



## **AICPA Update – The Auditing Year in Review**

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## **What Will Be Covered**

- AICPA Auditing Standards Board Update
- Status of Relevant AICPA Guides
- Latest from OMB, GAO, and Other Federal Activities
- Governmental Audit Quality Center and Other AICPA Assistance



## **AICPA Auditing Standards Board (ASB) and other Standard-Setters**



## **Auditing Standards Setters**

- U.S. Government Accountability Office (GAO) – Yellow Book
  - Government financial audits, attestation engagements, and performance audits
- American Institute of Certified Public Accountants (AICPA)
  - U.S. financial audit and attestation standards for entities other than publicly traded companies
- Public Company Accounting Oversight Board (PCAOB)
  - Financial auditing standards for public companies traded on the U.S. exchanges
- International Auditing and Assurance Standards Board (IAASB)
  - Financial audit and attestation standards used throughout the world



## **ASB Facts**

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- Focus on audits of non-public entities
- Diverse membership
- State Board representation
- Non-firm membership and user perspective
- International convergence strategy



## **The Latest on AICPA Auditing Standards**





## **SAS 102 and SSAE No. 13**

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- Issued in December 2005; effective on issuance
- SAS 102 and SSAE 13 define the terminology the ASB will use to describe the degrees of responsibility that the requirements impose on the auditor/practitioner
- Will result in clarification of standards
- Terms are substantially similar to those defined by the PCAOB in its Rule 3101



## **SAS 102 and SSAE 13**

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- Unconditional requirements
  - The auditor is required to comply in all cases
  - Indicated by the words "must" or "is required to"
- Presumptively mandatory requirements
  - The auditor is required to comply
  - In rare circumstances the auditor/practitioner may depart from the requirement provided he/she documents the justification and how alternative procedures performed were sufficient to achieve the objectives of the requirement
  - Indicated by "should"



## **SAS 103 Audit Documentation**

- Effective for periods ending on or after December 15, 2006; supersedes SAS 96
- The ASB considered:
  - The documentation requirements of PCAOB Auditing Standard No. 3
  - The documentation requirements of IAASB ISA 230
  - *Government Auditing Standards*
  - Suggestions received from NASBA



## **SAS 103 Audit Documentation**

- Prepare audit documentation in sufficient detail to provide an experienced auditor with no previous connection to the audit a clear understanding of the work performed, the evidence obtained and its source, and the conclusions reached
- Enhanced guidance on matters that should be documented
- Guidance on documentation that should be retained



## **SAS 103 Audit Documentation**

- Oral explanations on their own do not represent sufficient support for work the auditor performed or conclusions reached
  - May be used to clarify or explain audit documentation
- Document audit evidence that is contradictory or inconsistent with final conclusions and how the auditor addressed the contradiction or inconsistency



## **SAS 103 Audit Documentation**

- Assemble the final audit engagement file within 60 days following the report release date.
  - After 60 days – no deletion or discard of existing audit documentation
  - After 60 days – appropriately document subsequent additions
- Minimum file retention period of five years from the report release date.



## **SAS 103 Audit Documentation**

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- Dating of the auditor's report:
  - Not earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the opinion.
- When do you have "sufficient appropriate evidence"?
  - When you are at a point that you would be comfortable signing the report and releasing to the client.



## **Risk Assessment Standards**

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- The series of risk assessment standards:
  - SAS No. 104, Amendment to Statement on Auditing Standards No. 1
  - SAS No. 105, Amendment to Statement on Auditing Standards No. 95, *Generally Accepted Auditing Standards*
  - SAS No. 106, Audit Evidence
  - SAS No. 107, Audit Risk and Materiality in Conducting an Audit (Audit Risk and Materiality)



## **Risk Assessment Standards**

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- Recently issued risk assessment standards:
  - SAS, No. 108, Planning and Supervision
  - SAS No. 109, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Assessing Risks)
  - SAS No. 110, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Performing Procedures)
  - SAS No. 111, Amendment to Statement on Auditing Standards No. 39, *Audit Sampling*



