

2007 AUDITING STANDARDS UPDATE

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ALTEC

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ABOUT THE AUTHOR

J. Michael Inzina, CPA, CGFM is founder and chief executive officer of Audit Litigation Training and Efficiency Consulting, Inc. (ALTEC), a consulting company serving public accounting firms and other accounting and auditing organizations on matters of audit efficiency, continuing education, litigation and ethics. He has over 30 years of public accounting experience, and remains a partner in the firm of Stagni & Company, LLC, whose practice is concentrated in government and nonprofits organizations. Mike holds a BBA in accounting from the University of Louisiana (Monroe), where he graduated summa cum laude in May 1976. He is a member of the American Institute of CPAs, Society of Louisiana CPAs, Government Finance Officers Association of Louisiana, and the Association of Government Accountants. Mike earned the CEA in governmental in 1990, and was awarded the Certified Government Financial Manager (CGFM) designation in 1996. He is a past chapter president and member of the Society of Louisiana CPAs Board of Directors and served two terms as chairman of the Governmental Positive Enforcement Program of the Louisiana State Board of CPAs. He has served on a number of committees of the Society of Louisiana CPAs, and currently serves on its Ethics and Litigation Support Committees. Mike also serves on the GASB Service Efforts and Accomplishments Task Force.

Mike has twice been a member of the AICPA Professional Ethics Executive Committee (1989-1992 and 2000-2003), and served on the Auditing Standards Board from 1997 to 2000. From 1986 to 1993, he also served as a member of AICPA Independence and Behavioral Standards Subcommittee, and as Subgroup Chairman of the Governmental Technical Standards Committee. During this time he conducted numerous investigations of complaints filed by federal, state and local agencies alleging substandard performance of audits of governmental and nonprofit entities, and represented the Professional Ethics Division at hearings of the Joint Regional Trial Board.

He contributed to the *Implementation Guide* for GASB Statement 34, AICPA Statement of Position 98-3, *Audits of States, Local Governments and Not-for-Profit Organizations Receiving Federal Awards*, revisions to the AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, the AICPA Practice Aid *Fraud Detection in a GAAS Audit*, revisions to the Louisiana Governmental Audit Guide and in drafting state legislation affecting governmental accounting and auditing requirements. He has served as technical consultant and instructor for the Louisiana Division of Administration (Office of Community Development), and as consultant to the Louisiana Department of Education. Mike frequently appears as moderator and panelist on the Accountants' CPE Network. (ACPEN).

Mike has been named twelve times as an Outstanding Instructor by the American Institute of CPAs and several state societies, and received a Special Recognition Award from the Society of Louisiana CPAs Board of Directors for his contributions to continuing education in 1994. In addition, he was awarded the 2001 National Education and Training Award from the Association of Government Accountants.

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Accounting and Auditing Update
Not-for-Profit Accounting and Auditing Issues
OMB Circulars A-87, A-133 and the Compliance Supplement

2007 Auditing Standards Update

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Publisher/vendor: Audit Litigation, Training and Efficiency Consulting, Inc. (ALTEC)

Description: The *Auditing Standards Update* is designed to provide its participants with a comprehensive, in-depth review of what's happening at the AICPA Auditing Standards Board, including Statements on Auditing Standards, Auditing Interpretations, Audit Guides, Statements of Position, exposure drafts and projects in progress, with emphasis on the practical application and impact on practitioners in small to medium sized firms.

Learning objectives: To enable participants to understand and apply the recently adopted pronouncements of the Auditing Standards Board whose pronouncements affect the preparation and audit of financial statements.

Experience/Prerequisites: Minimum to intermediate level of auditing experience.

Who should attend: Partners and managers responsible for planning and supervision of engagements, and audit staff members who need to understand the changes which have occurred to enable them to conduct engagements.

Recommended CPE Credit: 2 hours (100 minutes)

In October 2005, the ASB issued a new SAS that supersedes SAS 96, *Audit Documentation*. Like the earlier standard, SAS 103 includes an appendix that refers to other specific documentation requirements located in other standards.

The Standard notes that professional judgment is integral in the application of the proposed requirements. For example, judgment is essential in determining the quantity (sufficiency), type (competency) and content of the documentation.

Auditors are required to prepare and maintain audit documentation in sufficient detail to provide a clear understanding of the work performed, the sources of that documentation and the conclusions reached. In addition, the SAS notes that audit documentation provides:

- Principal support for the representations in the auditor's report that the work was performed in accordance with GAAS
- Principal support for the opinion expressed that the financial information is presented in accordance with GAAP (or OCBOA) or the assertion that an opinion cannot be expressed.

Audit documentation is an essential element of audit quality, although it is no guarantee.

Audit documentation defined

Audit documentation is the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached. It may be recorded on paper or on electronic or other media. When transferring or copying paper documentation to another media, auditors should apply procedures to provide for identical form and content of the original paper document. A footnote refers to the possibility of legal, regulatory or other reasons to maintain original paper documentation.

Types of documentation

Audit documentation may consist of:

- Audit programs
- Analyses
- Issues memoranda
- Confirmations
- Representations letters
- Checklists
- Extracts of important documents
- Correspondence, including electronic mail, concerning important matters
- Schedules of the work performed

The audit documentation for a specific engagement is assembled in an *audit file*.

