has been to work to resolve disagreements between management and the independent auditor. We believe that this proposed change could lead to such disagreements by forcing management to agree with the auditor's determination of materiality in writing.

It has been our experience that neither the audit committee nor the governing board, want to be apprised of each and every immaterial misstatement. In fact, an auditor who raises immaterial matters to the attention of the audit committee runs the risk that important matters may be lost in the minutia. The auditor also runs the risk of losing the respect of management, the audit committee, and the general public.

We do not believe that SAS No. 61 should be amended.

PART 2, REPORTING CONSISTENCY

No comments.

PART 3, SERVICE ORGANIZATIONS

The first full sentence on page 15 of the exposure draft states: "The guidance in this section may also be relevant to situations in which an organization develop, provides, and maintains the software used by client organizations."

We understand that this sentence appears in SAS 70, and is not directly the subject of the proposed change; but it appears that the amendment of paragraph 3 of SAS 70 may give rise to more frequent application of SAS 70 as amended.

Are we correct in understanding that if an organization hires a software vendor to develop (for a fee), provide (for a fee) and maintain (for a fee) accounting software that ultimately produces financial statements, we as auditor's of the organization, may need to obtain a service center auditor's report related to the software vendor? It would be helpful if some examples could be provided to illustrate when the above quoted sentence from SAS 70 might or might not apply.

Yours truly,

Jerald C. Wulf, CPA
Director of External Audits

#16

Memo

Date: June 21, 1999

To: Judith Sherinsky

From: Ed Rockman

RE: Exposure Draft Re: Audit Adjustments, etc.

Please consider this my response to the Exposure Draft Dated April 22, 1999.

Audit Adjustments

Introduction

This proposal is designed to address a concern raised by the SEC. I have heard no similar concerns related to the audits of private companies. Accordingly, I strongly urge that the proposals here apply only to audits of public companies. I recognize that there are not many standards that apply only to public companies. However, given the stated purpose, which is to address SEC concerns, it is appropriate here.

One thrust of this proposal seems to be to discourage netting of material adjustments to an immaterial amount, and passing because the net amount is immaterial. I do not believe that is what SAS 47 is about. SAS 47 says (AU 312.34)

> In evaluating whether the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles, the auditor should aggregate misstatements that the entity has not corrected in a way that enables him or her to consider whether, in relation to individual *amounts, subtotals, or totals in the financial statements*, they materially misstate the financial statements taken as a whole. *Qualitative considerations* also influence the auditor in reaching a conclusion as to whether misstatements are material.

I do not think that the proposal has captured the need to consider subtotals and totals. When I evaluate passed adjustments, in practice, I look, particularly, at effects on such things as total current assets, total assets, etc. For example, if there are offsetting entries affecting inventory and accounts receivable, both of which are material by themselves, I believe it is fully appropriate to pass on both because they have no net effect on income, equity, or working capital. That is a judgment call the auditor should be able to make. It is also consistent with my reading of SAS 47 on evaluating audit findings. However, in my reading of the ED, it is not consistent with the ED.

Also, the proposal has not captured the qualitative aspects. Without both of these, it is difficult for management to make an assessment about materiality.

Engagement Understanding

From a practical standpoint, the addition of an item concerning adjustments to the engagement letter will not be very difficult to do. Although I doubt it will have any effect on audit performance in private companies, I doubt it will hurt much.

Representation Letters

The second part of the proposal is to add an item about these adjustments to the list of items that should be addressed in a management letter (AU 333.06.) I believe this changes the basis on which that paragraph was put together. That paragraph was designed to include only those items that would apply in *all* audits. In my experience, I have seen many audits where there are no passed adjustments. Thus, the requirement does not apply in all audits.

Beyond changing the basis for 333.06, there is no guidance for the auditor when there are no passed adjustments and the proposed paragraph is not applicable.

The addition to the representation letter of this acknowledgement is probably overkill, but it would certainly be easy to do. However, the requirement to include a summary of the uncorrected misstatements adds another little chore to the burdens on small audits. The amount of time needed to summarize the adjustments, put them into a formal format suitable for inclusion in a letter, subject them to review for appropriateness, etc., etc., etc. will be proportionately much greater than for must public companies. This is unnecessary and adds nothing to the effectiveness of the audit.

As to what is to be reported, SAS 47 says (AU 312.40)

> In aggregating known and likely misstatements that the entity has not corrected, pursuant to paragraphs .34 and .35, the auditor may designate an amount below which misstatements need not be accumulated.

While I would assume the Board does not intend for us to report such "minor" misstatements, the ED is not clear on this.

Further, I think this requirement is one of form with no substance. I doubt it will change small business audit practice at all.

I suggest that the specific requirement, to attach a summary of passed adjustments, be moved to the amendment to SAS 61. There, it would apply generally only to public companies and those others with audit committees. Very few of our closely held private companies have audit committees.

Further, it is the audit committees who need to be made aware of the passed adjustments, not management who signs the representation letter. In general, private company auditors have already discussed these issues with their client managements. It is in arena of entities with audit committees that this requirement might make some sense.

As to the requirement to inform the audit committee, what is the difference between this requirement and existing paragraph 9, particularly the italics?

> The auditor should inform the audit committee about adjustments arising from the audit that could, in his judgment, either individually or in the aggregate, have a significant effect on the entity's financial reporting process. For purposes of this section, an audit adjustment, *whether or not recorded* by the entity, is a proposed correction of the financial statements that, in the auditor's judgment, may not have been detected except through the auditing procedures performed. Matters underlying adjustments proposed by the auditor but not recorded by the entity could potentially cause future financial statements to be materially misstated, even though the auditor has concluded that the adjustments are not material to the current financial statements.

I assume the Board has discussed the distinction, but it is not evident to me. If there is, in fact, a difference, I suggest that it be made clearer.

Service Organizations

This amendment seems, to me, to be nothing but a placeholder. To the average practitioner in the field, I assume that these changes will have no effect on their practices. I hope that the changes to service organizations will be accompanied, or followed, by nonauthoritative practice aids. These aids should deal with the many situations that occur in everyday practice, from payroll services to securities custodians.

From the practitioner's standpoint, one of the more difficult issues is determining how much of an understanding is required to plan the audit. Practitioners need more nonauthoritative practice aids to help them in distinguishing between the amount of understanding needed for planning the audit and the amount needed for a control assessment below maximum. Examples, by type of service organization and service rendered, would be helpful.

Here is an example to try to clarify my point. Assume I have client using a standard, packaged service from a payroll service bureau such as ADP. I obtain an understanding of how the client forwards information to the organization, and what it does with the output that is returned. I have assessed the risk of misstatement due to error and “cooking the books” for the engagement as low. Because of the nature of the entity, I am concerned about defalcation. What do I need to know from ADP? I know that it is a national, well-known, respected entity. What else do I need?

These are the kinds of issues we face on a daily basis. I am hopeful that some nonauthoritative guidance can be issued to help with this.

EFR

#17

FRANCIS J. O'BRIEN
CERTIFIED PUBLIC ACCOUNTANT

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jsherinsky@aicpa.org

June 21, 1999

Judith M. Sherinsky
Technical Manager, Audit and Attest Standards
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

File 3509: Proposed Statement on Auditing Standards: *Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards - 1999)*

Dear Ms. Sherinsky:

I have a number of comments on the portion of the exposure draft dealing with Audit Adjustments. I write from the perspective of a former senior audit partner of a Big Five firm who is now the chief financial officer of a publicly held company.

I support the work of the Big Five Audit Materiality Task Force. It is clear that much remains to be done in establishing criteria for the qualitative and quantitative evaluation of materiality. It is equally clear, particularly in the material prepared by the Task Force, that many factors that are useful in evaluating materiality have been identified.

However, I do not believe that an audit standard requiring auditors, management and audit committees to give specific consideration to items that are not material will contribute to resolving questions of whether appropriate judgments are applied in evaluating the significance of known issues and errors. If the issues and errors are truly not material, then the financial statements are in conformity with generally accepted accounting principles. The Financial Accounting Standards Board has long acknowledged this: each of their standards concludes with the statement "The provisions of this Statement need not be applied to immaterial items." Thus, the only reason under gaap to consider recording adjustments to eliminate the supposedly immaterial misstatements is that they are not really immaterial. That judgment must be reached by auditors and managements. Simply encouraging that they be recorded does not contribute to applying apprpriate judgments.

The cost of dealing with items, which are immaterial in the first instance, would seem to exceed any benefit. After all, if the adjustments are immaterial, it is not probable that the judgment of a reasonable person relying on the information would have been changed or influenced (AU 312.06), so there is no benefit at all.

The evaluation is applied to objective as well as subjective items. Which misstatements is the Board proposing for adjustment? If they are all to be recorded, the cost of considering and quantifying immaterial subjective items would clearly exceed any benefit.

There are practical considerations as well. There needs to be a level of misstatement that is below the threshold for application of a standard such as that being proposed. Timely preparation of financial statements often requires use of many estimates that are routinely adjusted at a later date (e.g., unrecorded liabilities, sales returns, deferred taxes). These estimates usually are correct within a range of tolerable error; the degree of error may be known by auditor or management before completion of the audit, but adjustments to eliminate such errors are generally not recorded because their amount individually and in the aggregate are far below any reasonable threshold or materiality. Many of these are so small that they are not even accumulated and summarized by auditors. The cost of any attempt to include misstatement such as these within the scope of audit and notification procedures, as proposed, is clearly beyond any benefit to be achieved.

Will auditors now be responsible for more diligent attention to immaterial items in order to fulfill the requirements of the proposed standard? This might involve extension of audit procedures to quantify the effect of immaterial items. The environment for preparers and auditors is still litigious, and "defensive auditing" to assure compliance with the proposed standard could serve to undermine concepts of materiality that have achieved acceptance in the judicial system, as well as to increase audit costs.

What is the status of immaterial misstatements that management is aware of, but were not adjusted or brought to the auditors attention because they were immaterial? Management generally will know the precision of account balances better than the auditors. Potentially immaterial misstatements are not unusual. Some of these potentially immaterial misstatements may be easily quantifiable. Some may be judgmental and difficult to quantify precisely. Communication of all of these, and follow up by the auditors, could be extremely time consuming. Any benefit is not evident.

In summary, I believe that the Board should continue it work in establishing criteria for the qualitative and quantitative evaluation of materiality. However, the proposed standard should not be implemented. It is a piecemeal approach to a larger problem and is not warranted by gaap, suffers from lack of any benefit in relation to cost, and leaves unanswered a number of practical considerations.

Very truly yours,

Francis J. O'Brien

#18

To: The New Hampshire Society of CPA's

From: Accounting & Auditing Task Force

Re: Comment on exposure draft,
Proposed Statement on Auditing Standards
Audit Adjustments, Reporting on Consistency, and
Service Organizations.

Date: June 21, 1999

Please be advised of the following comments regarding the exposure draft dated April 22, 1999; received May 5th.

