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American Institute of Certified Public Accountants. Audit and Attest Standards Group

In Our Opinion........

The Newsletter of the AICPA Audit and Attest Standards Group

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inside...

New Fraud SAS is Issued

by Kim M. Gibson

The Auditing Standards Board has approved a new Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit*. Although this standard bears the same title as its predecessor (SAS No. 82), it contains much more specific auditing guidance and fraud detection procedures than its predecessor did. The ASB believes that the requirements and guidance provided in this new Statement will result in a substantial change in auditor performance and will improve the likelihood that auditors will detect material misstatements due to fraud in financial statement audits. The ASB also believes that the Statement will result in an increased focus on professional skepticism in the consideration of the risk of fraud in a financial statement audit.

Overview of SAS No. 99

The following is an overview of the organization and content of SAS No. 99:

- *Description and characteristics of fraud.*

- *The importance of exercising professional skepticism.* This section discusses the need for auditors to exercise professional skepticism when considering the possibility that a material misstatement due to fraud could be present.

- *Discussion among engagement personnel regarding the risks of material misstatement due to fraud.* This section requires, as part of planning the audit, that there be a discussion among the audit team members to (1) consider how and where the entity's financial statements might be susceptible to material misstatement due to fraud, and (2) reinforce the importance of adopting an appropriate mindset of professional skepticism.

- *Obtaining the information needed to identify risks of material misstatement due to fraud.* This section requires the auditor to gather information necessary to identify risks of material misstatement due to fraud, by:

    1. Inquiring of management and others within the entity about the risks of fraud.

    2. Considering the results of the analytical procedures performed in planning the audit.

    3. Considering fraud risk factors.

    4. Considering certain other information.

- *Identifying risks that may result in a material misstatement due to fraud.* This section requires the auditor to use the information gathered to identify risks that may result in a material misstatement due to fraud.

- *Assessing the identified risks after taking into account an evaluation of the entity's programs and controls.* This section requires the auditor to evaluate the entity's programs and controls that address the identified risks of material misstatement due to fraud, and to assess the risks taking into account this evaluation.

- *Responding to the results of the assessment.* This section emphasizes that the auditor's response to the risks of material misstatement due to fraud involves the application of professional skepticism when gathering and evaluating audit evidence. The section requires the auditor to respond to the results of the risk assessment in three ways:

    1. A response that has an overall effect on how the audit is conducted, that is, a response involving more general considerations apart from the specific procedures otherwise planned.

    2. A response to identified risks that involves the nature, timing, and extent of the auditing procedures to be performed.

3. A response involving the performance of certain procedures to further address the risk of material misstatement due to fraud involving management override of controls. The procedures include:

    - Examining journal entries and other adjustments for evidence of possible material misstatement due to fraud.
    - Reviewing accounting estimates for biases that could result in material misstatement due to fraud.
    - Evaluating the business rationale for significant unusual transactions.

- *Evaluating audit evidence.* This section requires the auditor to assess the risks of material misstatement due to fraud throughout the audit and to evaluate, at the completion of the audit, whether the accumulated results of auditing procedures and other observations affect the assessment. It also requires the auditor to consider whether identified misstatements may be indicative of fraud and, if so, directs the auditor to evaluate their implications.

- *Communicating about fraud to management, the audit committee, and others.* This section provides guidance regarding the auditor's communications about fraud to management, the audit committee, and others.

- *Documenting the auditor's consideration of fraud.* This section describes related documentation requirements.

In addition, SAS No. 99 amends AU Section 230, "Due Professional Care in the Performance of Work," and SAS No. 85, *Management Representations* (AU sec. 336).

Early Implementation

Although the new auditing standard is effective for audits of financial statements for periods beginning on or after December 15, 2002, the AICPA is encouraging firms that audit public companies to implement the new standard as quickly as possible. Some firms will decide to implement the entire auditing standard early; other firms may decide that even though they are not able to implement the entire standard this year, they will implement certain provisions of the new auditing standard.

The following are some of the key provisions that firms may want to consider implementing early:

- *Brainstorming*. The new standard requires members of the audit team to discuss the risks of material misstatement due to fraud. During this discussion, engagement personnel should be reminded of the need to exercise professional skepticism and to critically assess audit evidence. This discussion also serves as a good opportunity to remind the engagement team that in performing the audit, they need to set aside past relationships or experiences with the client.

During this session, the engagement team should brainstorm the question, "If someone wanted to perpetrate a fraud, how would they do it?" To be most effective, the brainstorming should be an open discussion among engagement team members about fraud risks that may occur through financial statement fraud or misappropriation of assets. It is important that no one person, including the engagement team partner, dominate the discussion. Rather, the brainstorming should occur with input from all engagement team members.

Also, in brainstorming about how fraud might be perpetrated and who might be involved, the engagement team should keep in mind the three conditions that are present in all frauds:

1. Incentives or pressures on management to commit fraud

2. Opportunity, such as management's ability to override controls

3. Attitude or someone's rationalization of why the fraud is acceptable behavior.

During this session, the audit team can critically discuss the risks and potential for fraud that could be material to the financial statements, and how they should best respond to these risks through the design of the audit program.

- *Inquiry*. The engagement team should ask management and others within the entity about the risk of fraud and whether they are aware of any fraud. Forensic experts note that often there are employees in an organization who would alert the auditor if only the auditor would ask. In this regard, auditors should make a point of talking to certain employees, including those in and outside of the accounting department and management rank.

  In smaller, privately owned entities, the following inquiries could be directed to those in the accounting office and other departments;

  - Do you know of anyone who may be stealing from the company?
  - Have you observed any coworkers whose behavior has been unusual?
  - Have you observed anyone who has access to company assets who appears to be living beyond their means?