Other purposes of audit documentation

In addition to the principal support that the auditor has complied with GAAS and the opinion, audit documentation:

- Assists the audit team in the planning and performance of the audit
- Assists staff new to the engagement who review the previous year's documentation to understand the work performed
- Assists those members of the engagement team responsible for supervision in directing and supervising the work and reviewing the quality of the work performed
- Demonstrates the accountability of the audit team for its work by documenting the procedures performed, the audit evidence examined, and the conclusions reached
- Retains a record of matters of continuing significance to future audits of the entity
- Assists quality control reviewers in understanding how the engagement team reached significant conclusions and whether there is adequate evidential support for those conclusions
- Enables an *experienced auditor* to conduct inspections or peer reviews in accordance with applicable requirements
- Assists a successor auditor

An experienced auditor means an individual (whether internal or external to the firm) who possesses the competencies and skills that would have enabled him or her to perform the audit, and therefore has an understanding of audit processes and of auditing and financial reporting issues relevant to the industry in which the entity operates.

Form, content and extent

The auditor should prepare audit documentation sufficient to enable an experienced auditor, having no previous connection to the audit, to understand:

- The nature, timing, extent and results of the procedures performed
- The audit evidence obtained
- The conclusions reached on significant matters
- In relation to audit procedures designed to address identified risks of material misstatement, conclusions that are not otherwise readily determinable from the documentation of the procedures performed or audit evidence obtained
- That the accounting records agree or reconcile with the financial statements or other information reported on

Every matter considered by the auditor cannot be documented, and it is neither necessary nor practical to do so. Therefore, the form, content and extent of audit documentation depend on the circumstances of the engagement, the audit methodology and the tools used. Oral explanations on their own do not represent sufficient support for the work performed or conclusions reached, but may clarify or explain information contained in the audit documentation.

Matters that bear on the nature and extent of audit documentation

Auditors should consider the following factors when determining the type and extent of documentation:

- The nature of the auditing procedure itself
- The risk of material misstatement associated with the assertion, account balance or class of transactions
- The extent of judgment required in performing the work and evaluating the result
- The significance of the evidence obtained relative to the assertion being tested
- The nature and extent of exceptions identified
- The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or evidence obtained

Independence, staff training and education and similar matters may be documented within the audit file, or may be documented centrally within the firm.

Significant matters

Findings or issues that, in the auditor's judgment, are significant, actions taken to address those findings or issues (including additional evidence obtained) and the basis for the final conclusions reached should be documented. Significant matters are those that fall into one of the following categories:

- Matters that are both (1) significant and (2) involve issues regarding the selection, application and consistency of accounting principles related to the financial statements, including disclosures. Such matters often relate to the accounting for complex or unusual transactions, estimates and uncertainties and the related management assumptions
- Results of audit procedures that indicate the possibility of a material misstatement or the need to revise the auditor's previous risk assessments and the response to those risks
- Circumstances that cause the auditor significant difficulty in applying procedures (such as non-replies to confirmations or the lack of original documentation)
- Findings that could result in modification of the auditor's report
- Audit adjustments (defined as a correction of a misstatement of the financial information identified by the auditor, whether or not recorded by management, that could, either individually or in the aggregate, have a material effect on the entity's financial information)

Oral discussions with management of significant matters should be documented on a timely basis, including the date of such discussions and the management personnel involved, as well as management's responses. Where information is identified that represents a contradiction or inconsistency with the auditor's final conclusions regarding a significant matter, the auditor should document how that contradiction or inconsistency was addressed in forming the conclusion. Documentation that is incorrect or is later superseded need not be retained.

Audit documentation should identify its preparer and reviewer, as well as the dates the work was performed and reviewed.

Documentation of specific items

Substantive tests of details and tests of the operating effectiveness of internal controls that involve inspection of documents or confirmation should identify the characteristics of the specific items tested. Such characteristics should be documented because it demonstrates the accountability of the audit team for its work and facilitates the investigation of exceptions or inconsistencies.

For example, detailed tests of purchase orders may identify the documents selected by date and purchase order number. Procedures that require selection or review of all items over a specific amount from a population may identify the scope of the procedure and identify the population, such as “all journal entries in excess of \$50,000 from the general journal.”

Inquiry procedure documentation should include the date of the inquiry, the name and job designation of the persons to whom the inquiry was directed. Observation procedures should be documented by description of the process or subject matter being observed, the relevant individuals and what they were responsible for, and when the observation was performed.

Systematic samples (selecting every nth item) should identify the source of the documents and indicate the starting point and interval.

Copies of entity records

Only when needed to meet the experienced auditor standard should copies of entity records, as when accounting for significant transactions is supported by reference to a specific contract. Excerpted documents may serve the same purpose.

Departure from GAAS

Should an auditor, in “exceptional circumstances” find it necessary to depart from the Statements on Auditing Standards in order to achieve more effectively the objective of the audit, the reasons for such departure should be documented.

Revisions to audit documentation after the report date

The auditor’s report should not be dated prior to the date on which the auditor has obtained sufficient competent audit evidence to support the opinion on the financial statements or other information on which the auditor is reporting. After the report date, audit documentation may be changed to:

- Complete the documentation and assembly of audit evidence obtained, discussed and agreed with relevant members of the audit team prior to the report date

- Perform routine audit file assembly (such as deleting or discarding superseded documentation, sorting, collating, indexing and cross-referencing final working papers)
- Sign off on file completion checklists prior to completion and archiving
- Add information received after the date of the auditor's report (such as adding an original confirmation that was previously faxed)
- Clarify documentation prepared during the audit

Updated or revised documentation should include all the original information, evidence and conclusions that were in the superseded documentation. If the information, evidence or conclusion is no longer valid or relevant, it need not be retained, except as noted below. However, if the information reflected in the superseded documentation reflects a disparate point of view or otherwise conflicting evidence related to a significant issue or finding, the auditor should retain such information.

New information may, of course, be obtained after the date of the auditor's report, relating to the audit, such as a late confirmation. The auditor should consider whether procedures should be applied to the new information, considering the nature and significance of the information and whether its relevance has been superseded by the passage of time.