Audit Adjustments:

Appropriate disposition of financial statement misstatements is the issue. Individual items or in their aggregate, would require the professional judgment of those responsible to report an acknowledgment of financial statement misstatements in the representation letter brought to its attention by the auditor. In part I "why issued" the proposed SAS would "encourage" clients to record financial statement adjustments proposed by the auditors. Part II #3 would require uncorrected misstatements, determined to be immaterial, to be communicated to the audit committee by the auditor. Paragraph on page 9 part I audit adjustments shows how the proposal will be presented. Since this matter has not been specifically addressed, we agree with this amendment as written.

Consistency:

No Comment.

Service Organizations:

There should be no changes except for the language issue (i.e. changing the title) regarding the applicability part of an entities information system. Guidance for the purpose of determining information systems significance, control and other areas of reliability. If the auditor is unable to achieve assurances on service organizations through user organizations or direct contact with the service organization, a scope limitation would cause an auditor to qualify or disclaim an opinion.

Effective dates of implementation:

No comment.

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NEW HAMPSHIRE SOCIETY OF CPAs
3 Executive Park Drive
Bedford, NH 03110
phone: (603)622-1999
fax: (603)626-0204

Date: 6-21-99
To: Judith M. Sherinsky, Tech. Mgr.
Company: AICPA - Audit + Attest Stds
Fax Number: 212-596-6091
Number of Pages: 2 **(including cover sheet)**
From: Marlene Garda

- ☐ **For your information**
- ☒ **At your request**
- ☐ **At the request of:** ____________
- ☐ **Response requested**

File 3509

Calendar of Events

Upcoming Dinner Meetings

All meetings begin at 5:30 PM with a social hour followed by dinner at 6:30 PM

September 22, 1999 - TBD
Past Presidents' Night
October 27, 1999 - *Wayfarer Inn*
Students' Night
December 1, 1999 - *Manchester Country Club*
Industry & Interprofessional Relations
January 19, 2000 - *Bedford Village Inn*
Joint with the Estate Planning Council
March 29, 2000 - *TBD*
Joint with the NH Bar Association
May 17, 2000 - *TBD*
Annual Dinner Meeting

To register for any of these events, please call the Society office.

Check out our web site for a complete listing of 1999/2000 courses!!
www.nhscpa.org

COMMET LETTER #19

Author: Wendy Frederick at AICPA4
Date: 6/21/99 3:58 PM
Priority: Normal
TO: Judith M. Sherinsky at AICPA3
Subject: Comments on the Proposed SAS, Audit Adjustments,.......
------------------------------- Message Contents -------------------------------

Judith,

Based on our discussion on Friday, June 18, 1999, the following are the employee benefit plan committee's specific comments on the proposed SAS, Audit Adjustments, Reporting on Consistency, and Service Organizations, specifically as they relate to Part 3, Service Organizations.

Paragraph 3: The proposed amendments to SAS 70 do not address situations where the auditee utilizes various service organizations to service its investments. Nor does it address situations where an auditees' service organizations subservices its functions to other organizations. The Committee recommends that the amendments include discussions on whether or not it would be appropriate for auditors to obtain SAS 70 reports from all servicers who provide services on financial instruments.

Paragraph 8: The Committee recommends adding an additional step where the auditor meets (via conference call) with auditee and service organization representatives in order to obtain and document the auditor's high level understanding of the services provided and the service organization's control environment.

Please call me if you have any questions or if you would like to discuss these comments in detail.

Thanks,

Wendy

COMMENT LETTER #20

Author: MIME:vrauser@mt.gov at INTERNET
Date: 6/21/99 8:02 PM
Priority: Normal
TO: Judith M. Sherinsky at AICPA3
Subject: Omnibus Statement on Auditing Standards-1999
------------------------------- Message Contents -------------------------------
From: Rauser, Vickie
Date: June 21, 1999 6:00p
Subject: Omnibus Statement on Auditing Standards-1999

We have read the Exposure Draft, "Proposed Statement on Auditing Standards, Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards-1999)" and offer the following comments.

We question the necessity of the proposed statement on auditing standards in "Part 1, Audit Adjustments." We believe the auditor should recommend only those financial statement adjustments which, if not made, would cause a qualification in the auditor's report. If any of those adjustments are not made, the auditor would be required to issue a qualified report identifying those adjustments. The qualified report then becomes the vehicle for informing the client's audit committee of uncorrected misstatements. The current guidance for the contents of an engagement letter clearly state the client is responsible for the fair presentation of its financial statements. Requiring an additional item in the engagement letter, additional management representation, and additional communication with the client's audit committee unnecessarily adds to audit costs.

We are in support of the proposed statements summarized in Parts 2 and 3.

Thank you for the opportunity to participate in this due process. Please contact me if you have any questions. I can be reached via e-mail at vrauser@state.mt.us or by phone at (406)444-3122.

Vickie Rauser
Audit Manager
Legislative Audit Division
State of Montana

COMMENT LETTER #21

Exposure Draft
Proposed Statement on Standards on Auditing Standards
Audit Adjustments, Reporting on Consistency, and Service Organizations
April 22, 1999
Comment Date: June 22, 1999

Name and Affiliation: **Washington Society of Certified Public Accountants**
Accounting, Auditing and Review Standards Committee
Bellevue, Washington 98005

Comments:

We support the exposure draft of "Audit Adjustments, Reporting on Consistency, and Service Organizations".

Regarding Part 1, Audit Adjustments, the majority of the committee felt that it made the client take note and responsibility for the audit adjustments. However, there was feeling that this is designed more for the larger SEC client and only creates more unnecessary regulations for smaller clients. If requirements are needed for clients to make adjustments for audits then should not the same requirements be made for other engagements?

Respectfully submitted,

Washington Society of Certified Public Accountants
Accounting, Auditing, & Review Standards Committee

Rick Foster, Chairman

#22

Douglas C. Davis
Vice President and Controller

Marsh & McLennan Companies, Inc.
1166 Avenue of the Americas
New York, NY 10036-2774
Telephone 212 345 5620
Telefax 212 345 6139

June 21, 1999

MARSH & MCLENNAN COMPANIES

Ms. Judith M. Sherinsky
Technical Manager, Audit and Attest Standards
File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement on Auditing Standards – Audit Adjustments, Reporting on Consistency, and Service Organizations

Dear Ms. Sherinsky:

Marsh & McLennan Companies ("MMC") welcomes the opportunity to express our views on the Auditing Standards Board's Exposure Draft entitled "Audit Adjustments, Reporting on Consistency, and Service Organizations." Our comments will address Part 1 – Audit Adjustments.

Paragraph 4 of this statement proposes that management's "... representation letter include an acknowledgment by management that it has considered the financial statement misstatements brought to its attention by the auditor and has concluded that any uncorrected misstatements are not material, both individually and in the aggregate, to the financial statements taken as a whole. It also requires that a summary of the uncorrected misstatements be included in the representation letter or in an attachment thereto."

Similarly, paragraph 7 of the proposed statement says, "The auditor should inform the audit committee about uncorrected misstatements brought to management's attention by the auditor that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole."

MMC fully supports all efforts to ensure responsible financial reporting for all organizations. However, it appears to us that strict enforcement of current literature, rather than the adoption of increasingly burdensome requirements, would be more effective in achieving that goal. Certain of the proposals are already addressed in current literature and other aspects are superfluous, at best. As support for our views, please consider the following points:

1. SAS 85 currently requires management to acknowledge its responsibility for the fair presentation of the financial statements in conformity with generally accepted accounting principles. The representation letter illustrated in SAS 85 suggests the following precise words, "There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements." The proposed addition of the specific reference to immaterial audit adjustments does not modify the substance of management's existing responsibilities and representations.

2. Issues presented to a committee of the Board of Directors should be limited to only matters of importance. We do not believe that audit committees should be burdened with the additional task of reviewing items that have been determined to be immaterial. In addition, this procedure could put the audit committee in the position of having to ratify the decisions of management and auditors related to immaterial adjustments. This process could ultimately lead to inefficiencies as companies may choose to delay earnings announcements until approval is received from the audit committee. Consequently, this action would move the audit committee out of an oversight role and into a management and auditor role.

3. It is common practice that materiality judgments are made in the process of preparing financial statements in accordance with GAAP. If these immaterial passed adjustments were highlighted in either the management representation letter or in the auditor's report to the audit committee, it would imply that they were the most important judgments considered. However, there are actually a multitude of such items made in the process of preparing the financial statements of any sizable organization.

In summary, MMC believes that when properly enforced, the current management representations and audit committee practices ensure the preparation of financial statements in accordance with GAAP and believes that the imposition of additional requirements surrounding immaterial audit adjustments would be a time consuming and potentially troublesome task, resulting in minimal incremental benefit.

We would be pleased to discuss these comments with you.

Sincerely,

Douglas C Da

DCD:cm

#23

THE OHIO SOCIETY
OF CERTIFIED
PUBLIC
ACCOUNTANTS

June 21, 1999

Judith M. Sherinsky
Technical Manager
Audit and Attest Standards
File 3509
American Institute of CPAs
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

The Ohio Society of CPAs' Accounting and Auditing Committee has reviewed the April 22, 1999 proposed Statement on Auditing Standards "Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards – 1999)".

In general, the committee was in agreement with the adoption of Parts 2 and 3 of the draft ("Reporting on Consistency" and "Service Organizations"). However, the committee had significant concerns about Part 1 "Audit Adjustments." Those concerns are outlined in the attached.

The committee appreciates the opportunity to participate in the standards development process. If you have any questions about the committee's deliberations, please contact me at (216)831-1200.

Sincerely,

Stanley J. Olejarski, CPA
Chair, Accounting and Auditing Committee

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THE OHIO SOCIETY OF CPAs ACCOUNTING & AUDITING COMMITTEE COMMENTS ON PROPOSED SAS "AUDIT ADJUSTMENTS, REPORTING ON CONSISTENCY, AND SERVICE ORGANIZATIONS"

Part I – Audit Adjustments

Committee members expressed significant concerns about the proposal regarding audit adjustments. In general, the committee agreed that it was desirable to clarify management's responsibility for the disposition of financial statement misstatements, but they believed that some of the proposed audit requirements would actually work counter to this goal.

More specifically, committee members agreed that a statement in the engagement letter and the management letter about management's responsibility for the disposition of financial statement misstatements was desirable. Significant concerns were raised, however, about the listing of uncorrected misstatements in the management letter, and especially about the reporting of these "passed adjustments" to the audit committee. Committee members concurred that the addition of this requirement would cause fewer adjustments to be proposed, thus reducing the effectiveness of the audit process. Specific comments included the following:

- In the presence of this requirement, the committee believes that auditors would propose fewer audit adjustments to management (those not of sufficient gravity to report to the audit committee), thus decreasing the quality of the audit. Professional standards already provide for reporting to the board and audit committee issues where there is disagreement between auditors and management. Members noted that standards allowing auditors to be more open with management would be more beneficial to the audit process and to the public.