  In larger organizations, inquiries could be made as to whether anyone has ever asked them to make unusual entries or whether they feel a great deal of pressure to "make the numbers." These, as well as other inquiries, especially of those outside management and the accounting office, may help an auditor detect fraud.

- *Designing audit tests that are not predictable and that are performed in areas that might otherwise be considered low risk.* Auditors, in designing audit tests and procedures, may become too predictable in the types of tests, the locations, and the accounts that are tested. As a result, the audit teams should consider designing certain audit tests that are less predictable and are unexpected by the client. Also, audit engagement teams should consider changing the nature and extent of their testing by including test areas, locations, and accounts that might not otherwise be tested because they would ordinarily be considered low risks.

- *Performing audit procedures that respond to the risk of management override.* Management often can override controls to perpetrate a material financial-statement fraud. Preparing and posting bogus journal entries or biasing accounting estimates are examples of how management might cook the books or manage earnings.

As a result, an engagement team might want to early implement some or all of the audit procedures that test for management override. The new Statement includes certain audit procedures that will be mandatory for all audits once the new Statement becomes effective. To obtain a copy of the SAS, see the ordering instructions below and request product number 060701.

Ordering Instructions

To order publications, call: (888) 777-7077 (menu selection #1); write: AICPA Order Department, CLA3, P.O. Box 2209, Jersey City, NJ 07303-2209; fax: (800) 362-5066 or go to www.cpa2biz.com Users of the Web site must register at the site prior to ordering. AICPA and state society members should have their membership numbers ready when they order. Nonmembers also may order AICPA products. Prices do not include shipping and handling.

ASB Issues Exposure Draft on the Auditor's Risk Assessment Process

by Julie Anne Dilley

At its October 2002 meeting, the Auditing Standards Board (ASB) voted to expose a suite of seven proposed Statements on Auditing Standards (SASs) relating to the auditor's risk assessment process. The ASB believes that the requirements and guidance provided in the proposed SASs, if adopted, would result in a substantial change in audit practice and in more effective audits. The primary objective of the proposed SASs is to enhance the auditor's application of the audit risk model in practice by requiring:

- A more in-depth understanding of the entity and its environment, including its internal control, that would better enable the auditor to identify the risks of material misstatement in the financial statements and any steps the entity is taking to mitigate them.
- A more rigorous assessment of the risks of material misstatement of the financial statements based on that understanding.

- A better linkage between the assessed risks of material misstatement and the nature, timing, and extent of audit procedures performed in response to those risks.

The proposed SASs were developed in response to the August 2000 report of the Public Oversight Board Panel on Audit Effectiveness, an extensive study of audit performance with recommendations to constituents, including recommendations to the ASB to increase the rigor and specificity of auditing standards in various areas. In particular, the proposed standards address recommendations concerning assessing inherent risk, assessing control risk, and linking the risk assessments to substantive procedures. The proposed SASs also have been influenced by recent major corporate failures that have undermined the public's confidence in the effectiveness of audits and led to an intense scrutiny of the work of auditors.

The proposed SASs, which are the outcome of a joint project of the ASB and the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC), also represent an effort among standard setters to promote the convergence and acceptance of an international set of auditing standards. The IAASB simultaneously is exposing proposed International Standards on Auditing (ISAs) that are essentially the same as the U. S. standards except that the proposed SASs contain some additional requirements to conform to other U.S. standards.

The exposure draft consists of the following proposed SASs:

- *Amendment to Statement on Auditing Standards No. 95,* Generally Accepted Auditing Standards
- *Audit Evidence*, which will supersede SAS No. 31, *Evidential Matter* (AU sec. 326)
- *Audit Risk and Materiality in Conducting an Audit,* which will supersede SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AU sec. 312)
- *Planning and Supervision*, which will supersede "Appointment of the Independent Auditor" (AU sec. 310), and SAS No. 22, *Planning and Supervision* (AU sec. 311)
- *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (*Assessing Risks*)
- *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, which will supersede SAS No. 45, *Substantive Tests Prior to the Balance-Sheet Date* (AU sec. 313), and, together with the proposed SAS *Assessing Risks* will supersede SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit* (AU sec. 319)
- *Amendment to SAS No. 39,* Audit Sampling

The "Summary" section of the exposure draft outlines the significant provisions in each of the these proposed standards.

The following are some of the key changes in audit practice that are expected to be achieved by the collective proposed standards.

- *The quality and depth of the auditor's required understanding of the entity and its environment, including its internal control, is significantly enhanced.* The guidance sets forth specific elements of the entity and its environment, in addition to the components of internal control, about which the auditor must obtain an understanding. The auditor is required to perform risk assessment procedures in all audits to obtain this understanding, including updating information obtained in prior audits that the auditor intends to use in the current audit. A sufficient understanding of the entity and its environment, including its internal control, is fundamental to an effective audit because it enhances the auditor's ability to identify and assess areas where material misstatement may occur. This understanding also assists the auditor throughout the audit, for example, in making judgments about materiality and evaluating audit evidence.

- *Based on the understanding obtained, the auditor is required to assess the risks of material misstatement at the financial statement level and at the assertion level.* The assessment of the risks of material misstatement encompasses a combined assessment of inherent and control risk. The option of assessing risk "at the maximum" without support is eliminated. Auditors are required to develop a risk assessment and to support that assessment based on their understanding of the entity and its environment, including its internal control. In addition, as part of the assessment, auditors are required to identify significant risks that require special audit consideration, and risks for which substantive procedures alone will not reduce audit risk to an appropriate level.