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## **Risk Assessment Standards**

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Originated as a joint project between the ASB and IAASB about the time we began work on SAS 99

- Why issued? The ASB believes that the SASs represent a significant strengthening of auditing standards
- Much of SAS 99 theory originated in our deliberations over risk assessment standards



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## **Risk Assessment Standards**

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- Enhances the auditor's application of the audit risk model in practice by requiring:
  - More in-depth understanding of the entity and its environment, including its internal control, to identify the risks of material misstatement in the financial statements and what the entity is doing to mitigate them
  - More rigorous assessment of the risks of material misstatement of the financial statements based on that understanding
  - Improved linkage between the assessed risks and the nature, timing, and extent of audit procedures performed in response to those risks



## **How the SASs Affect Practice**

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- The quality and depth of the required understanding of the entity and its environment, including its internal control, is significantly enhanced
  - Discussion among engagement team
    - What could go wrong?
  - Understand the 5 components of internal control (Control environment, Risk assessment, Control activities, Information and communication, and Monitoring)



## How the SASs Affect Practice

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- Identifying risks through considering
  - The entity and its environment, including its internal control
  - Classes of transactions, account balances, and disclosures
- Relating the identified risks to what could go wrong at the relevant assertion level
- Considering the significance and likelihood of the risks
- SAS 109, *Assessing Risks*, paragraphs 102-121



## How the SASs Affect Practice

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- The auditor should have an appropriate basis for his/her audit approach. **Default to maximum for control risk assessment is disallowed.**
- SAS 110, *Performing Procedures*, paragraph 8



## How the SASs Affect Practice

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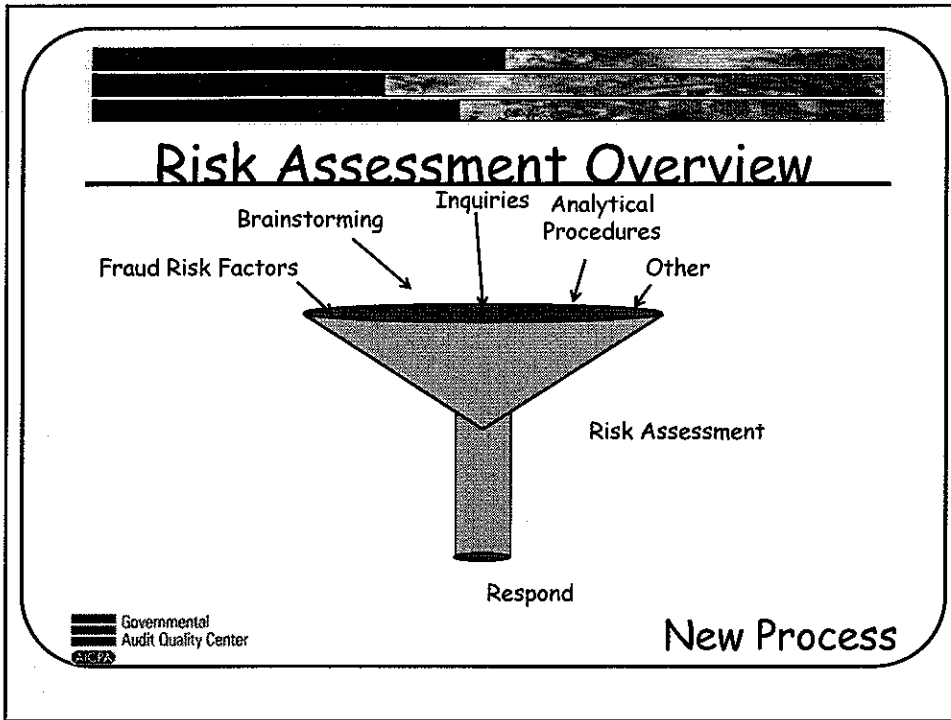
- Testing of controls is encouraged
- The requirement to link assessed risks and the audit procedures responsive to those risks is improved
  - Risk assessment is a continuous process, not a series of discrete stages
  - Respond to the risks at the financial statement level and relevant assertion level by:
    - Developing overall responses to the assessed risk at the financial statement level
    - Determining the nature, timing, and extent of further audit procedures at the relevant assertion level
    - SAS 110, *Performing Procedures*, paragraphs 4-22