- We are concerned that this proposal would lead to audit procedures being changed to "bury" immaterial adjustments in the workpapers, rather than bringing them to an effects schedule that would be reflected in the management letter and audit committee report. If these adjustments are buried in the workpapers, they would likely not be subject to the same level of partner review and scrutiny.

- Many members noted that one of the primary professional responsibilities of the auditor is to determine the materiality of financial misstatements. It is believed that this proposal essentially attempts to transfer that responsibility to the client, an act that the committee considers inappropriate, going too far in an attempt to protect the interests of the profession to the detriment of the public interest.

- Some members expressed a view that this proposal may be more appropriate for public companies, where the issue of earnings management is valid and highly relevant. They noted however, that in the case of private companies with unsophisticated boards and audit committees, the potential for misunderstandings of this disclosure and detrimental effects due to items that the auditor has already determined are immaterial are not beneficial to the company or the public.

In summary, the committee believes that the premise that this proposal will encourage management to post more proposed adjustments is flawed; instead, it would in fact result in a reduction in audit quality and in fewer adjustments being proposed to management. The committee recommends that the draft be approved without inclusion of the reporting requirement to client boards and audit committees of passed adjustments.

The Black & Decker Corporation
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410 716 2118
Fax 410 716 3879

Stephen F. Reeves
Vice President and Controller

#24

BLACK&DECKER®

21 June 1999

Judith M. Sherinsky
Technical Manager
Audit and Attest Standards
AICPA
1211 Avenue of the Americas
New York, NY

Reference: File 3509

Dear Ms. Sherinsky:

The Black & Decker Corporation appreciates the opportunity to respond to the exposure draft, Proposed Statement on Auditing Standards Audit Adjustments, Reporting on Consistency and Service Organizations (Omnibus Statement on Auditing Standards – 1999 "ED"). Our comments are restricted to Part 1 and silence as to the remainder of the document should not be interpreted as acquiescence. Black & Decker has a longstanding appreciation for the importance of integrity in financial reporting as well as management's role in instituting a control environment that safeguards that integrity. As such we find the proposed standard to be offensive, disingenuous and far more likely to result in the acceleration of the decline in esteem in which the audit profession is held than in improving financial reporting in any meaningful way.

We believe that the Audit Standards Board ("Board") should have made an effort to identify what problem they were attempting to solve and/or the causal relationship between the proposal and improved financial reporting. It is not clear to this reader how expending time and effort on immaterial items achieves that end. In fact it seems contradictory on its face that failure to record immaterial differences would in some way result in material misstatements of financial statements. It thereby contributes to the cynical view that this is no more than an effort by the profession to shift or spread its historical responsibilities for risk assessment and judgement to the audit committee, especially in light of recent efforts to the same end on independence. It does not change management's responsibility for the fair presentation of financial results, which already exists statutorily. We believe that the continued abdication of value adding judgements by the auditors will contribute to the view of an audit as a commodity product with commensurate pricing.

In our experience passed adjustments typically result from immaterial items arising late in the audit as well as from items with low inherent risk for which a methodology or judgmental disagreement exists between management and the auditors. In the former situation our observation is that auditors frequently complete areas with higher control and inherent risk early in the audit process leaving lower risk areas to the end. Frequently immaterial items identified late in the audit process will not be adjusted due to the ramifications on the communication process and obviously their inherent lack of significance. Assuring quality control over external communications is more difficult when the numbers change unnecessarily. A consequence of the proposed standard would therefore seem to be pressure on the auditors to complete their work earlier or delay communication of results to financial markets. Whether these are an intended, or an unintended consequence of the ED is difficult to ascertain given the poor quality of the rationale included in the ED. We recommend that the Board justify how the benefits of recording immaterial items outweigh the timely release of results to financial markets and how the benefits to be derived from expending management and auditor time on reconciling differing subjective judgements on immaterial amounts outweigh the costs.

With regard to the specific proposed amendments, management already represents its responsibility for the fair presentation of financial statements. It is not conceivable how that representation could not be construed to include recording all material audit differences. Accordingly, the proposed amendments to the guidance on engagement letters and representation letters are completely unnecessary. With regard to communication to the audit committee we continue to feel that the important communication remains that there are no unrecorded differences individually or in the aggregate that are material. We fail to see what is benefit is obtained from the itemization of the immaterial items. Further, auditors typically have complete access to audit committees, therefore if such information was important or desired by audit committees then there already exists an opportunity to present the information. We recommend that the Board identify what benefit is obtained from itemization and if, as we suspect, none exists then we oppose the mandatory disclosure of information that isn't meaningful.

We would be glad to discuss our comments further with representatives of the Board. If you have any questions, please contact me at (410) 716-2118.

Sincerely,

Stephen F. Reeves
Vice President and Controller

COMMENT LETTER #25

7915 Xavier Court
Dallas, Texas 75218-4513

June 22, 1999 **VIA EMAIL**

Judith M. Sherinsky
Technical Manager
Audit and Attest Standards
File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

I am writing to give my comment on the Proposed Statement on Auditing Standards *Audit Adjustments, Reporting on Consistency and Service Organizations (Omnibus Statement on Auditing Standards – 1999).*

The proposed SAS would amend SAS No. 61 to require the auditor to inform the audit committee about uncorrected misstatements brought to management's attention by the auditor that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

This requirement serves no useful purpose. If management determines the proposed adjustments are immaterial, and the auditor effectively concurs with that conclusion by issuance of their audit report, there is no reason to inform the audit committee of the immaterial misstatements that were not recorded. Many things occur within a company which are not sufficiently significant to warrant notification of the audit committee. To require otherwise in this case could lead to a needless, and time-consuming, process for the audit committee. Does the AICPA mean to require that a $10 unrecorded misstatement be brought the audit committee's attention? I would hope not.

AU 380.09 already requires the auditor to inform the audit committee about unrecorded adjustments that could cause future financial statements to be materially misstated, even though the auditor has concluded that the adjustments are not material to the current financial statements. This notification serves a useful purpose. However, I see no merit to requiring the auditor to inform the audit committee about unrecorded adjustments for which the auditor has concluded that the possible effect on future financial statements is not material as well.

Accordingly, I urge the AICPA to delete the requirement discussed above from the Exposure Draft. Thank you for your consideration to my comment.

Sincerely,

Greg Swalwell

ILLINOIS CPA SOCIETY & FOUNDATION

#26

June 22, 1999

Ms. Judith M Sherinsky, Technical Manager
Audit and Attest Standards, File 3509
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

The Committee on Auditing Services of the Illinois CPA Society ("Committee") is pleased to have the opportunity to comment on the exposure draft of the "Proposed Statement on Auditing Standards (SAS) titled *Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards – 1999)*". The following comments and considerations represent the collective views of the members of the Committee. The organization and operating procedures of the Committee are reflected in the Appendix to this letter.

SUMMARY

We are in general support of the issuance of the proposed SAS, with suggested considerations.

SPECIFIC CONSIDERATIONS

Part 1 – AUDIT ADJUSTMENTS

Part 1 requires that a "summary of the uncorrected misstatements" be included in the management representation letter or in an attachment thereto. At this time, it would be beneficial to the auditor to also include some authoritative guidance regarding the implied meaning and intent of the word "summary". To illustrate, to what level of detail should this summary be presented? Is an exact detailed listing of each and every item, to the extent accumulated, to be included in the summary or should the summary simply include the significant item(s)? Furthermore, should this summary be identical to the summary presented to the audit committee? Perhaps some additional clarification could be provided.

Furthermore, auditors commonly exclude some uncorrected misstatements from their summary of adjustments as these amounts are clearly immaterial. The threshold of these items is set in planning and some firms refer to these amounts as de minimus, or under scope. These amounts are passed on individual working papers and are normally never included on the summary of adjustments. It is unclear from the proposed standard whether these items would now be required to be summarized and included in the management representation letter. Our committee believes that there is a threshold of items that are so minor that they are not required to be included on the adjustment summary. We suggest that the proposed standard recognize these types of adjustments and specifically indicate that such adjustments are not required to be included in the representation letter.

Part 1 also discusses materiality, both individually and in the aggregate, as it relates to the financial statements taken as a whole. Will this pronouncement ultimately put undue pressure on the auditor when the clients' management "encourages" the auditor to make known and perhaps June 22, 1999

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to justify, adjust, or raise the limits of materiality? Will this pronouncement have a greater impact on public companies and their auditors? Perhaps these issues could also be addressed and some additional guidance provided.

Part 2 – REPORTING ON CONSISTENCY

Part 2 relates to the reporting requirements for a change in the reporting entity. Perhaps an example or two should be considered to provide a clear distinction / differentiation between the new language in paragraph 7 with that in paragraph 8.

Part 3 – SERVICE ORGANIZATIONS

Consideration should be given to including payroll services as a listed example since it probably is one of the most prevalent uses of a service organization by nonpublic entities.

Sincerely,

Jim A. Dolinar

James A. Dolinar
Chair, Auditing Services Committee, Illinois CPA Society

APPENDIX A

ILLINOIS CPA SOCIETY
AUDITING SERVICES COMMITTEE
ORGANIZATIONAL AND OPERATING PROCEDURES
1999

The Auditing Services Committee of the Illinois CPA Society (the Committee) is composed of nineteen technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to fifteen years. The Committee is a senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of auditing standards.

The Committee usually operates by assigning a subcommittee of its members to study and discuss fully exposure documents proposing additions to or revisions of auditing standards. The subcommittee ordinarily develops a proposed response which is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint.

COMMENT LETTER #27

Author: MIME:AERoevens@aol.com at INTERNET
Date: 6/22/99 5:49 PM
Priority: Normal
TO: Judith M. Sherinsky at AICPA3
CC: ASUFFRIN@lcpa.org at INTERNET
Subject: EXPOSURE DRAFT: PROPOSED STATEMENT ON AUDITING STANDARDS
------------------------------ Message Contents ------------------------------
Ms. Judith M. Sherinsky
Technical Manager
Audit and Attest Standards
AICPA

VIA INTERNET

COMMENTS TO EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

AUDIT ADJUSTMENTS, REPORTING ON CONSISTENCY, AND SERVICE ORGANIZATIONS
(OMNIBUS STATEMENT ON AUDITING STANDARDS - 1999)

COMMENT SUBMITTED BY: Accounting and Auditing Standards Committee - Louisiana Society of CPA's

COMMENT PREPARED BY: Albert E. Roevens, Jr. CPA

COMMITTEE MEMBERS RESPONDING: Brent A. Silva, CPA

Judson J. McCann, Jr., CPA

John D. Cameron CPA

I. AUDIT ADJUSTMENTS

The members responding believe that this exposure draft should be revised before issuance. Three of the four members responding believe that this SAS would require the audit client to make a judgment about materiality.

This judgement has always been the auditor's responsibiltiy.

This standard does not address the difference between an audit difference and an audit adjustment. What are the auditor's responsibility with regard to audit differences?