- *Testing of controls is encouraged*. Testing of controls is encouraged by eliminating the option to default to maximum risk and the concurrent ability to avoid documenting the basis for that conclusion. In addition, the auditor's required understanding of internal control is augmented by requiring the auditor to evaluate the design of controls, including relevant control procedures, that address significant risks, and to determine whether these controls have been implemented. The increased specificity of the guidance about the required understanding of internal control in such circumstances is expected to encourage testing of controls.

  Consistent with existing guidance, the auditor is not *required* to perform tests of controls unless the auditor intends to rely on the operating effectiveness of controls to alter the nature, timing, or extent of substantive procedures, or has determined that evidence obtained from substantive procedures alone will not reduce risk to an appropriate level.

- *Greater emphasis is placed on the entity's risk assessment process*. The entity's risk assessment process, a component of internal control, is discussed in the context of the entity's objectives, strategies, and related business risks because the purpose of the risk assessment process is to identify and respond to risks to the achievement of the entity's objectives, including its financial reporting objectives. If the auditor identifies risks that may result in material misstatement of the financial statements that the entity's risk assessment process has failed to identify, the auditor considers why the process failed to do so and whether the process is appropriate in the circumstances.

- *The linkage between assessed risks and audit procedures that are responsive to those risks is improved.* Auditors are required to determine overall responses, for example, assigning more experienced staff or individuals with special skills, to address the risks of material misstatement at the financial statement level. They also are required to design and perform audit procedures, including tests of controls and substantive procedures, whose nature, timing, and extent are clearly linked to the assessed risks of material misstatement at the assertion level. The proposed guidance emphasizes the importance of the nature of the audit procedures in responding to assessed risks. In addition, guidance on the auditor's ability to rely on audit evidence gathered in prior audits is clarified and strengthened. If the auditor plans to rely on controls that the auditor has determined have not changed since they were last tested, based on procedures performed in the current audit, the auditor is required to perform tests of the operating effectiveness of such controls at least every third audit, subject to the conditions of the next paragraph.

  For significant risks, the auditor is required to perform substantive procedures, consisting of tests of details alone or tests of details combined with substantive analytical procedures, that are specifically responsive to the risk. If the auditor plans to rely on the operating effectiveness of controls to mitigate a significant risk, all of the evidence about the operating effectiveness of those controls must be from tests of controls performed in the current period, even if such controls were determined to be operating effectively in the previous audit and the auditor has determined in the current audit that such controls have not changed.

- *Greater emphasis is placed on testing disclosures*. The guidance on assertions related to presentation and disclosure has been enhanced to include specific references to the completeness of disclosures and their understandability to users. In addition, throughout the proposed SASs, use of the phrase "risks of material misstatement in classes of transactions, account balances, or disclosures" reminds auditors that they must also consider how misstatement may occur in disclosures.

- *Documentation requirements are significantly expanded*. Documentation is important in driving auditor behavior by demonstrating that the auditor has complied with standards. The proposed SASs require the auditor to document, among other matters, the results of the risk assessments both at the financial statement and assertion levels; the nature, timing, and extent of audit procedures performed; the linkage with the assessed risks at the assertion level; and the results of the audit procedures.

In many cases, implementation of the proposed SASs will result in an overall increased work effort by the audit team, particularly for new engagements and when first implemented on continuing engagements. The benefits derived should be more effective audits resulting from better risk assessments and improved design and performance of audit procedures in response to the risks. The improved linkage between audit procedures and assessed risks is expected to result in a greater concentration of effort in areas for which there is a greater risk of misstatement. In some cases, this may result in a change to the audit approach or a change in the nature of audit procedures performed.

The proposed SASs represent a reorganization, as well as an enhancement, of the subject matter in several existing standards that is intended to facilitate the changes in audit practice discussed above. The "Summary" section of the exposure draft discusses major changes to the organization of guidance in the existing standards and the reasons for the changes. In addition, Appendix B of the "Summary" section presents proposed changes in the numbering and order of auditing standards in AU Section 300 of the AICPA *Codification of Statements on Auditing Standards*.

Certain terminology differences between the SASs and ISAs have been eliminated as an outcome of this joint project. For example, throughout the proposed SASs, *audit evidence* replaces *evidential matter*, *audit procedures* replaces *auditing procedures*, *control procedures* replaces *control activities*, *substantive procedures* replaces *substantive tests*, *reliability* replaces *validity* in the context of audit evidence, *reduce* replaces *limit* or *restrict* in the context of audit risk or detection risk, and *implemented* replaces *placed in operation* in the context of understanding internal control.

The proposed SASs will be exposed as a single document that will be available on the AICPA Web site towards the end of November. The comment deadline on the exposure draft is April 30, 2003.

ASB Issues SAS No. 100, *Interim Financial Information*

by Judith M. Sherinsky

At its October 2002 meeting, the Auditing Standards Board (ASB) voted to issue a final Statement on Auditing Standards (SAS) *Interim Financial Information*, that would replace SAS No. 71 of the same name.

The revised SAS will provide additional guidance on performing reviews of interim financial information and incorporate the requirement of the Securities and Exchange Commission (SEC) for timely filings of interim financial information. The SAS also incorporates relevant recommendations of the Public Oversight Board's Panel on Audit Effectiveness in its August 31, 2000 document, *Report and Recommendations*, as well as recommendations of the AICPA's Professional Issues Task Force in Practice Alert 2000-4, "Quarterly Review Procedures for Public Companies." To view the POB report, go to http://www.pobauditpanel.org/download.html and to view Practice Alert 2000-4, go to www.aicpa.org/pubs/cpaltr/oct2000/supps/palert1.htm

The standard is applicable to an accountant performing a review of interim financial information of:

- An SEC registrant
- A non-SEC registrant that makes a filing with a regulatory agency in preparation for a public offering or listing, if the entity's latest annual financial statements have been or are being audited.