## How the SASs Affect Practice

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- Perform further audit procedures that are clearly linked to risks at the relevant assertion level by:
  - Performing tests of the operating effectiveness of controls
  - Performing substantive procedures
  - Evaluating the adequacy of presentation and disclosure
  - SAS 110, *Performing Procedures* SAS, paragraphs 23-68
- Evaluate whether sufficient competent audit evidence has been obtained
  - SAS 110, *Performing Procedures*, paragraphs 70-76

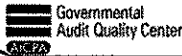


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- Risk Assessment Standards**
- SAS 104 amends SAS 1 to clarify that “reasonable assurance” is a “high level of assurance”
  - All eight standards are effective for all audits beginning after December 15, 2006
  - The ASB has a comprehensive roll out plan to assist auditors which includes:
    - Risk Alert
    - Authoritative Audit Guide geared towards smaller audits
    - CPE Courses
    - Conferences
- In the bottom left corner, there is a logo for the Governmental Audit Quality Center (GAQC) with the acronym "GAQC" below it.



## SAS 112: Communicating I/C Matters

- Issued – May 2006; Effective date = periods ending on or after December 15, 2006
- Recognizes that body to whom communication is made may take different forms
  - Board of Directors
  - Committee of management
  - Single owner
- *Those charged with governance* = the persons with responsibility for overseeing the strategic direction of the entity and the entity's financial reporting and disclosure process.



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## SAS 112: Communicating I/C Matters

- Conforms definitions of *control deficiency*, *significant deficiency*, and *material weakness* to those in PCAOB AS#2 . The term *significant deficiency* replaces the term *reportable condition*
- Requires written communication of significant deficiencies and material weaknesses to management and those charged with governance.
  - Should be communicated even if they were communicated in connection with previous audits



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## **SAS 112: Communicating I/C Matters**

- A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.



## **SAS 112: Communicating I/C Matters**

- A significant deficiency is a control deficiency, or combination of control deficiencies ... such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.
  - Significant deficiencies may involve one or more of the following five internal control components: (a) the control environment, (b) risk assessment, (c) control activities, (d) information and communication, and (e) monitoring.

## SAS 112: Communicating I/C Matters

- A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

### Old Definitions

### New Definitions

Material weakness	Material weakness
Reportable condition	Significant deficiency
Management letter comment (under Yellow Book only)	Other matters related to internal control



## **SAS 112: Communicating I/C Matters**

- After concluding on severity of deficiency (control deficiency, significant deficiency, material weakness), to consider whether “prudent individuals” having knowledge of facts and circumstances would come to same conclusion.
- Written communication required no later than 60 days following issuance of audit report
- Provides illustrative written communications



## **SAS 112: Communicating I/C Matters**

- Includes an appendix containing examples of circumstances that may be control deficiencies, significant deficiencies, or material weaknesses



## **SAS 112 and Government Auditing Standards**

- 2007 revision to *Government Auditing Standards* (Yellow Book) adopted new terminology
- GAO generally says that consistent with effective date of SAS 112, auditors should:
  - Report all significant deficiencies and material weaknesses in the Yellow Book report



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## **Other Yellow Book Requirements**

- Audit findings relating to internal control deficiencies would need to include the required elements defined by the Yellow Book as:
  - Criteria
  - Condition
  - Cause
  - Effect or potential effect
  - Recommendations for corrective action if able
  - Views of responsible officials, including planned corrective action



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## **Yellow Book Report Examples**

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- AICPA Governmental Audit Quality Center (GAQC) has issued updated illustrative Yellow Book audit reports that reflect the terminology on its Web site at: <http://www.aicpa.org/GAQC>