Additionally, this standard may adjust the auditors judgment with regard to materiality by requesting the audit client to record all audit adjustments. This part of the procedure would result in the auditor performing accounting and compliance procedures. This would not benefit the

overall quality of the audit and require more auditor time and cost.

II. REPORTING ON CONSISTENCY

One member stated that the new bold print in paragraph 9, page 13 does not appear clear and requests different wording or an example.

III. SERVICE ORGANIZATIONS

The sentence beginning "To illustrate how the degree..." in paragraph 6, page 15 appears to be more of a statement rather than an illustration. Perhaps an example could be used as an illustration.

COMMENT LETTE #28

June 18, 1999

Ms. Judith M. Sherinsky
Technical Manager, Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

VIA ELECTRONIC MAIL

Re: File 3509 – Proposed Statement on Auditing Standards – Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards – 1999)

Dear Ms. Sherinsky:

I am submitting the following comments for your consideration. These comments relate solely to Audit Adjustments (Part 1) of the Proposed Statement.

The proposed amendment to SAS No. 83, Establishing an Understanding With the Client, would state explicitly what is already self-evident. "Management is responsible for the entity's financial statements" (AU sec. 310.06). This responsibility includes misstatements of any magnitude, material or otherwise. The proposed amendment, though easily implemented, adds little to the understanding that should already exist in the client/auditor relationship.

The proposed amendment to SAS No. 61, Communication With Audit Committees, would place an unnecessary burden on the audit committee. SAS No. 61 notes that the audit committee is charged with "overseeing the financial reporting and disclosure process for which management is responsible" (AU sec. 380.02). The proposed amendment would force the audit committee to wade through a level of detail that is inconsistent with their oversight role. This is unnecessary. When the auditor concludes that certain misstatements are immaterial, and management concurs with this assessment, there is no compelling need to inform the audit committee of those conclusions. Let the audit committee fulfill its oversight role without miring it in unnecessary details.

Thank you for the opportunity to submit these comments. If you have any questions, please contact me at SCANA Corporation, 1426 Main Street, Columbia, SC 29201, or via electronic mail at msparks@scana.com.

Sincerely yours,

Mark L. Sparks, CPA

#29

National State Auditors Association

June 22, 1999

Judith M. Sherinsky
Technical Manager
Audit and Attest Standards, File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

On behalf of the National State Auditors Association (NSAA), we appreciate the opportunity to respond to the exposure draft (ED) entitled, *Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards-1999)*. We offer the following comments for consideration by the Auditing Standards Board ("Board").

Part 1 – Audit Adjustments

We support changes that would encourage auditees to record proposed adjustments or to acknowledge their decision in determining them to be immaterial. However, we have two specific concerns with the proposed guidance:

1. The terminology "brought to management's attention" is vague and ambiguous and should be further clarified. During the course of an audit, a large number of items may be discussed with an auditee, including clearly immaterial items. We also frequently bring minor errors to the attention of our auditees in an attempt to suggest control or procedural improvements, rather than to suggest that the auditee make adjustments to its financial records for relatively insignificant amounts. Does this constitute being "brought to management's attention" and, therefore, necessitate inclusion in the listing attached to the management representation letter?

   The proposed changes should be clarified to allow for auditor discretion to informally communicate clearly immaterial misstatements, without requiring that these misstatements be formally presented in the representation letter or in communication with the audit committee.

2. We object to the provisions of paragraph 7 which require the auditor "...to inform the audit committee about uncorrected misstatements brought to management's attention by the auditor that were determined by management

Relmond P. Van Daniker, Executive Director for NASACT
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COMMENT LETTER #30

FINANCIAL EXECUTIVES
INSTITUTE

June 23, 1999

Judith M. Sherinsky
Technical Manager
Audit and Attest Standards
File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

The Committee on Corporate Reporting (CCR) of the Financial Executives Institute appreciates the opportunity to comment on the Auditing Standards Board Exposure Draft, *Audit Adjustments, Reporting on Consistency and Service Organizations*. We would like to address some concerns regarding the amendments relating to Audit Adjustments.

Our membership in CCR is drawn from chief financial officers, controllers and other senior financial executives that have responsibility for accounting and external reporting in U.S. public companies. As such, the topic of resolution of audit adjustments (and in fact the resolution of accounting errors in general) is an area we address on a regular basis.

We believe that material errors, trend-affecting errors and deliberately fictitious entries absolutely need to be corrected, as well as discussed with the appropriate individuals, including higher levels of management and, when appropriate the Audit Committee and others. However, we do not believe the same treatment is warranted for accidental errors causing minor misstatements that arise out of the normal process of closing the books, that are both individually and in the aggregate immaterial. Unless such minor items are indicative of some larger problem or control fault that is of concern to the auditor, we fail to see a good purpose that would be served by booking them in the current period, and have serious concerns that any such expectation could work to the disadvantage of shareowners and other financial statement users. Furthermore, raising the recording of such minor items to the level of the representation letter or discussion with the Audit

Committee could create voluminous lists of extremely minor details, adding administrative costs with no real user benefit.

Currently the management representation letter acknowledges management's responsibility for the fair presentation of the company's financial statements and states that to the best of management's knowledge and belief, any unrecorded amounts are not material. Immaterial errors that are random oversights are currently the responsibility and should be the responsibility of management. Auditors have the responsibility to report to the Audit Committee any material unresolved items, or to report that they concur with management that any unresolved items are immaterial individually and in the aggregate.

Immaterial errors identified by the auditors generally occur for two main reasons – mistakes made through accidental human oversight, or minor differences in either estimate areas (e.g., warranty or bad debt provisions) or interpretations of GAAP. Systems and procedures are designed to identify and correct errors. Inescapably, at times human mistakes can occur; when minor, such mistakes are normally corrected in the next reporting period. Immaterial differences over judgmental interpretations of GAAP – representing minor differences that management and auditors agree need not be resolved in the current period due to their immaterial impact of the fair presentation of financial statements - are typically handled by "agreeing to disagree" in the current period, often with plans to conduct follow-up discussions in the next period – again, this is when the <u>amounts are clearly immaterial.</u>

Management currently uses auditor listings of any and all items not only to assure that the financial statements are properly and materially presented, but also to assist in improving systems and procedures, to correct errors, and to assess the performance and training needs of the staff. If a requirement is promulgated to identify all items which individually or in the aggregate are not material, by attaching a description of each one to the representation letter and discussing them with the Audit Committee, the time and cost to document and formally discuss such minor matters will far outweigh the benefit derived.

In some companies, particularly large enterprises with numerous operations and legal entities through out the world, lists of immaterial uncorrected items could be very lengthy. In our experience, such minor faults typically arise randomly and unexpectedly, and in addition to being of extremely minor amounts, often tend to offset one another. But if each must one be made part of a formal list, as opposed to being part of audit workpapers and discussions with management, the list could be quite long.

We anticipate that an Audit Committee will react to receiving such lists of minor items with concerns and uncertainty over differential expectations of action that might exist, and will legitimately wonder whether this could create additional liability for Audit Committee members. We question the need for individuals at the level of the Audit Committee to spend time on minor items when these are not indicative of any underlying problem of concern to an auditor. And if auditors and Audit Committees react to all this detail and uncertainly by simply instructing that any item found is to be booked, no matter how small or insignificant, we can all expect extensive recycling in book close processes and major delays in announcing results to the public, with little if any difference in the final results.

We believe there could be many unintended and undesirable implications from this proposal. We have already noted a potential for higher costs throughout both management and auditing, as more time is spent discussing and dealing with immaterial items. A second negative consequence is that some auditors, recognizing that many minor items are not significant enough to discuss with the Audit Committee, may then hesitate to list them. If this occurs, and some auditors now apply a more restrictive standard of interpretation to what should be listed, the result will be that they tend to not bring every minor item forward to management. This could have the unintentional and serious effect of restricting the ongoing and open discussions that occur between management and the auditors, which clearly would not be a positive development. A similar effect appears to have occurred at some financial institutions when regulatory changes paralleling the current proposal regarding auditor disclosure of minor items in the management letter were made. Previously, helpful though insignificant comments were made which management used to improve the system of internal control. After the change in requirements, many of these comments were no longer made as before.

In closing, we would like to emphasize that we continuously strive to attain quality in financial reporting, and appreciate the contribution made to this end from the external audit function and process. We are also cognizant and appreciative of the value added by a vigilant and effective Audit Committee. Taking all these roles and responsibilities into account, we do not believe that a cost-benefit threshold has been crossed by a proposed requirement which would expose an Audit Committee to items which have been deemed immaterial by both management and the auditor, and which have been fully discussed with management having the ultimate responsibility for the financial statements. We would be pleased to discuss our comments further with representatives of the Board. If you have any questions, please contact Michael Mathieson of Fortune Brands, Inc. at (203) 698-5383.

Sincerely,

Susan Koski-Grafer
Vice President – Professional Development
and Technical Activities

#31

Deloitte & Touche

Deloitte & Touche LLP
Ten Westport Road
P.O. Box 820
Wilton, Connecticut 06897-0820
Telephone: (203) 761-3000

June 18, 1999

Ms. Judith M. Sherinsky
Technical Manager
Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: **File 3509**

Dear Ms. Sherinsky:

We are pleased to comment on the Proposed Statement on Auditing Standards, *Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards—1999)*.

We fully support amending existing standards to establish audit requirements directed toward encouraging audit clients to record financial statement adjustments proposed by auditors in audits of financial statements. We believe that the proposal is an important step forward toward more accurate financial reporting. However, we do have some recommendations for clarifying the application of the proposed standard to "likely misstatements" and to engagements to report on comparative financial statements, as described in the attachment to this letter.

Although we also support amending AU sec. 420, *Consistency*, we do not believe that the proposed revisions appropriately capture the intent of the Auditing Standards Board, as discussed in more detail in the accompanying comments. We also support the proposed amendments to existing standards concerning service organizations.

The attachment also contains several editorial comments for your consideration.

Please contact Robert C. Steiner at (203) 761-3438 if you wish to discuss our comments.

Sincerely,

Deloitte & Touche LLP

R. C. Steiner

Attachment

Deloitte Touche Tohmatsu

OTHER COMMENTS

Part 1

Paragraphs 1-8

The proposed amendment requires the auditor to obtain a representation concerning immateriality of the effects on the financial statements taken as a whole of uncorrected misstatements brought to management's attention during the current engagement. We have two concerns with the application of the proposed requirement. First, the applicability of that requirement to "likely misstatements" versus "known misstatements" is unclear. Read literally, the proposed amendments could be interpreted as requiring that *all* known and likely misstatements (including, for example, estimated errors from the extrapolation of statistical sampling applications and to estimates of potential errors developed in performing substantive analytic procedures) be summarized in or included in the attachment to the representation letter and discussed with the audit committee.