The term *interim financial information* means financial information or statements covering a period less than a full year or for a 12-month period ending on a date other than the entity's fiscal year end.

The term *accountant*, as used in this SAS, refers to a CPA performing a review engagement in accordance with the new SAS.

The SAS revises SAS No. 71 by:

- Clarifying the applicability of generally accepted auditing standards to a review of interim financial information.

- Citing the SEC requirement that a registrant engage an independent accountant to review the registrant's interim financial information *before* the registrant files its quarterly report on Form 10-Q or Form 10-QSB, and modifying the relevant guidance in the SAS to reflect this requirement.

- Providing guidance to an accountant performing *an initial review* of interim financial information. A review engagement is deemed an initial review if the accountant has not audited the financial statements of the previous year end.

- Requiring an accountant to establish an understanding with his or her client regarding the services to be performed in an engagement to review interim financial information, and specifying the matters generally included in that understanding.

- Requiring the accountant to perform certain additional specified procedures in an interim review engagement, including:

    - Comparing disaggregated revenue data, for example, comparing revenue reported by month and by product line or business segment for the current interim period with that of comparable prior periods.

    - Obtaining evidence that the interim financial information agrees or reconciles with the accounting records.

- Inquiring of members of management who have responsibility for financial and accounting matters about their knowledge of any fraud or suspected fraud affecting the entity, and whether they are aware of allegations of fraud or suspected fraud, affecting the entity received in communications from employees, former employees, analysts, regulators, short sellers, or others.

- Providing an illustrative report for a review of comparative interim financial information.

- Providing guidance on the accountant's consideration, in an interim review engagement, of matters related to an entity's ability to continue as a going concern, and presenting reporting options related to such matters.

- Adding an appendix to the SAS that presents examples of analytical procedures the accountant may consider performing in a review of interim financial information.

- Adding an appendix to the SAS that provides examples of unusual or complex situations to be considered by an accountant when conducting a review of interim financial information.

- Adding an appendix to the SAS containing two illustrative representation letters for a review of interim financial information. The first letter is designed to be used in conjunction with the representation letter provided by management in connection with the audit of the financial statements of the prior year end. The second letter, may be used independently of any other representation letter.

The SAS is effective for interim periods within fiscal years beginning after December 15, 2002. Earlier application of the provisions of the Statement are permitted.

The SAS will be available in December 2002. To obtain a copy of the SAS, see the ordering instructions below and request product number 060702.

Ordering Instructions

To order publications, call: (888) 777-7077 (menu selection #1); write: AICPA Order Department, CLA3, P.O. Box 2209, Jersey City, NJ 07303-2209; fax: (800) 362-5066 or go to www.cpa2biz.com Users of the Web site must register at the site prior to ordering. AICPA and state society members should have their membership numbers ready when they order. Nonmembers also may order AICPA products. Prices do not include shipping and handling.

Four New Members of the ASB

The Auditing Standards Board expresses gratitude and best wishes to its departing members, Linda Cheatham, Richard Dieter, Michael Manspeaker, and Ray Whittington. We also welcome the following four new members:

Kenneth Macias is the founder and managing partner of Macias, Gini & Company LLP with offices in Sacramento, Fresno, Los Angeles, and the San Francisco Bay area. He has over 23 years of experience, including audits of government, nonprofit, and business organizations. Ken earned a B.S. in Business Administration and an M.S. in Accountancy and Taxation from California State University, an M.B.A. in Finance from Golden Gate University, an M.P.A. in Management from the University of Southern California (USC) and a Doctorate in Public Administration from USC.

Ken was a member of the AICPA Group of 100 and served on the AICPA's State and Local Government Accounting and Auditing Committee. Ken was a member of the GASB task force that ultimately issued GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, and currently serves on GASB's Asset Impairment Task Force. Ken was chair of the Government Accounting and Auditing Committee for the California Society of CPAs, Sacramento Chapter.

Ken was featured in California CPA (June 2002), "Because Trust Matters" and in the Journal of Accountancy (December 1995) in an article on "Understanding Program-Specific Audits; Case Study: Making Program-Specific Audits Work." The Sacramento Hispanic Chamber of Commerce awarded Ken the "Businessman of the Year" in 1992.

William F. Messier, Jr. is the Deloitte & Touche Professor at the School of Accountancy, Georgia State University, and currently serves as the Interim Director of the School of Accountancy. He is also a Professor II at the Institute for Accounting & Auditing, Norwegian School of Economics and Business Administration and a visiting professor at SDA Bocconi in Milan, Italy. Bill holds a B.B.A. from Siena College, an M.S. from Clarkson University, and an M.B.A. and D.B.A. from Indiana University. He is a CPA in Florida.

Bill currently serves on the AICPA's International Auditing Standards Subcommittee. He was formerly Chairperson of the Auditing Section of the American Accounting Association. Professor Messier is Editor of *Auditing: A Journal of Practice & Theory*. Bill is the author of *Auditing and Assurance Services: An Integrated Approach,* third edition and he has published over 50 articles in accounting, decision science, and computer science journals.