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## **SAS 112 and Single Audits**

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- Circular requires auditor's single audit report to include reportable conditions and material weaknesses that relate to federal programs
- OMB issuing a government-wide memorandum that instructs agencies and auditors to begin using internal control terminology consistent with SAS No. 112
- Auditing Standards Board issuing an auditing interpretation which defines the terms control deficiency, significant deficiency, and material weakness from the perspective of reporting on internal control over compliance in a Circular A-133 audit
- AICPA GAQC issuing updated illustrative Circular A-133 auditor reports that reflect the new terminology—See GAQC Web site at: <http://www.aicpa.org/GAQC>



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## Single Audit Definitions

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- A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis noncompliance with a type of compliance requirement of a federal program



## Single Audit Definitions

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- A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected



## Single Audit Definitions

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- A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected



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## Single Audits

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- Changes in terminology and definitions could affect the scope of future single audits in that under the Circular:
  - A Type A program can not be considered low-risk if it had a reportable condition
  - An entity is not able to be a low-risk auditee if it had deficiencies in I/C over financial reporting that would be considered material weaknesses or if any of the federal programs (that were classified as Type A programs) had material weaknesses (in either of the 2 preceding years)



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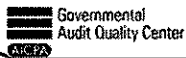
## Need More Help?

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- AICPA Governmental Audit Quality Center has made available a conference call that it held with its member firms on SAS No. 112 that has been left open for anyone to listen to. If you or your staff would like to listen to the call, visit the GAQC Web site at:

<http://gaqc.aicpa.org/Resources/Impact+of+SAS+112+on+Governmental+Financial+Audits+Conference+Call.htm>

- Attend tomorrow's SAS 112 session



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## SAS 113: Omnibus – 2006

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- Amends the general and reporting standards that were not amended by SAS 105 (SAS 105 amended SAS 95 to clarify the terminology used by the ASB in describing professional requirements in accordance with SAS 102)
- Amends those SASs that quote the 10 standards to conform them with the changes in SAS 105 and the changes proposed in the Omnibus



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## **SAS 113: Omnibus – 2006**

- Amends SAS 99 to add a footnote that provides a clear link between the auditor's consideration of fraud and the auditor's assessment of risk and the auditor's procedures in response to those assessed risks
- Removes references to "completion of fieldwork"
- The date of management's representation letter is changed to align it with the requirement in SAS 103 that the auditor's report not be dated prior to the date on which the auditor has obtained sufficient appropriate audit evidence.



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## **SAS 114: Communications**

- Replaces SAS 61, *Communication with Audit Committees* which established communication requirements to entities that either have an audit committee or have designated oversight of the financial reporting process to an equivalent group
- The new SAS:
  - Broadens the applicability to audits of all non-issuers
  - Establishes a requirement for the auditor to determine that certain significant matters related to the audit are communicated



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## SAS 114: Communications

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- *Those charged with governance* = those with the responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the entity's financial reporting process and internal control over financial reporting.
- *Management* = Those that have executive responsibility for the conduct of the entity's operations, including preparation of the entity's financial statements.



## SAS 114: Communications

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- Identifies matters to be communicated (many are carryovers from SAS 61).
- Requires the auditor to determine the appropriate persons with whom to communicate particular matters.
  - May be different based on the matters to be communicated.
- Encourages the use of professional judgment in deciding with whom to communicate particular matters.



## **SAS 114: Communications**

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- Considerations when all of “those charged with governance” are involved in managing the entity
- Required to communicate:
  - The auditor’s responsibilities under GAAS
  - An overview of the planned scope and timing of the audit
  - Significant findings from the audit
- Significant findings must be communicated in writing while other communications may be oral



## **SAS 114: Communications**

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- Requirement to evaluate the two-way communication between the auditor and those charged with governance.
- Document significant matters communicated
- Communicate events or conditions that indicate that there could be substantial doubt about the entity’s ability to continue as a going concern
- Effective date = periods beginning on or after December 15, 2006.