Paragraphs 34 through 40 of SAS 47 (AU sec. 312) provide guidance to the auditor when evaluating the possible effects of audit findings on the financial statements being audited. In making that evaluation, the auditor aggregates all information developed in the course of the audit—known and likely misstatements, the carryover effects, if any, of prior period errors, and other information, and considers the qualitative implications of the matters noted. Based on his or her evaluation, the auditor concludes as to whether the financial statements require adjustment.

We agree that the auditor should evaluate the possible effects on the financial statements of all information developed in the course of the audit. We do not believe, however, that the proposed amendments to SAS 85 and SAS 61 should require that the auditor discuss with management and the audit committee *all* of the matters he or she has evaluated in forming an opinion on the financial statements. For example, the use of statistical sampling techniques in performing substantive auditing procedures or the application of substantive analytic review procedures may result in estimates of potential error in the related account balances which may lead the auditor to perform additional substantitive procedures in order to conclude that the amount of the estimated potential error can be accepted without adjustment to the financial statements. While the estimates of potential errors are important to the auditor's evaluation of possible misstatement of the financial statements, we do not believe that the auditor should be required in all cases to include those estimated potential errors in the schedule of unadjusted misstatements to be attached to the management representation letter and discussed with the audit committee. Accordingly, we recommend that the proposed amendments be revised to acknowledge explicitly the use of the auditor's professional judgment in determining the likely misstatements to be addressed in the summary attached to the representation letter and subsequently to be discussed with the audit committee.

Specifically, we recommend that footnote 4 of AU sec. 333 be revised to articulate such intent. For example, footnote 4 might read as follows (new text is in **bold**):

> 4 SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards,* vol. 1, AU sec. 312.04) states that a misstatement can result from errors or fraud, and discusses the auditor's evaluation of audit findings (AU sec. 312.34-.40). **The auditor should exercise his or her professional judgement in considering the extent, if any, to which likely misstatements are brought to management's attention.**

In addition, a reference to footnote 3 would be added to the proposed new paragraph 10 of SAS No. 61. The related footnote would repeat footnote 4 (as amended) to AU sec. 333. The revised new paragraph 10 and footnote 3 are as follows:

> Immaterial Uncorrected Misstatements
>
> 10. The auditor should inform the audit committee about uncorrected misstatements[3] brought to management's attention by the auditor that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.
>
> ---
>
> **3 SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 312.04) states that a misstatement can result from errors or fraud, and discusses the auditor's evaluation of audit findings (AU sec. 312.34-.40). The auditor should exercise his or her professional judgment in considering the extent, if any, to which likely misstatements are brought to management's attention.**

Our second concern with the proposed amendment relates to the application of the requirement to discuss uncorrected financial statement misstatements brought to management's attention by the auditor *during the current engagement* (emphasis added). In most instances when comparative financial statements are presented, the auditor has "updated" his or her report on the prior period financial statements. Paragraph 5 of SAS No. 85 (Au sec. 333) requires that "if comparative financial statements are reported on, . . . written representations obtained should address all periods being reported on."

Some practitioners might conclude that a summary of the uncorrected misstatements for each period covered by the representation letter is required. We believe that the intent of the proposed amendment is for management's representation (and the related schedule) to run only to uncorrected misstatements in the most recent period covered by the auditors' report, and we support that interpretation. However, we recommend that the final standard explicitly state that intent.

Part 2

Paragraphs 7-9

Although part of the intent of these revisions was to conform the list that constitutes a change in reporting entity to the guidance in paragraph 12 of APB No. 20, the proposed revised paragraph 7 of AU sec. 420 fails to explicitly state that "a business combination accounted for by the pooling of interests method also results in a different reporting entity," as is stated in paragraph 12 of APB No. 20. It can be inferred, however, that a pooling of interests might fall under 7c, "changing the companies included in combined financial statements." Accordingly, one might then conclude that it therefore requires recognition in the auditor's report through inclusion of an explanatory paragraph.

Paragraph 8 then sends a conflicting message to all of paragraph 7, stating that if the change in reporting entity results from "a transaction or event," an explanatory paragraph about consistency is not required. Even though several examples are provided of what may constitute "a transaction or event," it would appear that an argument could be made for each and every change in reporting entity so that a consistency paragraph would never be required.

We believe that combining the last sentence of paragraph 7 and paragraph 8 may eliminate part of the conflict; for example, such combined paragraph might read as follows:

> Because a change in the reporting entity is a special type of change in accounting principles, the consistency standard is applicable. Accordingly, a change in reporting entity requires recognition in the auditor's report through inclusion of an explanatory paragraph unless the change in reporting entity results from a transaction or event, such as the creation, cessation, or complete or partial purchase or disposition of a subsidiary or other business unit.

We would then recommend that paragraph 9 be split into two paragraphs with the following additional language shown in bold (including the addition of the concept of materiality):

> . . . and, in comparative financial statements, for years prior to the year of pooling, as described in APB Opinion No. 16, Business Combinations [AC section B50]. **Although a business combination accounted for by the pooling of interests method also results in a different reporting entity, such different reporting entity was a result of a transaction; accordingly, it does not require recognition in the auditor's report with an explanatory paragraph about consistency**.
>
> If prior year financial statements, presented in comparison with current year financial statements, are not restated to give appropriate recognition to a pooling of interests, a departure from generally accepted accounting principles has occurred, which **if material,** necessitates that the auditor express a qualified or an adverse opinion as discussed in SAS No. 58 . . . an explanatory paragraph (in addition to ~~the~~ **any** modification relating to the departure from generally accepted accounting principles) is not required.

Such changes, if made, would still not resolve the issue that each and every change in reporting entity could be explained as resulting from a certain transaction or event and, therefore, never requiring the addition of an explanatory paragraph regarding consistency.

EDITORIAL COMMENTS

Part 1

Paragraph 5

The proposed item to be added to AU sec. 333.06 lacks parallel sentence construction with the other items in such paragraph; accordingly, we recommend that item g. read as follows:

g. **Management's belief that** ~~Immateriality, both individually and in the aggregate, of~~ the effects of any uncorrected financial statement misstatements brought to management's attention by the auditor during the current engagement **are immaterial, both individually and in the aggregate, to the financial statements taken as a whole**.

We also believe that footnote 5 should also be added to the proposed new item 5 in Appendix A of AU sec. 333.

Part 3

Paragraph 3

We recommend the following change for clarity:

3. The guidance in this section is applicable to the audit of the financial statements of an entity that obtains services from another organization that are part of ~~its~~ **the entity's** information system.

Ronald G. Nelson
Vice President and
Controller

3M General Offices

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#33

3M

June 23, 1999

Judith M. Sherinsky
Technical Manager
Audit and Attest Standards
File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

3M appreciates the opportunity to comment on the Auditing Standards Board Exposure Draft, *Audit Adjustments, Reporting on Consistency and Service Organizations*. We have some concerns with the amendments relating to audit adjustments.

As a preparer, we are committed to financial reporting in the context of high ethical standards. Today, we correct any material errors, errors that could affect trends (and therefore investment decisions), and any unsubstantiated entries as we discover them. However, we will not deny that there may be immaterial errors accidentally produced in the normal process of closing our ledgers or random oversights that may arise from transactions missing cutoffs outside our accrual processes. Unless the immaterial (individually or in the aggregate) items suggest a larger problem, deliberate misstatement, or may be indicative of an internal control issue, we fail to see the need to have them documented in the representation letter and/or discussed with the Audit Committee.

Each year (with quarterly updates) we provide our independent auditors with a management representation letter that confirms that management is "responsible for the fair presentation in the consolidated financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles."
In addition, we confirm, "to the best of our knowledge and belief", that "there are no material transactions, agreements or accounts that have not been properly recorded in the accounting records . . ." Accidental errors or random oversights are currently, and should remain, the responsibility of management. Generally, we try to correct all unintentional mistakes in the subsequent accounting period.

The items on our auditors' "schedule of unresolved differences" (SUD) generally stem from either unintentional mistakes, differences of judgment on management estimates used in the financial statements or varying interpretations of GAAP. The SUD includes both income and expense items. We use this schedule to assist in the assessment of the fairness of our financial statement presentation, as a tool to facilitate correction of errors, and to plan how future occurrences can be avoided (i.e., improved systems and procedures, better staff training, etc.).

If you promulgate requirements to attach immaterial items to the representation letter and to discuss them with the Audit Committee, we believe there will be unfortunate and unintended consequences stemming from your decision:

- How will independent auditors avoid members of the Audit Committee becoming frustrated in having their valuable time used in discussion of insignificant items?
- Today, our independent auditors have told us that they use a dollar amount in determining what is significant enough to list on the SUD (i.e., where we and they "agree to disagree"). Will your proposal cause auditors to use higher dollar amounts in defining immateriality to avoid discussions of inconsequential items with the Audit Committee?
- If auditors use higher dollar thresholds, management will not get information on smaller items for use in improving systems, training, or making corrections.
- Fees for Audit Committee members may rise if they need longer meetings to discuss immaterial items.
- Fees for independent auditors may rise to cover the extra time required to discuss accidental errors and questions of judgment and interpretation.
- Preparers and auditors will spend more time negotiating with each other as to what is immaterial, knowing that those items will go to the Audit Committee.
- Earnings releases may be delayed if the Audit Committee were to insist that the financial closing be re-run to accommodate some or all of the immaterial items attached to the representation letter. A re-run would also add appreciably to the pressure of meeting SEC filing deadlines. Please note that the SEC's "aircraft carrier" proposal would shorten the time for filing the Form 10-Qs and the annual Form 10-K.

Frankly, we think your proposal is trying for a degree of near-perfection that will be very difficult to make operational in practice. If you want to require the attaching and reviewing of the net total dollars of the SUD and/or the net total dollars of the SUD expressed as a percent of net income, that is one thing. Listing each individual immaterial item is overkill to us.

Finally, we would recommend you postpone any further action on this ED until the SEC has published its Staff Accounting Bulletin on materiality.

Thank you for the opportunity to provide input on this exposure draft.

Sincerely,

A Team AICPA Note

AICPA

DATE: July 13, 1999

TO: Pat Meyer

FROM: Sherry Boothe

SUBJECT: Comment Letters

Attached are copies of the *Audit Adjustment* Comment Letters 33-42.

Ronald G. Nelson
Vice President and
Controller

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June 23, 1999

Judith M. Sherinsky
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Audit and Attest Standards
File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

3M appreciates the opportunity to comment on the Auditing Standards Board Exposure Draft, *Audit Adjustments, Reporting on Consistency and Service Organizations*. We have some concerns with the amendments relating to audit adjustments.

As a preparer, we are committed to financial reporting in the context of high ethical standards. Today, we correct any material errors, errors that could affect trends (and therefore investment decisions), and any unsubstantiated entries as we discover them. However, we will not deny that there may be immaterial errors accidentally produced in the normal process of closing our ledgers or random oversights that may arise from transactions missing cutoffs outside our accrual processes. Unless the immaterial (individually or in the aggregate) items suggest a larger problem, deliberate misstatement, or may be indicative of an internal control issue, we fail to see the need to have them documented in the representation letter and/or discussed with the Audit Committee.