Steven L. Schenbeck is an audit principal in the accounting and consulting firm of Ehrhardt, Keefe, Steiner & Hottman PC., Denver based accounting and consulting firm providing services to clients in the Rocky Mountain region. He has served public companies and closely held businesses for over twenty years and specializes in securities offerings, control systems, and SEC registration and compliance. He graduated from the University of Denver in 1982 with a Bachelor of Science in accounting.

Michael T. Umscheid is a partner with Witt, Mares & Company, PLC in Virginia Beach Virginia where he specializes in the credit union industry. He has been with the firm since his graduation from Virginia Tech 17 years ago. Mike currently serves on the AICPA's Financial Institutions Audit Guide Task Force and has served as Chair of the AICPA's Financial Services Expert Panel. Mike is a contributing author to various publications and is a speaker at credit union conferences sponsored by the AICPA, National Credit Union Association, and National Association of Credit Union Service Organizations. In 2000, Mike was selected by *Inside Business* as one of the areas "Top 40 Under 40" business leaders.

Accounting and Review Services Committee Issues SSARS No. 9

By Kim M. Gibson

Periodically, the Accounting and Review Services Committee (ARSC) issues an Omnibus Statement. Statement on Standards for Accounting and Review Services (SSARS) No. 9, Omnibus – 2002 was recently issued by the ARSC. The Omnibus includes revisions to existing SSARSs that have been accumulated over a period of time.

The following is a summary of the amendments included in SSARS No. 9:

- The auditing literature permits an accountant who may be associated with financial statements of a public company, but has not audited or reviewed such statements to state that he or she has not audited the unaudited information and includes illustrative report wording. This guidance is also appropriate for compilation and review engagements; however, SSARSs currently does not include illustrative wording. This amendment revises SSARS No. 1, *Compilation and Review of Financial Statements* (AR sec. 100.03), to include wording that may be appropriate under the circumstances.

- The accounting literature does not require the statement of retained earnings to be presented as a financial statement. Accounting Principles Board Opinion No. 12, *Omnibus Opinion—1967,* requires disclosure of a change in capital. This can be done by preparation of a separate statement in the notes to the financial statements or as part of another basic statement. In addition, the illustrative reports currently do not refer to the statement of comprehensive income. This amendment will include two footnotes to SSARS No. 1 (AR sec. 100.14 and 100.36), stating (1) the statement of retained earnings is not a required statement and, if not presented as a separate statement, reference in the compilation and review report is not needed and (2) if the statement of comprehensive income is presented, reference should be made in the appropriate paragraphs of the report.

- SSARSs currently does not specifically require a signature of the accounting firm or the accountant on a review or compilation report. This amendment will revise SSARS No. 1 (AR sec. 100.11 and 100.33) to require a signature. The guidance in AR section 100.12 and 100.13 has been deleted and included in AR Section 100.11; guidance in AR section 100.34 and 100.35 has been deleted and included in AR Section 100.33.

- The current guidance found in SSARS No. 1 (AR sec. 100.29) requires the accountant to obtain a representation letter from management. The guidance is not specific about the content of the letter, the dating of the letter, and current management's responsibility regarding previous years. This amendment will require the accountant to obtain specific representations from management when performing a review engagement, will provide guidance on the dating of the letter, and provide guidance regarding obtaining representations from current management when they were not present during all periods covered by the accountant's report.

- SSARS No. 1 (AR sec. 100.44) includes the guidance on reporting on supplementary information. Currently, the guidance is unclear with respect to separate reporting on supplementary information in a compilation engagement. This amendment would explicitly permit the accountant to issue a separate report on supplementary information in a compilation engagement, consistent with guidance on supplemental information in a review report.

- SSARSs currently does not refer to the Statements on Quality Control Standards (SQCSs) and how those standards interact with SSARSs. The proposed amendment will clarify that although an effective quality control system is conducive to compliance with SSARSs, deficiencies in or noncompliance with a firm's quality control system do not, in and of themselves, indicate that an engagement was not performed in accordance with the applicable professional standards. This amendment would be included as the last section of SSARS No. 1.

- SSARS No. 4, *Communications Between Predecessor and Successor Accountants* (AR sec. 400), provides guidance on communications between accountants when the successor accountant decides to communicate with the predecessor regarding acceptance of an engagement. This amendment defines predecessor and successor accountants, provides guidance regarding acceptance of an engagement, suggests inquiries the successor accountant may decide to ask the predecessor accountant, and includes an illustrative successor-accountant acknowledgment letter that the predecessor may want to use in connection with granting access to the working papers.

SSARS No. 9 will be available by December 2002.

Highlights of Technical Activities

The Auditing Standards Board (ASB) performs its work through task forces composed of members of the ASB and others with technical expertise in the subject matter of the projects. The findings of these task forces periodically are presented to members of the ASB, at public meetings, for their review and discussion. Listed below are the current task forces of the ASB and brief summaries of their objectives and activities.

Task Forces of the ASB

ASB Horizons II Task Force (Staff Liaison: Gretchen Fischbach; Task Force Chair: John A. Fogarty). This task force is developing the ASB's strategic plan for the next three to five years. The ASB welcomes the input of AICPA members and others interested in the ASB's planning activities. Comments should be directed to Gretchen Fischbach via the Internet at gfischbach@aicpa.org.

Audit Committee Task Force: (Staff Liaison: Kim Gibson; Task Force Chair: Bruce Webb). This new task force has been charged with amending existing professional standards that contain guidance on audit committee communications to reflect the applicable provisions of the Sarbanes-Oxley Act. The exposure draft is expected to be approved by the ASB at its December 2002 meeting.