If the auditor concludes that procedures considered necessary at the time of the audit were omitted, he or she should refer to AU 390/SAS 46, *Consideration of Omitted Procedures After the Report Date*. Documentation of the auditor's compliance with SAS 46 should be prepared accordingly.

Should the auditor become subsequently aware of information related to the financial information previously reported on, but which information was not previously known at the date of the auditor's report, he or she should refer to AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*.

In either case, the auditor should make the required changes to reflect the performance of additional procedures or the new conclusion reaches, including:

- When and by whom such changes were made, and reviewed
- Specific reasons for the change
- The effect, if any, of the changes on the auditor's conclusions

If the audit documentation is not in final form at the delivery of the auditor's report to the entity, the auditor should assemble the documentation to form the final audit file within sixty days following the delivery of the auditor's report. Such date is referred to as the *documentation completion date*. After that date, the auditor should *not* delete or discard audit documentation. Where the auditor finds it necessary to make an addition (including amendments) to audit documentation after the documentation completion date, the addition should be documented as provided in the standard.

Ownership and confidentiality

The SAS retains the concept that the documentation is the property of the auditor, recognized in some states by statute. The auditor should establish reasonable procedures regarding retention of audit documentation that will satisfy the relevant legal or regulatory requirements. It is expected that such period would not be less than five years from the date of the auditor's report.

Auditors have an ethical, and sometimes a legal, obligation to maintain the confidentiality of client information contained in audit documentation. Therefore, auditors should establish procedures to maintain the confidentiality of that information.

In whatever form, auditors should apply reasonable controls over audit documentation to prevent alteration, addition to or deletion from documentation that would compromise its integrity, accessibility and retrievability. Such controls should:

- Enable the clear determination of when and by whom the documentation was created, changed or reviewed
- Protect the integrity of the information at all stages of the engagement, especially when shared with the audit team or transmitted to other parties electronically
- Prevent unauthorized changes
- Allow access by the audit team and other authorized parties

Portions of the audit documentation that the auditor may make available to the entity do not substitute for the entity's accounting records (such as internal control documentation).

Effective date

SAS 103 is effective for periods ending on or after December 15, 2006.

SAS 104 - 111

THE AUDITOR'S RISK ASSESSMENT PROCESS

At its October 2005 meeting, the Auditing Standards Board approved final issuance of a suite of eight Statements on Auditing Standards relating to the auditor's risk assessment process. The ASB believes that the requirements and guidance provided in the SASs will result in a substantial change in audit practice and in more effective audits. The primary objective of the 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 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 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 new standards, 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 new SASs contain some additional requirements to conform to other U.S. standards.

The suite of standards consists of the following SASs:

- **SAS 104, *Amendment to "Due Professional Care in the Performance of Work", of Statement on Auditing Standards No. 1, Codification of Auditing Standards and Procedures.*** This is a brief standard, but may contain the most controversial change. Paragraph 10 of AU 230 s amended to read (new language in bold type):

“While exercising due professional care, **the auditor must plan and perform the audit to obtain sufficient appropriate evidence so that audit risk will be limited to a low level¹ that is, in his or her professional judgment, appropriate for expressing an opinion on the financial statements. The high level of assurance that is intended to be obtained by the auditor is expressed in the auditor's report as obtaining reasonable assurance about whether the financial statements are free of material misstatement (whether caused by error or fraud).** Absolute assurance is not attainable because of the nature of audit evidence and the characteristics of fraud. Therefore, an audit conducted in accordance with generally accepted auditing standards may not detect a material misstatement.”

¹ A low level of audit risk means that there is a remote likelihood that an auditor may unknowingly fail to appropriately modify his or her opinion on financial statements that are materially misstated whether caused by error or fraud.

- **SAS 105, Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards.** In accordance with the clarified language prescribed in SAS 102, the first general standard and all of the fieldwork standards of generally accepted auditing standards are amended to include the word “must”. The second and third standards of fieldwork is further amended to read (new language in bold type):

The auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing and extent of further audit procedures.

The auditor must obtain sufficient appropriate audit evidence through audit procedures performed to afford a reasonable basis for an opinion regarding the financial statements under audit.

- **SAS 106, Audit Evidence**, which will supersede SAS No. 31, *Evidential Matter* (AU sec. 326). Among other things, this standard defines audit evidence as “all the information used by the auditor in arriving at the conclusion on which the audit opinion is based and includes the information contained in the accounting records underlying the financial statements and other information. Auditors are not expected to examine all information that may exist. Audit evidence, which is cumulative in nature, includes audit evidence obtained from auditor procedures performed during the course of the audit and may include audit evidence obtained from other sources, such as previous audits and a firm’s quality control procedures for client acceptance and continuance.

The old term “competence” has been replaced by “appropriateness”, which is defined as the measure of the quality of audit evidence, i.e., its relevance and its reliability in providing support for, or detecting misstatements in, the classes of transactions, account balances, and disclosures and related assertions.

In addition, a noticeable change occurs in the financial statement *assertions*, with separate categories of assertions for the balance sheet, operating statement and disclosures:

Assertions related to classes of transactions and events for the period under audit (the operating statement):

- Occurrence
- Completeness
- Accuracy
- Cutoff
- Classification

Assertions related to account balances at the end of the period (the balance sheet):

- Existence
- Rights and obligations
- Completeness
- Valuation

Assertions related to presentation and disclosure (the footnotes):

- Occurrence and rights and obligations
- Completeness
- Classification and understandability
- Accuracy and valuation

The SAS describes and defines *inspection* (of records or documents and assets), *observation*, *inquiry*, *confirmation*, *recalculation*, *reperformance*, and *analytical procedures* as the types of audit procedures that auditor *should* use to obtain audit evidence.