Each year (with quarterly updates) we provide our independent auditors with a management representation letter that confirms that management is "responsible for the fair presentation in the consolidated financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles."
In addition, we confirm, "to the best of our knowledge and belief", that "there are no material transactions, agreements or accounts that have not been properly recorded in the accounting records . . ." Accidental errors or random oversights are currently, and should remain, the responsibility of management. Generally, we try to correct all unintentional mistakes in the subsequent accounting period.

The items on our auditors' "schedule of unresolved differences" (SUD) generally stem from either unintentional mistakes, differences of judgment on management estimates used in the financial statements or varying interpretations of GAAP. The SUD includes
both income and expense items. We use this schedule to assist in the assessment of the fairness

of our financial statement presentation, as a tool to facilitate correction of errors, and to plan how future occurrences can be avoided (i.e., improved systems and procedures, better staff training, etc.).

If you promulgate requirements to attach immaterial items to the representation letter and to discuss them with the Audit Committee, we believe there will be unfortunate and unintended consequences stemming from your decision:

- How will independent auditors avoid members of the Audit Committee becoming frustrated in having their valuable time used in discussion of insignificant items?
- Today, our independent auditors have told us that they use a dollar amount in determining what is significant enough to list on the SUD (i.e., where we and they "agree to disagree"). Will your proposal cause auditors to use higher dollar amounts in defining immateriality to avoid discussions of inconsequential items with the Audit Committee?
- If auditors use higher dollar thresholds, management will not get information on smaller items for use in improving systems, training, or making corrections.
- Fees for Audit Committee members may rise if they need longer meetings to discuss immaterial items.
- Fees for independent auditors may rise to cover the extra time required to discuss accidental errors and questions of judgment and interpretation.
- Preparers and auditors will spend more time negotiating with each other as to what is immaterial, knowing that those items will go to the Audit Committee.
- Earnings releases may be delayed if the Audit Committee were to insist that the financial closing be re-run to accommodate some or all of the immaterial items attached to the representation letter. A re-run would also add appreciably to the pressure of meeting SEC filing deadlines. Please note that the SEC's "aircraft carrier" proposal would shorten the time for filing the Form 10-Qs and the annual Form 10-K.

Frankly, we think your proposal is trying for a degree of near-perfection that will be very difficult to make operational in practice. If you want to require the attaching and reviewing of the net total dollars of the SUD and/or the net total dollars of the SUD expressed as a percent of net income, that is one thing. Listing each individual immaterial item is overkill to us.

Finally, we would recommend you postpone any further action on this ED until the SEC has published its Staff Accounting Bulletin on materiality.

Thank you for the opportunity to provide input on this exposure draft.

Sincerely,

#34

citigroup

Roger W. Trupin
Controller

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June 22, 1999

Ms. Judith M. Sherinsky
Technical Manager
Audit and Attest Standards
File 3509
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky,

Citigroup appreciates the opportunity to comment on the proposed Statement on Auditing Standards, *Audit Adjustments, Reporting on Consistency, and Service Organizations*.

Our comments relate to the Auditing Standards Board proposal to require that external auditors inform audit committees about immaterial misstatements that are identified by the auditors but not adjusted in the financial statements. We believe that the proposed requirement represents a poor use of audit committees' valuable time and is more likely to chill than invigorate effective communication with auditors.

In our view, the audit committee should play a central role in corporate governance by providing informed, vigorous, and effective oversight over accounting and controls. The committee should hold management responsible for producing financial reports that are accurate in accordance with accounting rules, and it should hold auditors responsible for conducting an examination in accordance with auditing standards.

In this regard, the committee certainly has an interest in any material errors and differences identified as a result of the auditor's work. In particular, the committee would be interested in errors and differences that individually or in the aggregate significantly affect trends, indicate a systemic weakness in controls, or reveal a lack of integrity in the financial statements.

But the proposed Statement on Auditing Standards would require the committee to review and evaluate matters that management and the auditors agree need no action because of their immateriality. That's what these "immaterial misstatements" are. They represent the sort of minor errors and differences that inevitably occur in the increasingly complex and time-sensitive process of financial reporting. Any important items requiring action will have been resolved.

Reviewing and evaluating immaterial items would be a waste of the audit committee's valuable time and yet another burden on the heavily-burdened reporting process. Nothing is gained by asking the committee to review unimportant items, and much is lost if the committee is given a list of issues with respect to which no action is expected or necessary.

Of course, the committee should be free to discuss all errors and differences with the auditors, and the auditors should be free to raise any such matters with the committee. Unfortunately, the proposed Statement on Auditing Standards would likely discourage this open communication.

A requirement to list all errors and differences for the committee would elevate these issues, with undesirable consequences. Because the committee would have to be formally burdened with a list of "misstatements," there would be a natural tendency to apply an abundance of caution despite the professional judgment that no action is needed. Resources would be unnecessarily expended to "correct" items that need no correcting, or alternatively to justify inaction on items that need no action.

Finally, by formalizing a requirement to list all immaterial items, we believe the "back and forth" which naturally occurs between independent auditors and audit committees would inevitably be chilled.

As a result, we believe that the proposed Statement on Auditing Standards would neither improve the financial reporting process nor contribute to the effectiveness of audit committees. We would be pleased to discuss our views further if that would be of assistance to you. If you have any questions, please contact me at (212) 559-2867.

Very truly yours,

Roger W Trupin

Roger W. Trupin

#35

DePaul University

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June 22, 1999

Judith M. Sherinsky, Technical Manager,
Audit and Attest Standards, file 3509
American Institute of CPAs
1211 Avenue of the Americas
New York, NY 10036-8775

By fax 212 596-6213

Dear Judith,

My comments are limited to the first issue addressed by the proposed statement, audit adjustments. The general thrust of this portion of the ED seems designed to clarify already existing client responsibilities rather than to clarify or add to those of auditors, which is the primary purpose of auditing standards. Thus, I believe there is little chance the ED will contribute in any meaningful way to achieving its stated objective of improving the financial reporting process. Rather, I believe the ASB should consider adopting the approach of Canadian auditing standards which provide for a specific auditor responsibility to detect and communicate misstatements.

1. The fact that management is responsible for the fair presentation of an entity's financial statements is already well covered in auditing literature and well understood by management, auditors, and financial statement users. In fact, research shows that management of three-fourths of the 500 largest U.S. public companies already make a public assertion of their responsibility for proper financial statement preparation and maintenance of appropriate internal control.

Specifically, SAS No. 83 recently issued in October 1997 clearly states that the engagement letter should document that "management is responsible for the entity's financial statements." Adding the current ED's phrase that management "is responsible for adjusting the financial statements to correct material misstatements" is thus redundant and not necessary. Further, SAS No. 85 recently issued in November 1997 provides that management's representation letter should contain "management's belief that the financial statements are fairly presented in conformity with GAAP." Thus, the ED's requirement for management to represent to its auditors that any uncorrected audit adjustments are not material also results in an unnecessary redundancy.

2. The requirement for clients to report to their auditors a summary of any uncorrected audit adjustments they consider not material seems to be a role reversal. The most important objective of an audit is that an auditor should detect all misstatements (both errors and irregularities) and then determine whether the client has corrected all those that are material. To users of financial information, it is the auditor's opinion that the financial statements are fairly presented in all material respects that is critical, not that of the client.

3. The ED's requirement for the auditor to act as a communications channel to inform the audit committee of management's determination that any uncorrected audit adjustments brought to its attention by the auditor are immaterial contains two crucial flaws. The ED contains no definitional specification as to what items auditors should bring to the attention of client management in the first place or how it should be done. Thus, management could, either consciously or unwittingly, fail to communicate back to the auditor important matters of which the audit committee should be aware. Additionally, the audit committee is more interested in the auditor's rather than management's opinion of the materiality of matters about which discussions have taken place between management and the auditor.

In summary, I believe the "audit adjustments" portion of the ED should be deleted because it puts the auditor into the unflattering position of being a message carrier for management. Instead, the auditor should function as an independent professional whose primary function is to form an opinion on the fairness of financial statements and then communicate that opinion to interested parties. As noted above, I also believe the ASB should consider the merits of the CICA auditing standard "Auditor's Responsibility to Detect and Communicate Misstatements."

Yours very truly,

Curtis C. Verschoor

Curtis C. Verschoor, CPA, CMA, CIA, CFE

#36

ERNST & YOUNG LLP

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June 30, 1999

Ms. Judith M. Sherinsky, Technical Manager
Audit and Attest Standards, File 3509
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Proposed Statement on Auditing Standards (SAS)
Audit Adjustments, Reporting on Consistency, and Service Organizations
(Omnibus Statement on Auditing Standards—1999)

Dear Ms. Sherinsky:

Ernst & Young LLP supports the issuance of the above referenced proposal to amend certain SASs to provide guidance to auditors in the areas of audit adjustments, reporting on consistency, and service organizations. However, with respect to the guidance being provided on audit adjustments, we believe that the SAS amendments should explicitly state that (1) the summary of uncorrected misstatements that is included in or attached to the letter of representations should cover the current period financial statements only and (2) the summary should include uncorrected misstatements identified by management as well as those identified by the auditor. The remainder of this letter discusses these comments.

Period to be Covered in the Summary

The proposed amendments to SAS 85, *Management Representations*, and to SAS 61, *Communication with Audit Committees*, are silent as to the financial statement period to be covered in the summary of items brought to management's and the audit committee's attention by the auditor. We understand the intent of the amendments is to require communication of items that relate to the current period financial statements, and we recognize that the proposed amendments state the management representation and schedule should include items brought to management's attention "during the current engagement." However, AU333.05 states: "Written representations from management should be obtained for all financial statements and periods covered by the auditor's report." Therefore, we recommend that a footnote be added to the proposed amendment to AU333.06g stating that "the summary of uncorrected financial statement misstatements included in or attached to the letter of representations should not cover all periods presented but rather should cover only the current period covered by the auditor's report."

Items to be Included in the Summary

The proposed amendments to SAS 85 and SAS 61 each refer to "uncorrected financial statement misstatements brought to management's attention by the auditor." However, during the course of an audit, financial statement misstatements may be identified by management as well as the auditors. The proposed amendments would not require misstatements identified by management to be included in the summary of uncorrected financial statement misstatements. As a result, the amended standards would not require management to address such items in their written representations, nor would they necessarily be included in the required communication to the audit committee.

We believe it would be preferable for the proposed amendments to refer to "uncorrected financial statement misstatements of which management is aware" to include items identified as a result of management's own analysis and process of preparing the financial statements and as a result of communication from the auditor. Inclusion of all misstatements in the summary regardless of how they were identified would improve the communication between auditors, management, and the audit committee.

*****

We would be pleased to discuss our comments with members of the Auditing Standards Board or its staff.