## Other ASB Projects

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- SSAE 14: SSAE Hierarchy
- Proposed Quality Control Standard, *A Firm's System of Quality Control*
- Proposed SSAE, *Reporting on an Entity's Internal Control Over Financial Reporting*
- Other Projects
  - Revisions to SAS No. 74, compliance auditing
  - Revisions to SAS 69, GAAP hierarchy
  - Auditor's reports



## Status of Relevant AICPA Guides





## **State and Local A&A Guide**

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- 2007 conforming changes expected over the summer
  - Updates for new GASB standards and SASs
- Make sure you focus on and have good understanding of Guide's materiality guidance



## **NPO A&A Guide**

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- 2007 conforming changes expected over the summer
  - Updates for new FASB standards and SASs
- Task force working on complete overhaul to the Guide to address many issues that have accumulated
  - 3-5 year timeframe



## **GAS/A133 Guide**

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- 2007 conforming changes expected over summer
  - Updates for new SASs
  - Not incorporating new Yellow Book provisions until 2008
- Make sure you are familiar with changes made in previous years
  - Abuse
  - Various reporting levels for findings
  - Report wording



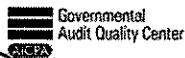
## **Latest from OMB, GAO, and Other Federal Activities**



## **OMB**

- 2007 Compliance Supplement expected to be issued in its entirety in April 2007
- Data Collection Form being revised in 2007
- Late Clearinghouse filings and effect on Low-Risk Auditee Status
  - IGs beginning to interpret Section 530 of Circular A-133 to mean that a late submission to the Clearinghouse precludes low-risk auditee status in the following year
  - Firms should check with cognizant or oversight agency for audit before providing low-risk auditee status to an entity that has a late submission in the previous year
  - Moral of the story is to get the Data Collection Form and reporting package in before the deadline



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## **GAO Government Auditing Standards**

- Issued revision late January 2007
  - Contains final 2007 revision except for quality control and peer review sections
- 2007 revision supersedes the 2003 revision
- At same time issued exposure draft requesting comments on redrafted sections on quality control and peer review
  - Comments were due March 30, 2007
- The complete, 2007 revision will be available after the quality assurance and peer review sections are finalized and incorporated into the standards



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## **Effective Dates**

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- For performance audits, the standards to become effective for audits beginning on or after January 1, 2008.
- For financial audits and attestation engagements, the standards are proposed to become effective for audits of periods beginning on or after January 1, 2008.
  - Certain standards issued by the AICPA's Auditing Standards Board (ASB) have earlier effective dates. Effective dates of those new ASB standards apply to GAGAS audits.
    - Until the 2007 Revision becomes effective, auditors should adopt the terminology and definitions of SAS No. 112 in reporting on internal control
- Early implementation is permissible and encouraged



## **GAO Government Auditing Standards**

- Areas of the Yellow Book with Changes
  - Quality control and assurance
  - Reporting deficiencies in internal control
  - Audit documentation
  - Defining professional requirements
  - Restatements
  - Communicating significant matters
  - Revisions to non-audit service guidance to acknowledge certain services performed primarily by governmental auditors
  - Performance audit chapters



## **ED on Quality Control and Assurance**

- Wide range of comments on June 2006 ED
  - Deferred any changes on section pending further consideration
  - Comments requested by March 30, 2007
- Major changes
  - Strengthened emphasis on audit quality and expanded description of overall objectives and elements of quality control
  - Added flexibility to have peer review cycles of up to 5 years for performance audits
  - Increased transparency regarding the effectiveness of quality control systems by requiring external peer review reports be made public



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## **Governmental Audit Quality Center and Other AICPA Assistance**



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## **AICPA Governmental Audit Quality Center**

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- Council authorized in October 2003 (also established EBP Audit Quality Center)
- Governmental audit practice is pervasive
  - > 6,300 AICPA firms involved
  - Thousands of single audits and other governmental audits annually
- Public interest high - federal \$\$\$