Audit Issues Task Force (Staff Liaison: Gretchen Fischbach; Task Force Chair: James S. Gerson). This task force generally meets on a monthly basis to (1) oversee the ASB's planning process, (2) evaluate technical issues raised by various constituencies and determine their appropriate disposition including referral to an ASB task force or development of an interpretation or other guidance, (3) address emerging audit and attestation practice issues, (4) provide advice on ASB task force objectives and composition, and monitor the progress of task forces, and (5) assist the ASB Chair and the Audit and Attest Standards staff in carrying out their functions, including liaising with other groups.

Consistency Task Force (Staff Liaison: Gretchen Fischbach; Task Force Chair: Craig W. Crawford). This task force is considering whether the second reporting standard of the ten generally accepted auditing standards, which relates to consistency, should be eliminated. The consistency standard requires the auditor to identify in his or her report circumstances in which generally accepted accounting principles have not been consistently observed in the current period in relation to the preceding period. This topic as addressed in AU Section 420, "Consistency of Application of Generally Accepted Accounting Principles." At its July 2002 meeting, the ASB asked the task force to research the usefulness of the consistency explanatory paragraph and to obtain the reactions of user groups to the possible elimination of the consistency standard. The task force also is considering whether aspects of Statement of Financial Accounting Concepts

No. 2, *Qualitative Characteristics of Accounting Information*, should be added to SAS No. 32, *Adequacy of Disclosure in Financial Statements*. The task force will present the results of its research and a draft of an expanded SAS No. 32 at a future ASB meeting.

Fair Value Task Force (Staff Liaison: Gretchen Fischbach; Task Force Chair: Susan L. Menelaides). On June 28, 2002, the ASB issued an exposure draft entitled *Auditing Fair Value Measurements and Disclosures.* The proposed SAS establishes general guidance and a framework to assist auditors in exercising professional judgment when auditing fair value measurements and disclosures. The comment period for the exposure draft ended on August 28, 2002. The ASB will discuss a revised draft of the proposed SAS at its December 2002 meeting. If approved at that meeting, the SAS will be issued by February 2002.

Financial Instruments Task Force (Staff Liaison: Judith M. Sherinsky; Task Force Chair: Stephen D. Holton) The task force has drafted the following updates to the Audit Guide, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*:

- A significant expansion of an existing case study to add considerations for assertions about ineffectiveness in the hedging relationship.
- A case study that addresses considerations for a foreign currency hedge when part of the change in the derivative's fair value is excluded from the assessment of hedging effectiveness and the remaining critical terms of the derivative and the hedged item match.
- A case study that addresses considerations for assertions about a hedge for which the shortcut method is used and impairment considerations when the carrying amount of the hedged item has been increased under fair value hedge accounting.
- A case study and an appendix that address considerations when assertions about hedge effectiveness are based on the use of regression analysis

The task force is drafting additional auditing guidance related to energy and other commodity contracts for which there is no readily determinable market and anticipates that the updated Guide will be issued in the Spring of 2003.

Fraud Task Force (Staff Liaison: Kim M. Gibson; Task Force Chair: David Landsittel). At its September 2002 meeting, the ASB voted to issue SAS No. 99, *Consideration of Fraud in a Financial Statement Audit.* See the article on page 1 for information about the SAS.

Internal Control Reporting Task Force (Staff Liaison: Julie Anne Dilley; Task Force Chair: Garrett L. Stauffer). The task force will revisit AT Section 501, *Reporting on an Entity's Internal Control*, to ensure that it appropriately addresses matters relating to the auditor's evaluation of internal control that are specified in the Sarbanes-Oxley Act of 2002 (SOA), including the sufficiency of guidance on performing such engagements and the suitability of the report language. The task force also will consider implications of the prohibition in AT Section 501 to perform review level services on internal control, and whether another approach is more suitable. The task force also will consider whether amendments should be made to AU Section 508, *Reports on Audited Financial*

Statements, or to other auditing standards pursuant to the SOA internal control reporting requirements.

International Auditing Standards Subcommittee (Staff Liaison: Susan S. Jones; Subcommittee Chair: Tom Ray). The ASB created this subcommittee to support the development of international standards. Subcommittee activities include providing technical advice and support to the AICPA representative and technical advisors to the International Auditing and Assurance Standards Board, commenting on exposure drafts of international assurance standards, participating in and identifying U.S. volunteer participants for international standard-setting projects, identifying opportunities for establishing joint standards with other standard setters, identifying international issues that affect auditing and attestation standards and practices, and assisting the ASB and other AICPA committees in developing and implementing AICPA international strategies.

Joint Quality Control Standards Task Force (Staff Liaison: Judith M. Sherinsky; Task Force Chair: Craig W. Crawford). The task force considers matters related to Statements on Quality Control Standards (SQCSs). The task force has revised, *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (Guide) to respond to recommendations from the Public Oversight Board's Panel on Audit Effectiveness, to incorporate recently issued SQCSs, and to provide practitioners with more specific and detailed guidance. The task force will reconvene in November 2002 to discuss additional changes that need to made to the Guide, and possibly the SQCSs, in response to provisions of the Sarbanes-Oxley Act, and issues related to significant clients and fee dependency.

Joint Risk Assessments Task Force (Staff Liaisons: Julie Anne Dilley and Sylvia Barrett; Task Force Chairs: John A. Fogarty and John Kellas). This task force is a joint effort of the International Auditing and Assurance Standards Board (IAASB) and the ASB. At its October 2002 meeting, the ASB voted to expose seven proposed SASs related to the auditor's risk assessment process, including assessing the risks of material misstatement and designing audit procedures to respond to the assessed risks. See the article on page 5 for additional information.