- **SAS 107, *Audit Risk and Materiality in Conducting an Audit***, which supersedes SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AU sec. 312). This standard reiterates the principles established in SAS 47, but makes some changes in the established audit risk model. The original audit risk model was as follows:

$$AR (\text{Audit Risk}) = IR (\text{Inherent Risk}) \times CR (\text{Control Risk}) \times DR (\text{Detection Risk})$$

The revised model combines IR and CR into the RMM (Risk of Material Misstatement), and further, breaks down DR into its components of TD (Tests of Details risk) and AP (Analytical Procedures risk). As a result, the model now appears as follows:

$$AR = RMM \times TD \times AP$$

Although *materiality* remains a “financial statements as a whole” concept, items of lesser amounts are identified that the auditor *should consider*, such as

- Accounting standards, laws or regulations, user expectations regarding certain items, such as related party transactions, remuneration of management and those charged with governance
- Key disclosures in relation to the industry and the environment in which the entity operates (such as research and development costs for a pharmaceutical company)

- Whether attention is focused on the financial performance of a particular business segment that is separately disclosed in the financial statements, such as a newly acquired business)

Further guidance is provided on tolerable misstatement, considerations as the audit progresses, communications of misstatements to management and evaluating audit findings. In addition, guidance on qualitative considerations (previously an interpretation of AU 312) has been incorporated into the standard. Specific documentation requirements include:

- Levels of materiality, tolerable misstatement (including any changes thereto), and the bases on which those levels were determined
 - A summary of uncorrected misstatements, other than those that are “trivial”, related to known and likely misstatements
 - The auditor’s conclusion as to whether uncorrected misstatements, individually or in the aggregate, do or do not cause the financial statements to be materially misstated, and the basis for that conclusion
- **SAS 108, *Planning and Supervision***, which will supersede “Appointment of the Independent Auditor” (AU sec. 310), and SAS No. 22, *Planning and Supervision* (AU sec. 311). This standard uses the term “auditor” to mean the auditor with final responsibility for the audit, and “assistants” to mean firm personnel other than the auditor with final responsibility.

Regarding audit planning, the standard requires the establishment of an *overall audit strategy*, which determines the characteristics of the engagement (basis of reporting, industry-specific reporting requirements, etc.), ascertains the reporting objectives of the engagement (planning the timing of the audit and the nature of the communications required), and considers important factors that will determine the focus of the audit team’s efforts (such as determination of appropriate materiality levels, identification of areas where the risk of material misstatement may be high and material locations and account balances).

In addition, the SAS requires development of an *audit plan*, which is more detailed than the audit strategy, and includes the nature, timing and extent of audit procedures to be performed sufficient to assess the risk of material misstatement, address each material class of transactions and account balance and disclosure, and whether to test the operating effectiveness of internal controls. Other procedures, such as communication with the entity’s legal counsel are also included in the audit plan.

The standard defines supervision as directing the efforts of assistants who are involved in accomplishing the objectives of the audit and determining whether those objectives were accomplished. Among other requirements, the SAS requires that the work of each assistant, including the audit documentation should be reviewed to determine whether it was adequately performed and documented and to evaluate the results relative to the

conclusions to be presented in the auditor's report. parts of the review responsibility may be delegated to assistants.

An appendix to the SAS identifies matters the auditor may consider in establishing the overall audit strategy.

- **SAS 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.** This standard is designed to assist the auditor in the implementation of the revised second standard of fieldwork (see above). It provides detailed guidance on:
 - Risk assessment procedures and sources of information about the entity and its environment including its internal control. It specifically requires the audit team to discuss the susceptibility of the entity's financial statements to material misstatement (whether caused by error or fraud).
 - Understanding the entity and its environment including internal control. Specifically, this section notes that matters such as the industry, regulatory and other external factors, as well as the nature of the entity (including its selection and application of accounting principles), objectives and strategies and related business risks, measurement and review of the entity's financial performance, and internal controls are all matters that auditors must understand. The COSO definition of internal controls and the effects of IT on internal control remain unchanged.
 - Assessing the risks of material misstatements. Auditors must assess risk at the financial statement and assertion levels. In doing so, the auditor must (1) identify risks by considering the entity and its environment, including internal control, and the classes of transactions, account balances and disclosures in the financial statements, (2) relate the identified risks to what could go wrong at the relevant assertion level, and (3) consider the significance and likelihood of material misstatement for each identified risk. Detailed guidance is provided on significant risks that require special audit consideration. For significant risks, the auditor's responsibility includes evaluation of the design of the entity's related controls (including control activities) and whether they have been implemented (arbitrarily assessing risk at the maximum level is not permissible).
 - Documentation. The auditor is required to document the discussion among engagement personnel (how and when the discussion occurred, the subject matter discussed, the audit team members who participated and significant decisions reached regarding planned responses at the financial statement and assertion levels), key elements of the understanding obtained regarding each of the components of internal control, the assessment of risk at the financial statement and assertion levels, and the risks identified and related controls evaluated.