Sincerely,

Ernst + Young LLP

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new york state society of
NYSSCPA
certified public accountants

#37

June 29, 1999

RE: Proposed Statement on Auditing Standards: ***Audit Adjustments, Reporting on Consistency, and Service Organizations***

Judith M. Sherinsky, Technical Manager
Audit and Attest Standards, File 3509
American Institute of CPAs
1211 Avenue of the Americas
New York NY 10036-8775

Dear Ms. Sherinsky:

The New York State Society of Certified Public Accountants is pleased to submit the attached comments on the proposed Statement on Auditing Standards. Our Auditing Standards and Procedures Committee, Vincent J. Love, chair, developed the comments. Members of that committee would be pleased to respond to questions you may have about the comments.

Very truly yours

James L. Craig, Jr.
Technical Services Division

Enclosure (1)

cc: Vincent J. Love, CPA
Chair Auditing Standards and Procedures Committee

Members of the Auditing Standards and Procedures Committee
Accounting and Auditing Committee Chairs

NYSSCPA Committee on Auditing Standards and Procedures

Comments on the Exposure Draft

Proposed Statement on Auditing Standards

Audit Adjustments, Reporting on Consistency, and Service Organizations

Omnibus Statement on Auditing Standards — 1999

The Auditing Standards and Procedures Committee of the New York State Society of Certified Public Accountants (the Committee) would like to thank the AICPA Auditing Standards Board ("The Board") for this opportunity to comment on the proposed statement on auditing standards dated April 22, 1999.

We agree with all of the proposals, but have some suggestions for changes, and the need for additional implementation guidance on, Part 1 — Audit Adjustments.

The understanding with the client that management is responsible for adjusting its financial statements to correct material misstatements and management's acknowledgement of the immateriality of unadjusted misstatements begs for guidance on materiality and on how adjustments should be aggregated and assessed. This guidance could be included in the proposed statement, or in separate guidance for implementation of this proposed statement, similar to the guidance material on SAS No. 82.

When management does not correct misstatements brought to its attention by its auditors, a number of issues may come into play. Recommended adjustments should not be ignored if they materially affect the financial statements of the current or any prior period. Moreover, recommended adjustments that were not made in a prior period affect the ending balance sheet of that period, and although they were judged to be immaterial to that prior period (and likely to be immaterial to the subsequent period) need to be reevaluated in the subsequent period. In addition, there may be misstatements identified in the current period affecting prior periods that were not discovered in those prior periods. These misstatements may be difficult or impossible to isolate into specific prior periods. When evaluating materiality of multi-period misstatements should the auditor use current period materiality criteria, or a prior year's criteria, or some combination of these?

Many auditors still evaluate misstatements in the financial statements from a rather simplistic income statement perspective. The Board should consider including guidance in the proposed standard that when looking at misstatements in the financial statements, both individually and in the aggregate, all financial statement effects must be considered, even those affecting individual line items. Also, when considering the aggregate effects of misstatements on the financial statements, "hard" adjustments should not be used to directly offset "soft" adjustments, i. e., quantifiable adjustments generally should not offset adjustments based on estimates and judgment on a dollar-for-dollar bases.

Additionally, when there are different entities, not reported on separately, but included in consolidated financial statements, is it appropriate to offset, in the aggregate, material misstatements in each entity's financial statements.

The major auditing firms have guidance material dealing with these kinds of matters. There is very little specific guidance in the AICPA standards.

Audit Adjustments

Amendment to SAS 85, *Management Representations* (AICPA *Professional Standards*, vol. 1, AU sec 333.06 and .16.)

SUMMARY

This comment deals with the proposed requirement to include a schedule of uncorrected immaterial misstatements known to both the auditor and management in the management representation letter. The inclusion of the schedule is a needless burden placed on the auditor and management whose cost may exceed its benefit.

¶ 4. As presented in the proposed statement:

> "It also requires that a summary of the uncorrected misstatements be included in the representation letter or in an attachment thereof."

The auditor in his or her own judgment will bring immaterial misstatements to the attention of management. If management elects to not correct the misstatements then other audit procedures ensure that all immaterial uncorrected misstatements in the aggregate are immaterial to the financial statements. If not, the auditor should appropriately modify the opinion. This would ordinarily be documented in audit working papers prepared according to GAAS.

Inclusion of a summary of uncorrected immaterial misstatements in the management representation letter provides no benefit to either the auditor or management. It does add cost to the audit in creating more documentation of the misstatement, discussion with the client, and preparation and review of the representation letter.

The requirement to include the summary of uncorrected immaterial misstatements in the management representation letter should be stricken from the proposed statement.

¶ 5. g. As presented in the proposed statement:

> "Immateriality .... (A summary of such items should be included in or attached to the letter.)"

Since the sentence referred to in ¶ 4 should be stricken, so should this sentence.

New ¶ 5 in appendix A "Illustrative Management Representation letter"

> "We believe that the effects of the uncorrected misstatements summarized in the accompanying schedule are immaterial, both individually and in aggregate, to the financial statements taken as a whole."

Since the sentence referred to in ¶ 4 should be stricken, the paragraph should read as follows:

> "We believe that the effects of any uncorrected misstatements are immaterial both individually and in aggregate, to the financial statements taken as a whole."

CONCLUSION

The cost to the auditor and management of inclusion of a schedule of uncorrected immaterial misstatements exceeds its benefit and should not be required by the statement.

Amendment to SAS 61, *Communications With Audit Committees* (AICPA *Professional Standards*, vol. 1, AU sec 380)

SUMMARY

This comment deals with the proposed requirement to inform the audit committee of uncorrected misstatements determined by management to be immaterial, both individually and in aggregate. Like the proposed schedule for the management representation letter, the discussion of immaterial misstatements between the auditor and the audit committee is a needless burden placed on the auditor and the audit committee whose cost may exceed its benefit.

¶ 7 As presented in the proposed statement:

> "This amendment inserts the following paragraph after AU section 380.09 to require the auditor to inform the audit committee about uncorrected misstatements whose effects management believes are immaterial, both individually and in aggregate, to the financial statements taken as a whole [AU sec. 380.10-.15 is renumbered 380.11-.16.]"

The auditor in his or her own judgment has already determined that the uncorrected misstatements are immaterial, both individually and in aggregate, to the financial statements taken as a whole. If not, and the auditor deemed them material, the auditor would have qualified his or her opinion. Informing the audit committee of the uncorrected misstatement opens up the door for the audit committee to "Monday morning quarterback" the audit. In addition, substantial documentation may have to be prepared, reviewed, and presented by the auditor to explain each misstatement.

The audit committee may have to spend significant time to understand the uncorrected misstatements. They have already employed management, engaged the auditor, and implicitly trust both parties' judgment. Would the audit committee have the power to overrule management and the auditor if they deem the uncorrected misstatements material? This is unnecessary micro management and casts a shadow of doubt on the trust and responsibility between management, the auditor, and the audit committee.

CONCLUSION

The cost to the auditor and management of informing the audit committee of uncorrected immaterial misstatements exceeds its benefit and should not berequired by the statement.

Amendment to SAS 70, *Reports on the Processing of Transactions by Service Organizations* (AICPA *Professional Standards*, vol. 1, AU sec 324.03 and .06-.10)

Given the actual and projected growth of e-Business and the Internet, and that many businesses are already or plan to outsource the processing of key financial transactions to

Internet Service Providers (ISP's), the statement should recognize and explicitly state that ISP's are a type of service organization contemplated by the statement.

¶3. As presented in the original and proposed statement:

> "Service organizations that provide such service, for example, are bank trust departments that invest and service assets for employee benefit plans or for others, mortgage bankers that service mortgages for others and electronic data processing (EDP) service centers that process transactions and related data for others. The guidance in this section may also be relevant to situations in which an organization develops, provides, and maintains the software used by client organizations. ...."

Transactions processed by ISP's may comprise a material amount of the transaction processed by an entity and in some cases 100% of the transactions. With respect to this, the statement should explicitly state that financial transactions processed by ISP's are an example of such services contemplated by the statement.

CONCLUSION

The new statement should recognize the importance of e-Business and the Internet and explicitly state that Internet Service Providers (ISP's) are a type of organization contemplated by the statement

Once again, we thank the Board for this opportunity to make our views known.

#38

COMMONWEALTH of VIRGINIA

Auditor of Public Accounts

WALTER J. KUCHARSKI
AUDITOR

POST OFFICE BOX 1295
RICHMOND, VIRGINIA 23218
(804) 225-3350

June 30, 1999

Judith M. Sherinsky
Technical Manager
Audit and Attest Standards, File 3509
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

The Auditor of Public Accounts is pleased to respond to your Exposure Draft on *Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards-1999)*. In addition to comments made by the National State Auditors Association (NSAA), we offer the following comment for consideration by the Auditing Standards Board ("Board").

We support the change to the engagement letter that specifies that management has responsibility for adjusting the financial statements to correct material misstatements. However, the Board should clarify the terminology to "correct material misstatements" to include an understanding between the auditor and auditee before the start of an audit as to what amount of adjustment(s) or difference(s) in accounting principle would constitute a material misstatement. This clarification is especially important where an accounting principle requires additional disclosures in the notes or supplementary information and not a financial statement adjustment.

Should you have any questions concerning this response, please contact me at (804) 225-3350.

Sincerely,

Walter J. Kucharski
Auditor of Public Accounts

WJK:aom

#39

Arkansas Society of Certified Public Accountants

415 North McKinley Street • Suite 970 • Little Rock, Arkansas 72205-3022

June 29, 1999

Judith M. Sherinsky, Technical Manager
Audit and Attest Standards, File 3509
American Institute of CPAs
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Sherinsky:

Attached is response from the Arkansas Society of Certified Public Accountants to the Exposure Draft identified on the response.

Please let me know if you need anything else.

Thank you.

Sincerely,

Barbara Angel

Barbara S. Angel
Executive Director

/enclosure

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ASCPA ACCOUNTING PRINCIPLES AND AUDITING COMMITTEE RESPONSE TO EXPOSURE DRAFT:

"Proposed Statement on Auditing Standards-Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards-1999)"

The ASCPA Accounting Principles and Auditing Committee supports the proposed Statement on Auditing Standards (SAS) identified above.

The proposed statement amends various SAS's to provide guidance to auditors in the following three areas:

Part 1- (Auditing Adjustments): Management's responsibility for the disposition of financial misstatements brought to its attention,
Part 2- (Reporting on Consistency): Changes in the reporting entity that require a consistency explanatory paragraph in the auditor's report, and
Part 3- (Service Organizations): Determining whether information about a service organization's controls is needed to plan the audit.

COMMENTS AND RECOMMENDATIONS

Part 1-Audit Adjustments:

The purpose of this proposed change is to encourage audit clients to record financial statements proposed by auditors during audits of financial statements. The proposed change would amend three SAS's to establish audit requirements that clarify management's responsibility for the disposition of financial statements misstatements brought to its attention.

The committee supports this proposed chance because of the additional communication it provides to the audit committee and the additional encouragement it provides audit clients to comply with financial statements adjustments proposed by the auditors.