Legal Inquiry Letters Reeducation Task Force (Staff Liaison: Gretchen Fischbach; Task Force Chair: Susan L. Menelaides). This joint task force, composed of representatives of the AICPA and the American Bar Association, was established to address concerns regarding language used by auditors in audit inquiry letters issued pursuant to SAS No. 12, *Inquiry of a Client's Lawyer concerning Litigation, Claims, and Assessments,* and responses by attorneys to those letters.

Sarbanes-Oxley Omnibus SAS Task Force (Staff Liaison: Jane M. Mancino; Task Force Chair: Susan Menelaides) This new task force has been charged with developing technical amendments to the professional standards to reflect certain provisions of the Sarbanes-Oxley Act other than those relating to internal control and audit committees. The exposure draft is expected to be approved by the ASB at its December 2002 meeting.

SAS No. 71 Task Force (Staff Liaison: Judith M. Sherinsky, Task Force Chair: Alan G. Paulus). At its October 2002 meeting, the ASB approved the issuance of a SAS No. 100, *Interim Financial Information*, as a final SAS that will supersede SAS No. 71 of the same name. For information about the new SAS see the article on page 9, "ASB Issues SAS No. 100, *Interim Financial Information*."

Sustainability Reporting Task Force (Staff Liaison: Jane M. Mancino; Task Force Chair: Beth A. Schneider). This joint task force of the AICPA's ASB and Assurance Services Executive Committee and the Canadian Institute of Chartered Accountants (CICA) is charged with developing a marketable assurance service that addresses sustainability reporting, and participating with other organizations in the development of suitable criteria for the preparation of such presentations. Sustainability presentations are issued by companies to explain their economic, environmental, and social performance. Recently, the Task Force has been focusing on possible services CPAs and Chartered Accountants (CAs) might provide related to greenhouse gas (GHG) emissions trading.

Based on updated market research, the AICPA has concluded that the demand by U.S. companies for attest services related to sustainability reporting is only in its early stages, and that significant market demand for such services may be several years off. Although much work has been done by organizations such as the Global Reporting Initiative to develop criteria for sustainability reporting, significant work is still needed before such criteria meet the suitability requirements of the AICPA's Attestation Standards and become generally accepted.

Therefore, the AICPA has chosen to postpone joint development of an assurance service on sustainability reporting. The task force will continue to work on a Statement of Position that provides guidance for performing an attestation engagement related to GHG emissions, and will disband once that project is complete. The AICPA will continue to monitor the market demand for sustainability reporting in the U.S. and will re group if and when market demand warrants. It is important to note that many CPA firms in the U.S. are developing services in this area and that activity will certainly continue. These firms' activities will be an important part of the developing market and the AICPA's monitoring activity.

In Canada, the Assurance Services Development Board of the CICA is obtaining an updated assessment of the potential market for sustainability reporting by CAs, and will determine its future service development activities based on the results of that research. The CICA will continue to emphasize the need for accounting-profession involvement in the development of suitable criteria for sustainability reporting, through the efforts of the Global Reporting Initiative or other processes.

The AICPA, as part of its ongoing commitment to the public interest, will continue to focus on areas that the capital markets view as highly relevant, including the Business Reporting Model of the Future and such recent developments as the new audit standard for detecting fraud.

For more information on sustainability reporting and GHG emissions trading, visit http://www.aicpa.org/innovation/baas/environ/index.htm.

Other Task Forces, Committees, and Activities

Accounting and Review Services Committee (ARSC) (Staff Liaison: Kim M. Gibson; Committee Chair: Diane S. Conant). For information about the work of this Committee, see the article on page 13, "Accounting and Review Services Committee Issues SSARS No. 9."

Auditing Standards Committee (Chair: Brian Ballou, Auburn University) The Auditing Standards Committee of the American Accounting Association is charged with fostering interaction between the Association's Auditing Section and auditing standard-setting bodies such as the AICPA's ASB. The ASB has long supported strengthening its relationship with the academic community as well as increasing the community's participation in the standard-setting process. Ray Whittington, ASB member, and Gretchen Fischbach, Audit and Attest Standards Technical Manager, attend the AAA Auditing Standards Committee meetings. Under that Committee's auspices, the ASB presented a panel on research opportunities in auditing standards at the Auditing Section's 2002 Mid-Year Meeting. The ASB expects to participate in another panel tentatively titled "Perspectives on Risk Assessments" at the 2003 Meeting.

International Auditing and Assurance Standards Board (IAASB) (U.S. Member: Edmund R. Noonan; U.S. Technical Advisor: Susan S. Jones). In September, the IAASB (formerly the International Auditing Practices Committee) voted to expose its proposed International Standards on Auditing (ISAs) related to the auditor's risk assessment process, including assessing the risks of material misstatement and designing audit procedures to respond to the assessed risks. (See the article on page 5 for additional information.) The IAASB also voted to expose a proposed International Auditing Practices Statement (IAPS) that provides guidance addressing the circumstance when reporting on the financial statements of an entity that includes an inaccurate statement regarding compliance with the requirements of International Financial Reporting Standards. For more information on the activities of the IAASB, including information on attending public meetings of the IAASB, go to http://www.ifac.org/IAASB/.

Other projects of the IAPC include quality control standards, consolidated financial statements, interim financial information and fraud. All of these projects may result in new standards or other forms of guidance. An analysis comparing the International Standards on Auditing with the SASs that identifies instances in which the ISAs specify procedures not specified by U.S. auditing standards is included in Appendix B of the *Codification of Statements on Auditing Standards*.