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## **Who Should Consider Joining?**

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- Auditors that perform not-for-profit organization or governmental audits (under the Yellow Book and/or single audit rules)
- Auditors that perform audits under federal audit guides (for example, HUD)



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## **AICPA Governmental Audit Quality Center**

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- AICPA helps firms achieve the highest standards in performing quality governmental audits
- Firm demonstrates its commitment to governmental audit quality (must adhere to membership requirements)



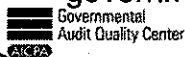
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## **GAQC Status**

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- Center launched at end of September 2004 and has over 750 member firms (those firms audit over 80% of federal expenditures covered in single audits performed by CPA firms)
- Executive committee oversees Center
- Center provides members with Web site, tools (including monthly newsletters, regular news alerts, best practices) and ability to interact with other members)
- Center undertaking outreach activities with stakeholder organizations to increase public awareness of the Center among members of the governmental audit community



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**GAQC Web Site: [www.aicpa.org/GAQC](http://www.aicpa.org/GAQC)**

- Comprehensive resource to Center members which includes:
  - The latest news and spotlight items regarding governmental audits
  - Resources regarding the performance of audits under *Government Auditing Standards*, Circular A-133, and other compliance audit rules
  - Archives of Center Webcast and periodic conference calls
  - A listing of firms that belong to the Center sorted by firm name and state
  - Member forum so that firm members can interact with other members
- Some portions of the site are available to the general public and provide useful information



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**Membership Requirements - Highlights**

*Effective at admission date:*

- Designate audit partner to have firm-wide responsibility for quality of firm's governmental audit practice
- Require designated government audit quality partner to:
  - Meet GAS CPE requirements
  - Participate in an annual Center-sponsored webcast on recent developments in governmental auditing
- Make publicly available information about most recently accepted peer review



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## **Membership Requirements - Highlights**

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### *Other Membership Requirements:*

- Establish annual internal inspection procedures within 3 months of admission date
- Establish policies and procedures specific to the firm's governmental audit practice to comply with professional standards and GAQC membership requirements (within 6 months of admission date)
- Have governmental audits selected as part of firm's peer review reviewed by a peer review team member who is employed by a Center member firm



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## **Quality Concerns Not Just an Auditor Issue**

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- Purchasers have a fiduciary responsibility to ensure that auditor hired is qualified
  - Helps assure you about integrity of funded programs
  - Allow you to uncover noncompliance early
  - The right thing to do



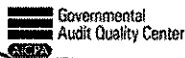
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## **Quality Concerns Not Just an Auditor Issue**

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- Factors to consider when hiring an auditor:
  - Demonstration of qualifications
  - Availability of staff with appropriate technical abilities
  - Extent of auditor's experience with organizations like yours
  - Results of the external peer review
  - Participation in quality improvement programs



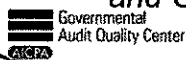
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## **Other AICPA Assistance**

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- The AICPA has a number of other mechanisms to assist practitioners in enhancing single audit quality:
  - AICPA Audit Guide, *Government Auditing Standards and OMB Circular A-133 Audits*
  - GAS/A133 Audit Risk Alert
  - Revised Practice Aid, *Auditing Recipients of Federal Awards: Practical Guidance for Applying OMB Circular A-133*
  - Practice Aid, *Independence Compliance: Checklists and Tools for Complying With AICPA and GAO Independence Requirements*



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## Other AICPA Assistance

- AICPA has a number of other mechanisms to assist practitioners in enhancing governmental financial statement audit quality:
  - SLG and NPO Guides
  - SLG, NPO, and GAS/A133 Risk Alerts
  - Practice Aid, *Auditing Governmental Financial Statements: Programs and Other Practice Aids* (product no. 006602)
  - Practice Aid: *Applying OCBOA in State and Local Government Financial Statements* (product no. 006614)
  - Disclosure Checklists
  - Audit and Accounting Manuals



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