Part 2-Reporting on Consistency:

The purpose of this proposed change is to clarify which changes in the reporting entity require a consistency explanatory paragraph in the auditor's report. The proposed change would accomplish the following:

1. Conform the list of changes in AU sec. 420.07 that constitutes a change in reporting entity to the guidance provided in paragraph 12 of Accounting Principles Board Opinion No. 20, Accounting Changes,
2. Clarify that a consistency explanatory paragraph does not need to be added to the audit report when the change in reporting entity results from a transaction or event,
3. Eliminate the requirement to add a consistency paragraph to the auditor's report when a pooling of interests is not accounted for retroactively in comparative financial statements (However, the auditor would still be required to issue either a qualified or adverse opinion because of the departure from GAAP.), and
4. Eliminate the requirement to qualify the auditor's report and consider adding a consistency explanatory paragraph to the report if single year financial statements that report a pooling of interests do not disclose combined information for the prior year.

The committee supports this proposed change because the readers of the audit report need to be aware of the failure to restate prior years following a pooling of interests and that the requirement for the auditor to express either a qualified or an adverse opinion accomplishes that the best.

Part 3-Service Organizations:

The purpose of this proposed change is to help auditors determine the kind of information about a service organization they need when auditing the financial statement of a client that uses a service organization to process transactions. The proposed amendments to SAS No. 70 would change the title as well as provide guidance and clarification to the auditor on the consideration and evaluation of a service organization's information system and controls.

The committee supports the proposed change, but has some concern about the deletion of the old paragraph 8 because of the guidance that it provided auditors.

In conclusion, the ASCPA Accounting Principles and Auditing Committee endorses the Proposed Statement of Auditing Standards-Audit Adjustments, Reporting on Consistency, and Service Organizations and hopes that the comments offered will be beneficial.

ASCPA Accounting Principles and Auditing Committee

#40

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

June 24, 1999

Ms. Judith M. Sherinsky, Technical Manager
Audit and Attest Standards, File 3509
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Sherinsky:

We have reviewed the AICPA Exposure Draft (ED) of the proposed Statement on Auditing Standards, entitled *Audit Adjustments, Reporting on Consistency, and Service Organizations (Omnibus Statement on Auditing Standards—1999)*, and we agree in principle with much of the proposed guidance. We do, however, have the following four comments for consideration by the Auditing Standards Board (Board) in developing the final Statement.

1. The first portion of Paragraph 5, on Page 10 of the ED, states that "This amendment adds the following item to the list of matters that should be addressed in a representation letter in connection with a financial statement audit (AU sec. 333.06). [Items *g* through *q* become items *h* through *r*.]" Because a new item *g* could be categorized under either subtopic 'Completeness of Information' (currently items *c* through *f*) or subtopic 'Recognition, Measurement, and Disclosure' (currently items *g* through *p*) in AU sec. 333.06, we suggest that the Board further clarify the location of this amendment in the final Statement.

2. The last portion of Paragraph 5, also on Page 10 of the ED, states that "...the following item is added to the illustrative management representation letter in paragraph 6 of appendix A..." The item refers to an accompanying schedule, summarizing the uncorrected misstatements. To provide more complete guidance to the auditor, we suggest that the Board also include an illustrative schedule of uncorrected misstatements in Appendix A of the final Statement.

3. Paragraph 7, on Page 11 of the ED, would require the auditor "...to inform the audit committee about uncorrected misstatements brought to management's attention by the auditor that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole." We object to the proposed guidance in Paragraph 7. We believe that the professional standards currently provide adequate guidance to the auditor in communicating with an audit committee. These standards recognize the concept of materiality and require the auditor to inform the audit committee about adjustments, whether or not recorded by management, that could have a *significant* effect on the financial reporting process. To expand these standards to further *require* that the auditor inform the audit committee about uncorrected misstatements determined by management to be *immaterial* would, in our opinion, erode the integrity and respect of the profession. Unless the auditor is allowed to continue to use professional judgment and to apply a concept of materiality to his/her communications with the audit committee, those committee members, and other users of our audit services, may question the relevance of our services as we enter the new millennium. For these reasons, we recommend that the Board delete Paragraphs 7 and 8 in the final Statement.

4. The first three amendments in the ED each contain a specific prospective effective date, but encourage early adoption. However, Paragraph 10, on Page 13 of the ED, and Paragraph 13, on Page 17, both merely state that "This amendment is effective upon issuance." By prescribing that an auditing standard is effective upon issuance, typically through publication in *The Journal of Accountancy*, the Board places an unnecessary burden on the auditor conducting an engagement who may not become immediately aware of the issuance of a standard. For this reason, and for consistency with the effective date of the other three amendments, we suggest that the Board revise Paragraphs 10 and 13 in the final Statement to read "This amendment is effective for audits of financial statements for periods beginning on or after December 15, 1999. Early adoption is encouraged."

We appreciate this opportunity to comment on the Exposure Draft. Should you have any questions, or desire further details on our comments, please contact me or Jon A. Wise, C.P.A., Director of Professional Practice.

Sincerely,

Thomas H. McTavish

Thomas H. McTavish, C.P.A.
Auditor General

COMMENT LETTER #41

June 30, 1999

Ms. Judith Sherinsky
Technical Manager,
Audit and Attest Standards
File 3509
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Sherinsky:

We are pleased to respond to the Exposure Draft, Audit Adjustments, Reporting on Consistency, and Service Organizations.

The Auditor of State is responsible for auditing over 4,000 entities receiving public money in Ohio. The Office follows Generally Accepted Auditing Standards and Government Auditing Standards for these engagements. The Office also prescribes accounting polices and procedures for most Ohio local governments.

Our comments on the three topics of the proposed omnibus statement follow.

Audit Adjustments
We believe that the currently required communication to audit committees of significant adjustments made and waived (AU 380.09) adequately addresses this objective. We believe the proposed requirements, if adopted, should not apply to clearly inconsequential adjustments. We suggest the proposed revisions be amended to allow auditors and clients (including their audit committees) to agree upon a limit, beneath which adjustments would not be subject to these requirements. This amendment would not be dissimilar to that of AU 316.38, which requires auditors to reach an understanding with audit committees regarding the nature and extent of communications about fraud perpetrated by lower-level employees.

Consistency
We do encounter changes in government reporting entities. Such changes can result from new contractual arrangements or legislative changes. The nature of these changes fundamentally differs from the stock transactions that change commercial reporting entities. We request the revision clarify whether changes affecting governmental reporting entities falls within the scope of AU 420.08.

We believe that if a change in reporting entity is adequately disclosed, the change need not be repeated in the auditor's report. Such reporting would be consistent with recent SAS 79 (AU

Ms. Judith Sherinsky
Technical Manager,
Audit and Attest Standards
File 3509
American Institute of Certified Public Accountants

508.30), which omitted the requirement to emphasize uncertainties that were adequately disclosed by the client.

Service Organizations
This Office has committed considerable effort in complying with SAS 70. We concur with the proposed changes.

AU 324.08, as revised in the Exposure Draft, lists important sources of information on controls. In our experiences, service organizations often submit summarized reports, listing transactions they have processed. We believe that if the user organization's management applies appropriate reviews to these reports, they constitute control procedures we can rely on to reduce control risk. We therefore suggest that the revisions to AU 324.08 include reporting provided by the service organization to the user organization, as an important source of information about control activities.

We appreciate the opportunity to comment. If you have questions or comments, please contact me at (614)728-7111.

Very truly yours,

JIM PETRO
Auditor of State of Ohio

Frederick Kruse, CPA
Assistant Senior Deputy Auditor

COMMENT LETTER #42

June 30, 1999

Judith M. Sherinsky, Technical Manager,
Audit and Attest Standards, file 3509
American Institute of CPAs
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Judith,

The Institute of Internal Auditors (IIA) is pleased to comment on the Auditing Standards Board (ASB) Exposure Draft (ED) dated April 22, 1999. Thank you for allowing us an extension to the original response due date. Our comments are limited to just the first issue addressed by the proposed statement, audit adjustments.

The general thrust of this portion of the ED is to clarify already existing client responsibilities rather than to clarify or expand those of auditors. Thus, we believe there is little chance that it will achieve its stated objective of improving the financial reporting process. We believe the ASB should adopt the Canadian Institute of Chartered Accountants (CICA) approach of mandating an auditor's responsibility to detect and communicate misstatements rather than the converse.

1. The fact that management is responsible for the fair presentation of financial statements is already well covered in auditing literature and well understood by management, auditors, and users of financial statements. In fact, research shows that the management of three-fourths of the 500 largest U.S. public companies already make a public assertion of their responsibility for proper financial statement preparation and maintenance of appropriate internal control.

Specifically, SAS No. 83 issued in October 1997 clearly states that the engagement letter should document that "management is responsible for the entity's financial statements." The ED's requirement that management "is responsible for adjusting the financial statements to correct material misstatements" is thus redundant. Further, SAS No. 85 issued in November 1997 provides that management's representation letter should contain "management's belief that the financial statements are fairly presented in conformity with GAAP." Thus, the ED's requirement for management to represent to its auditors that any uncorrected audit adjustments are not material results in further redundancy.

2. The requirement for clients to report a summary of uncorrected audit adjustments to the auditors seems to be a role reversal. The most important objective of an audit is that an auditor should detect all material misstatements and then determine whether the client has made the appropriate corrections. To users of financial information, it is the auditor's opinion that the financial statements are fairly presented in all material respects that is critical, not the opinion of the client.

3. The requirement for the auditor to act as a communications channel to inform the audit committee of management's determination that any uncorrected audit adjustments brought to its

attention by the auditor are immaterial contains two crucial flaws. The ED contains no definitional specification as to which items auditors should bring to the attention of client management in the first place or how it should be done. Thus, management could, either consciously or unwittingly, fail to communicate back to the auditor important matters of which the audit committee should be aware. Additionally, the audit committee is more interested in the independent auditor's opinion rather than management's opinion of the materiality of matters about which discussions have taken place.

In summary, we believe the ED puts the auditor in the unflattering position of being a message carrier for management. Instead the auditor should function as a professional whose primary function is to form an opinion on the fairness of financial statements and then communicate that opinion to interested parties. As noted above, we believe the ASB should consider the CICA standard "Auditor's Responsibility to Detect and Communicate Misstatements" which mandates an independent auditor's responsibility to detect and communicate misstatements.

Established in 1941, The Institute of Internal Auditors is an international professional organization with world headquarters in Altamonte Springs, Florida. The IIA has over 70,000 members in internal auditing, governance, internal control, IT audit, education, and security. With representation from more than 100 countries, The Institute is the acknowledged leader in standards, certification, education, research, and technological guidance for the profession worldwide.

Thank you again for allowing The IIA to provide our comments on these exposure drafts. If The IIA can provide further assistance, please feel free to call me.

Sincerely,

William G. Bishop III, CIA