Privacy Task Force (Staff Liaison: Erin P. Mackler; Chair: Everett Johnson) A task force of the Business Advisory and Assurance Services Executive Committee is establishing criteria and services to address enterprise-wide privacy. Such criteria might be used to evaluate compliance with regulatory requirements related to privacy or to help entities establish best practices for managing risk related to privacy. Judith Sherinsky is assisting the task force with aspects of the project related to attestation engagements.

Valuing Privately-Held-Company Equity Securities (VPES) Issued in Other Than a Business Combination Task Force (Staff: Marc Simon; Chair: Val Bitton**)** Since October 2001, this task force of the AICPA's Accounting Standards Team has been addressing the issue of how to value the common stock of a private company. The task force consists of a cross section of experts from industry, public accounting, academe, and business valuation, and is working to identify best practices. The ASB is monitoring this project and plans to develop auditing guidance relating to the valuation of privately-held-company equity securities. Lynford Graham, ASB member, is a member of the VPES task force and Gretchen Fischbach, Audit and Attest Standards Technical Manager, attends the meetings as an observer.

Recently Issued and Approved Documents

Title (Product Number)	Issue Date	Effective Date
Statements on Auditing Standards (SASs)		
SAS No. 100, *Interim Financial Information* (060702) Not yet available **New**	November 2002	Effective for interim periods within fiscal years beginning after December 15, 2002. Earlier application is permitted
SAS No. 99, *Consideration of Fraud in a Financial Statement Audit* (060701) **New**	October 2002	Effective for audits of financial statements beginning on or after December 15, 2002. Earlier application is permitted
SAS No. 98, *Omnibus—2002* (060700) **New**	September 2002	Effective upon issuance except for the revision to SAS No. 70, effective for reports issued on or after January 1, 2003. Earlier application is permissible.
SAS No. 97, *Amendment to SAS No. 50,* Reports on the Application of Accounting Principles (060699) **New**	August 2002	Effective for written reports issued, or oral advice provided on or after June 30, 2002. Earlier application of the provisions of the Statement is permissible.
SAS No. 96, *Audit Documentation* (060698)	January 2002	Effective for audits of financial statements for periods beginning on or after May 15, 2002. Earlier application is permitted.
SAS No. 95, *Generally Accepted Auditing Standards*	December 2001	Effective for audits of financial statements for periods beginning on or after December 15, 2001.
Statements on Standards for Attestation Engagements (SSAEs)		
SSAE No. 12, Omnibus— 2002 (023031) **New**	September 2002	Effective upon issuance.
SSAE No. 11, *Attest Documentation* (023030)	January 2002	Effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002. Earlier application is permitted.

Statements on Quality Control Standards (SQCSs)		
SQCS No. 6, *Amendment to Statement on Quality Control Standards No. 2* , System of Quality Control for a CPA Firm's Accounting and Auditing Practice (067024) **New**	September 2002	Effective upon issuance.
Interpretations of SASs		
Title	Issue Date	Effective Date
Interpretation of SAS No. 58, *Reports on Audited Financial Statements*, Interpretation No. 14 "Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and in Accordance With International Standards on Auditing" (AU sec. 9508)	March 2002	Interpretations of audit, attest, and quality control standards are effective upon issuance in the *Journal of Accountancy.*
Interpretations of SAS No. 70, *Service Organizations* Interpretation No. 4, "Responsibilities of Service Organizations and Service Auditors With Respect to Forward-Looking Information in a Service Organization's Description of Controls" Interpretation No. 5, "Statements About the Risk of Projecting Evaluations of the Effectiveness of Controls to Future Periods" Interpretation No. 6, "Responsibilities of Service Organizations and Service Auditors With Respect to Subsequent Events in a Service Auditor's Engagement"	February 2002	

Interpretation of SAS No. 73, *Using the Work of a Specialist*, "The Use of Legal Interpretations as Evidential Matter to Support Management's Assertion That a Transfer of Financial Assets Has Met the Isolation Criterion in Paragraph 9(a) of Financial Accounting Standards Board Statement No. 140"	December 2001	.
Statements of Position		
Title (Product Number)	Issue Date	Effective Date
Statement of Position 02-1, *Performing Agreed-Upon Procedures Engagements That Address Annual Claims Prompt Payment Reports as Required by the New Jersey Administrative Code* (014934) **New**	May 23, 2002	Effective upon issuance
Statement of Position 01-4, *Reporting Pursuant to the Association for Investment Management and Research Performance Presentation Standards* (014931)	November 15, 2001	Effective for engagements to examine and report on aspects of an investment firm's compliance with, and/or examining and reporting on specific composite results in conformity with, the redrafted AIMR-PPS standards, the U.S. and Canadian version of GIPS. The SOP may not be applied to engagements in which the investment firm has not yet adopted the redrafted AIMR-PPS standards.
AICPA Audit Guides		
Service Organizations: Applying SAS No. 70, As Amended (012772)	April 15, 2002	

Projected Auditing Standards Board Agenda

Codes: DI- Discussion of issues, DD - Discussion of draft document, ED-Vote to ballot a document for exposure, EP-Exposure Period, CL- Discussion of comment letters, FI-Vote to ballot a document for final issuance, SU- Status Update

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	ASB Meeting Dates and Locations		
Project	**December 17-19, 2002** **Tempe, AZ**	**Feb. 11-13, 2003** **Nevada**	**April 8-10, 2003** **New York, NY**
Consistency	DI	DD	DD
Fair Values	FI		
Internal Control Reporting	DI	DD	ED
Risk Assessment	EP	EP	EP
Sarbanes-Oxley Omnibus SAS	DD ED	EP	CL FI
Sarbanes-Oxley Audit Committee	DD ED	EP	CL FI

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