- **SAS 110, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained***. This standard supersedes SAS No. 45, *Substantive Tests Prior to the Balance-Sheet Date* (AU sec. 313), and, together with the previous SAS will supersede SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit* (AU sec. 319). Specifically, this standard provides guidance to the auditor in implementation of the revised third standard of fieldwork. It provides detailed guidance on:
 - Overall responses to address risks of material misstatements at the financial statement and assertion levels, such as emphasis to the audit team of the need to maintain professional skepticism in gathering and evaluating audit evidence, assignment of more experienced personnel, closer levels of supervision, and incorporation of an element of unpredictability.
 - Designing audit procedures that are responsive to risks at the assertion level, including tests of the effectiveness of internal controls and substantive procedures, based on the auditor's consideration of factors such as the significance of the risk, the likelihood that a material misstatement would occur, the characteristics of the class of transactions, account balance or disclosure involved, and expectations about the effectiveness of internal controls in preventing or detecting misstatements.
 - Evaluating the sufficiency and appropriateness of the evidence obtained, and
 - Documentation. The auditor must document the overall responses to assessed risks at the financial statement level, the nature timing and extent of further audit procedures, the linkage of those procedures with the assessed risks at the assertion level, the results of the audit procedures, and the conclusions reached.

- **SAS 111, *Amendment to SAS No. 39***, Audit Sampling, to incorporate terminology changes and the modification to the audit risk model (as described above).

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

- *Guidance on the assessment of the risk of material misstatement is significantly enhanced and expanded.* Assessing the risks of material misstatement encompasses a combined assessment of inherent and control risk. The concept of assessing risk “at maximum” without support is eliminated. Auditors should support risk assessments, at whatever level, based on their understanding of the entity and its environment, including its internal control. In addition, as part of the assessment, auditors will 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, and audit evidence about the effectiveness of controls must be obtained.
- *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 guidance emphasizes the importance of the nature of the audit procedures in responding to assessed risks.
- *Guidance on substantive procedures is expanded.* Regardless of the assessed risk of material misstatement, the auditor should design and perform substantive procedures for all assertions related to each material class of transactions, account balance and disclosure to detect material misstatements at the relevant assertion level. In addition, the auditor should agree the financial statements, including the accompanying notes, to the entity’s underlying records, and should examine material journal entries and other adjustments made during the course of preparing the financial statements.
- *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.

- *Guidance on evaluating audit findings is clarified and expanded.* In evaluating audit findings, the SASs specify that auditors should consider the effect of uncorrected misstatements related to prior periods on the current-period financial statements.
- *Documentation requirements are significantly expanded.* Documentation is important in driving auditor behavior by demonstrating that the auditor has complied with standards. The 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 new 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 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.

Certain terminology differences between the SASs and ISAs have been eliminated. For example, throughout the proposed SASs, *audit evidence* replaces *evidential matter*, *audit procedures* replaces *auditing procedures*, *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.

Effective date

SAS 104 – 111 will be effective for audits of financial statements for periods beginning on or after December 15, 2006. Early adoption is permitted. An audit guide will be issued to assist practitioners in implementation.

SAS 112

COMMUNICATION OF INTERNAL CONTROL RELATED MATTERS NOTED IN AN AUDIT

The ASB has issued a new standard that supersedes SAS 60 of the same title. The revised standard changes terminology, reporting and other long-standing guidance as described below. The SAS does not apply to publicly traded companies, whose audits are subject to internal control reporting under standards issued by the PCAOB.

The new standard has created a great deal of confusion about what must be reported, how such matters are to be presented and whether auditors still have any latitude in determining those matters.

Why SAS 112 was adopted

SAS 112 is responsive to PCAOB Auditing Standard No. 2. The Auditing Standard Board determined that a change to SAS 60 requirements was warranted for a number of reasons:

- Auditors were often perceived as inconsistent in communicating internal control matters identified in previous audits that had not been remediated
- The Board believed that it should require communication of internal control matters in writing
- The Board believed that consistency with PCAOB standards was desirable

The standard contains two *unconditional* requirements:

- The auditor must evaluate identified control deficiencies and determine whether those deficiencies, individually or in the aggregate, are significant deficiencies or material weaknesses;
- The auditor must communicate *in writing* significant deficiencies and material weaknesses to management and those charged with governance. This communication includes significant deficiencies and material weaknesses identified and communicated to management and those charged with governance in prior audits but not yet remediated.

Internal control deficiencies

During the course of an audit, the auditor may become aware of internal control deficiencies of interest to the audit committee (or its equivalent). Such internal control deficiencies may be either a design deficiency or an operating deficiency.

- *Design deficiencies* exist when necessary controls are non-existent, or designed so that, even when operating, the control objective is not always met.
- *Operating deficiencies* exist when a properly designed internal control is not operating as designed, or the person performing the control does not possess the necessary qualifications or authority to perform the control effectively.

Internal control deficiencies range from inconsequential deficiencies to material weaknesses.

The SAS requires that the following internal control deficiencies be reported to the audit committee:

- Significant deficiencies – a control deficiency, or combination of control deficiencies that could adversely affect the entity’s ability to initiate, record, process and report financial data reliably in accordance with GAAP, 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. They may arise from any of the five components of internal control (i.e., the control environment, risk assessment, control activities, information and communication, and monitoring), or may be an aggregation of more than one of the components. [Note that this term replaces but *is not synonymous with* SAS 60’s term “reportable conditions”.]
- Material weaknesses – a significant deficiency, or combination of significant deficiencies, that results in *more than a remote likelihood* that *material* misstatements in the financial statements will not be prevented or detected.

The term “remote likelihood” as used in the definitions above has the same meaning as the term “remote” used in SFAS 5, *Accounting for Contingencies*, which states that the term means that “The chance of the future event or events occurring is slight.”² In other words, the likelihood that is “reasonably possible” is within the scope of SAS 112.

Identifying significant deficiencies

Since auditors are principally concerned with the formation of an opinion on the financial statements taken as a whole, the standard *does not require auditors to search* for significant deficiencies in internal control, but notes that auditors may become aware of them through:

- Obtaining an understanding of internal controls
- Assessing the risk of material misstatement due to fraud or error
- Application of further audit procedures to respond to assessed risks
- Communications with management, internal auditors or governmental authorities

The auditor’s awareness of significant deficiencies varies with each audit, influenced by the nature, timing and extent of audit procedures and other factors, such as the entity’s size, complexity and nature and diversity of the entity’s operations. The evaluation of the significance of a deficiency is based on the *potential for misstatement*, not whether a misstatement has actually occurred. There are certain factors identified, however that auditors should take into consideration in determining whether a matter is a significant deficiency:

- The **likelihood** that the deficiency could result in a misstatement – for example, failure to obtain required authorization for a valid disbursement, or a deficiency identified as a result of a financial statement misstatement. If in the auditor’s judgment, it is at least “reasonably possible” that a misstatement could have occurred because of a control that is missing or not operating properly, then the likelihood is *more than remote*.

² SFAS No. 5, *Accounting for Contingencies*, paragraph 3.

- The **magnitude** of potential misstatements resulting from the deficiency, either those that could occur or have occurred. A misstatement may be:
 - *Inconsequential* – if based on the conclusion of a reasonable person, after considering the possibility of further undetected misstatements, the misstatement, either individually or in the aggregate with other misstatements would be clearly immaterial to the financial statements.
 - *More than inconsequential* – more than inconsequential, but less than material
 - *Material*
- The importance of the control that is deficient, including the degree to which other controls that are effective achieve the same control objectives (such as complementary, redundant or compensating controls)
- The nature of the account balances and classes of transactions that are affected by the deficiency and the financial statement assertions involved
- If the deficiency is an operating deficiency, the frequency of the exceptions

The standard also allows, but does not require, auditors to report matters that are inconsequential, as well as matters related to operational or administrative efficiency and other items of potential benefit to the entity. As an example of an “inconsequential” misstatement, the standard provides that a potential misstatement of less than 20% of overall financial statement materiality, absent other factors, may be considered inconsequential. However, the same misstatement may be considered more than inconsequential as a result of qualitative factors, such as a potential misstatement that would change a loss into a profit (or vice versa) or result in a violation of a loan or other agreement.

The guidance notes that numerous or repeated instances of otherwise insignificant deficiencies may constitute a significant deficiency in the aggregate.

Identifying material weaknesses

The evaluation of whether a significant deficiency (either individually or in the aggregate) is also a material weakness is a subjective process, and is dependent on the nature of the accounting system, the financial statement amounts or transactions that are exposed to the significant deficiency, the overall control environment, other controls, and the judgment of the evaluator. The fact that misstatements have not occurred as a result of the deficiency is not evidence that the matter is not a material weakness. However, the identification of a material misstatement by the auditor that was undetected by the entity ordinarily is indicative of the existence of a material weakness in internal control.

The following examples are presented as circumstances that should be regarded as at least a significant deficiency *and a strong indicator that a material weakness in internal control exists*:

- Ineffective oversight of the controls over financial reporting by those charged with governance, or ineffective overall governance structure
- Restatement of previously issued financial statements to reflect the correction of a material misstatement

- Identification by the auditor of a material misstatement in the financial statements under audit that was not initially identified by the entity’s internal control (even if management subsequently corrects the misstatement)
- An ineffective internal audit function or risk assessment function at an entity for which such functions are important to the monitoring or risk assessment component of internal control, such as for a very large or highly complex entity
- For complex entities in highly regulated industries, an ineffective regulatory compliance function
- Identification of fraud of any magnitude on the part of senior management
- Failure by management or those charged with governance to assess the effect of a significant deficiency that has been communicated to management and those charged with governance and failure to either correct it or conclude that it will not be corrected (if management decides not to correct a significant deficiency, for example, because of cost/benefit considerations, the significant deficiency should continue to be communicated in subsequent audits)
- An ineffective control environment

The following table may be useful in considering whether a control deficiency is described:

Magnitude of Misstatement that Occurred or Could Have Occurred	Likelihood of Misstatement	
	More than Remote	Remote
Quantitatively or qualitatively material	Material weakness	Control deficiency, but not a significant deficiency or material weakness
More than inconsequential, but not material	Significant deficiency, but not a material weakness	Control deficiency, but not a significant deficiency or material weakness
Inconsequential	Control deficiency, but not a significant deficiency or material weakness	Control deficiency, but not a significant deficiency or material weakness

Compensating controls

When the auditor identifies a control deficiency, both the auditor and management should consider the mitigating effects of compensating controls, should any exist. A compensating control is one that limits the severity of a significant deficiency (or in some cases, a material weakness), even though it does not eliminate the control deficiency. For example, in a small entity, there may be inadequate segregation of duties over accounts payable. As a compensating control, an owner (or board member) reviews all supporting documentation for disbursements in excess of \$1,000. The auditor could test the compensating control and determine whether it is operating effectively to mitigate the lack of segregation of duties. If the compensating control is operating effectively, even though the original control deficiency still exists, it may not be considered as a significant deficiency or material weakness because of the compensating control.

Reporting – form and content

Significant deficiencies and material weaknesses must be reported *in writing*, even if they have previously been communicated in connection with previous audits. These matters are best communicated by the delivery date of the auditor's report on the financial statements, but no later than 60 days after the release of the report. Other matters, such as those that may be specified by the client, may also be reported. The SAS requires the communication either be in writing, or if orally communicated, that the auditor document such communication. In either case, the report should:

- Indicate that the purpose of the audit was to report on the financial statements and not to provide assurance on internal control
- State that the auditor is not expressing an opinion on internal control
- Include the definition of significant deficiencies, and where relevant, the definition of material weaknesses
- Identify which matters are considered to be significant deficiencies, and if applicable, which are considered to be material weaknesses
- State that the communication is intended solely for the information and use of management, those charged with governance, and others within the organization and is not intended to be, and should not be, used by anyone other than these specified parties. When there are requirements established by governmental authorities to furnish such communications, specific reference to such governmental authorities may be made.

Specific reporting language and the variations of the report are presented in the SAS. Like the previous standard, the auditor is precluded from issuance of a report stating that no significant deficiencies were noted during the audit.

Effective date

The standard is effective for audits of financial statements for periods ending on or after December 15, 2006.

Appendix - circumstances that may be control deficiencies, significant deficiencies or material weaknesses

Deficiencies in the design of controls:

- Inadequate design of internal control over the preparation of the financial statements
- Inadequate design of internal control over a significant account or process
- Inadequate documentation of the components of internal control
- Insufficient control consciousness within the organization
- Absent or inadequate controls over the safeguarding of assets needed for internal control over financial reporting

- Flaws in the design of information technology general and application controls that prevent the information system from providing complete and accurate information consistent with the financial reporting objectives and current needs
- Employees or management who lack the qualifications and training to fulfill their assigned functions, for example, the corporate controller who is unable to apply generally accepted accounting principles in recording the entity's financial transactions or preparing its financial statements
- Inadequate design of monitoring controls that assess the design and operating effectiveness of the entity's internal controls over time

Failures in the operation of internal control:

- Failure in the operation of properly designed controls within a significant account or process, for example, the failure of a control such as dual authorization for significant disbursements within the purchasing process
- Failure of the information and communication component of internal control to provide complete and accurate output because of deficiencies in timeliness, completeness, or accuracy, for example, the failure to obtain timely and accurate consolidating information from remote locations that is needed to prepare the financial statements
- Failure of control designed to safeguard assets from loss, damage or misappropriation
- Failure to perform reconciliations of significant accounts, for example, accounts receivable subsidiary ledgers are not reconciled to the general ledger account in a timely or accurate manner
- Undue bias or lack of objectivity by those responsible for accounting decisions, for example, consistent underaccruals of expenses or overstatement of allowances at the direction of management
- Misrepresentation by client personnel to the auditor (an indicator of fraud)
- Failure of an application control caused by a deficiency in the design or operation of an IT general control

Following the Appendix, the SAS provides a framework for evaluating control deficiencies when applying the standard, to assist auditors in achieving consistency in application. Notably, considerable judgment is required, and consequently, different individuals may reach different conclusions on similar fact patterns.

Practical help

The Audit Risk Alert, *Understanding SAS No. 112 and Evaluating Control Deficiencies*, a companion document provides some useful practical guidance in applying the provisions of the SAS.

To begin with, the Risk Alert notes that discussions with clients may be helpful. Clients need to be aware that the auditor cannot be part of the client's internal controls (although another firm with no audit responsibilities may be). Clients should also be made aware of the fact that the reporting criteria have changed, and consequently, more reporting on internal control can be

expected, in addition to the fact that prior significant deficiencies and material weaknesses must also be reported in subsequent years until they are remediated. Auditors should be aware that assisting management in their implementation of internal controls or training client personnel to be more knowledgeable about internal controls does not impair auditor independence.

The Risk Alert presents a number of case studies that illustrate how SAS 112 might affect reporting of internal control related matters:

- Segregation of duties – as noted above, where compensating controls exist (such as a board member or owner who reviews supporting documents in accounts payable, or reviews bank statements and contents) a control deficiency may be limited by the compensating controls and not considered either a significant deficiency or material weakness. Conversely, the absence of compensating controls may lead the auditor to conclude that a reasonable person would agree that there is more than a remote possibility that a misstatement could occur and not be corrected, and therefore a significant deficiency (and possibly a material weakness) exists and must be reported.
- Lack of client expertise in financial accounting and reporting – three different situations are explored that are typical of smaller engagements.

In the first, the client's CFO, fairly skilled and able to perform most functions, outsources (to the auditor) the fixed asset and depreciation records. As long as the CFO would be, in the auditor's judgment, likely to detect a misstatement that might occur in the fixed asset or depreciation records, no control deficiency exists. The CFO would be expected to review and take responsibility for the depreciation and related calculations and have the skills necessary to prevent, detect and correct potential misstatements.

In the second, the client has an accounting manager who requests that you assist in drafting the financial statements and related notes. Before signing the representations letter, the manager obtains and reviews the financial statements and grouping schedules and the schedules that support the amounts presented in the notes. In addition, the manager obtains a disclosure checklist for comparison with the note disclosures and makes sure all required disclosures are presented. The financial statements are read, revised and approved by the accounting manager and owner. Given these facts, there is no control deficiency to report.

In the third, the auditor has instructed the bookkeeper on recording of cash receipts and disbursements and adjusting entries for year-end payable and receivables. The bookkeeper prepares a draft of the financial statements from a format provided by the auditor, including recurring disclosures. In performing audit procedures, the auditor notes that a vehicle was leased during the year, and the lease meets the criteria for capitalization. The cost of the vehicle was material to the financial statements and the bookkeeper has only recorded the lease payments. In addition the vehicle was involved in an accident on the last day of the year and the insurance only covered a portion of the damage. The financial statements do not reflect any expense and liability for the damages. Based on these facts,

there is a control deficiency. In this case, the deficiency is a material weakness based on the magnitude of the misstatement. However, the case notes that had the bookkeeper called the auditor for guidance on recording these events, the result might have been different, since a discussion with the auditor about a technical matter is not an indication of a weakness in internal control.

- Lack of controls over inventory – although the client lacks adequate controls over inventory quantities, a physical count is taken each quarter. When the physical count was below the recorded inventory, a manager confessed to selling inventory, not posting sales and retaining the receipts. Although the adjustment was not material to the financial statements, fraud is evidence of a control deficiency and must be brought to the attention of management. The auditor may wish to include it (with any other risks of fraud noted) in the written report of significant deficiencies and material weaknesses.
- Fraud involving cash – in a small nonprofit organization that receives an immaterial amount of cash contributions, the auditor identifies the fact that there are no controls over cash receipts as a fraud risk. Through inquiry, the auditor learns that someone may be stealing cash. The auditor brings the matter to management’s attention, and through application of procedures, finds evidence that cash donations were not being recorded. Because the matter has occurred, the likelihood is clearly more than remote. The potential amount is more than inconsequential, but less than material; however, because the entity is a nonprofit and cash is a sensitive area, the auditor may conclude that the matter is a material weakness.

SAS 113

2006 OMNIBUS STATEMENT

In December 2006, the ASB approved an omnibus standard that:

- Amends the general and reporting standards that were not amended by SAS 105, *Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards*, to incorporate the language changes required by SAS 102, *Defining Professional Requirements in Statements on Auditing Standards*. All of the standards now include the word “must”. Other references in the auditing standards to the ten standards are also revised to reflect the revised language.
- Amends SAS 99, *Consideration of Fraud in a Financial Statement Audit*, to add footnote which establishes a clear link between the auditor’s consideration of fraud and the auditor’s assessment of risk and the audit procedures in response to those risks, as provided in SAS 109, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* and SAS 110, *Performing Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.
- Amends a number of other SASs to remove reference to the “completion of fieldwork”. SAS 103 establishes that the date of the auditor’s report is the date the auditor has

obtained sufficient evidence to allow him or her to issue the report on the financial statements. The other standards will now simply refer to the “date of the auditor’s report” rather than completion of field work.

- Amends SAS 85, *Management Representation* and SAS 1, *Codification of Auditing Standards and Procedures*, to align the date of the representations letter 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. Both SAS 1 and SAS 85 will now provide that the representations letter should be dated “as of the date of the auditor’s report”, rather than “no earlier than the date of the auditor’s report”.

SAS 114

THE AUDITOR’S COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

Also in December 2006, the ASB adopted a new standard that supersedes SAS 61, *Communication with Audit Committees*. The Board notes that in the wake of highly publicized audit failures and emerging best practices in corporate governance, expectations have increased for auditors to communicate more openly with those charges with governance regarding significant findings and issues related to the audit. The SAS broadens the applicability of the communications required to audits of financial statements of all nonissuers and establishes a requirement for the auditor to communicate with those charged with governance (those with 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 means those responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management is responsible for preparing the financial statements, including the design, implementation and maintenance of internal controls over financial reporting. *Those charged with governance* may include members of management in some entities.

When all of those charged with governance are involved in the management of an entity, communications that are required by the standard need not be communicated twice. If matters that are required to be communicated are relevant only to the oversight function of those charged with governance, no action on the part of the auditor is necessary, since there is no oversight separate and apart from management. In such a case, the auditor should consider whether communication with persons with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity.

The SAS identifies specific communication requirements, many of which were previously included in SAS 61:

- The auditor’s responsibilities under Generally Accepted Auditing Standards
 - Performing the auditing in accordance with GAAS
 - Forming and expressing an opinion about whether the financial statements that have been prepared by management are presented fairly, in all material respects, in conformity with GAAP
 - Communication of significant matters that are relevant to the responsibilities of those charged with governance
 - That an audit conducted in accordance with GAAS is designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement
 - The audit does not relieve management or those charged with governance of their responsibilities

- The planned scope and timing of the audit, which may include
 - How the auditor proposes to address the significant risks of material misstatement, whether due to error or fraud
 - The auditor’s approach to internal controls relevant to the audit
 - The concept of materiality in planning and executing the audit, focusing on factors considered rather than specific thresholds or amounts
 - Whether the entity has an internal audit function, the extent to which the auditor will use the work of the internal auditor
 - Other planning matters

- Significant findings from the audit
 - Qualitative aspects about the entity’s accounting practices, including policies, estimates, and disclosures
 - Significant difficulties encountered during the audit
 - Uncorrected misstatements, other than those considered “trivial”
 - Disagreements with management
 - Other findings and issues, if any, arising from the audit that are significant and relevant to those charged with governance
 - Material corrected misstatements that were brought to the attention of management as a result of audit procedures*
 - Representations the auditor is requesting from management (such as a copy of the representations letter) *
 - Management’s consultation with other accountants *
 - Significant issues discussed or the subject of correspondence with management *

The auditor should communicate in writing significant findings from the audit. Other communications may be either oral or written. When in writing, the communication should note that the communication is intended solely for the information and use of those charged with

governance and, if appropriate, management, and is not intended to be and should not be used by anyone other than these specified parties.

Communication should be made in a timely manner, so that appropriate actions may be taken. Specific guidance is offered on when best to communicate certain matters. Auditors should evaluate the adequacy of the communication process, and if the auditor considers the communication inadequate, appropriate action should be taken.

Significant matters communicated with those charged with governance should be documented, including copies of the written communications.

The SAS is effective for periods beginning on or after December 15, 2006.

* Unless those charged with governance include only members of management.

EXPOSURE DRAFT

AMENDMENT TO SAS 69, THE MEANING OF PRESENT FAIRLY IN CONFORMITY WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, FOR NONGOVERNMENTAL ENTITIES

This standard would remove the hierarchy of generally accepted accounting principles (GAAP) for nongovernmental (commercial and not-for-profit) entities from AU 411. This is necessary because the FASB, who establishes the accounting standards for those entities, is establishing its own GAAP hierarchy. GAAP for state and local governments (established by the GASB) and federal government entities (established by the FASAB) remain unaffected.