

# Auditing Standards: New & Updated

## *How these Changes Affect the University of Alaska's Financial Statement Audit*

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## Audit Standards Background

- The American Institute of Certified Public Accountants (AICPA) issues auditing standards through their Auditing Standards Board (ASB)
- These standards, known as Statements of Auditing Standards (SAS), affect the way audits are conducted and, subsequently, the results
- In 2006 the ASB issued 11 new or modified audit standards
- These standards are intended to represent the ASB's efforts to develop stronger and more definitive auditing standards to enhance auditor performance and improve audit effectiveness

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## Audit Standards Background

The new and modified standards accommodate the Auditing Standards Board goals to develop stronger and more definitive auditing standards, enhance auditor performance, and improve audit effectiveness through the following:

- Exemplify a greater effort towards planning and conducting risk-based audits
- Provide an improved correlation between the risks assessed and the audit procedures performed
- Require the auditors to gain a more in-depth understanding of the entity and its environment (controls and areas of increased risk)
- Require a mandatory evaluation of design and implementation of controls in all five components of internal control:
  1. The Control Environment
  2. Risk Assessment
  3. Control Activities
  4. Information & Communication
  5. Monitoring

## Audit Standards Summary SAS 104 -111

These are the new or modified auditing standards also referred to as the 'Risk Assessment Standards'

- SAS 104 – Due Professional Care and Performance of Work
- SAS 105 – Generally Accepted Auditing Standards (GAAS)
- SAS 106 – Audit evidence
- SAS 107 – Audit risk and materiality
- SAS 108 – Planning and supervision
- SAS 109 – Understanding the entity and its environment and assessing the risks of material misstatement
- SAS 110 – Performing audit procedures in response to assessed risks and evaluating the audit evidence obtained
- SAS 111 – Audit sampling

## Audit Standards Summary SAS 103, 112, & 114

### Additional new or modified auditing standards:

- **SAS 103** – Audit documentation
- **SAS 112** – Communicating internal control related matters identified in an Audit
- **SAS 114** – The Auditor's Communication with those Charged with Governance

## Auditing Standards – Major Changes SAS 104- SAS 111

States that the auditor must plan and perform the audit to obtain sufficient appropriate audit evidence to limit audit risk to a low level that, per professional judgment, is appropriate for expressing an opinion on the financial statements;

Audit tests are now designed to assess 13 assertions divided into three categories instead of the prior five assertions

The auditor must obtain a sufficient understanding of the entity and its environment, to include:

- Mandatory evaluation of the design and implementation of controls in all five components of internal control
- Period end financial reporting process should be included
- Less reliance on inquiry to assess a control
- Risk assessment should be made at the overall financial statement level and at the relevant assertion level

The auditor must identify and respond to significant risks that require special audit attention; Substantive procedures specific to the risk must be performed; The link between the assessed risks and the audit procedures performed in response must be explicit

## Auditing Standards – Major Changes SAS 103 Audit Documentation

- Audit documentation **should** be prepared 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 is provided on matters that should be documented and retained, such as
  - Significant findings and issues;
  - Specific items tested and considered;
  - Preparer and reviewer sign off.
- Oral explanations on their own do not represent sufficient support for work the auditor performed or conclusions reached, but they may be used to clarify or explain audit documentation;
- Audit evidence that is contradictory or inconsistent with final conclusions **should** be documented including how the auditor addressed the contradiction or inconsistency;
- Audit reports **should not** be dated earlier than the date on which the auditor has obtained **sufficient, appropriate audit evidence** to support the opinion.

## Auditing Standards – Major Changes SAS 112 Communicating Internal Control Related Matters

Definition Changes - Note: Subsequent to SAS 112 issuance, these definitions have also been modified in the Generally Accepted Government Auditing Standards (GAGAS)

- The definitions for **control deficiency, significant deficiency, and material weakness** parallel those in PCAOB AS#2;
- The term **significant deficiency** replaces the term **reportable condition**;
- SAS 112 requires written communication of significant deficiencies and material weaknesses to management and those charged with governance, even if they were communicated in connection with previous audits.

## Auditing Standards – Major Changes SAS 112 Communicating Internal Control Related Matters

### SAS 112 Old Definitions to New Definitions

Old Definitions	New Definitions
Material weakness	Material weakness: A significant deficiency or combination of significant deficiencies resulting in <b>more than a remote likelihood</b> that a <b>material misstatement</b> of the financial statements will not be prevented or detected
Reportable condition	Significant deficiency: A control deficiency or combination of control deficiencies, such that there is <b>more than a remote likelihood</b> that a misstatement of the entity's financial statements that is <b>more than inconsequential</b> will not be prevented or detected
Management letter comment	Deficiency and best practice

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## Auditing Standards – Major Changes SAS 112 Communicating Internal Control Related Matters

### SAS 112 Classification using new definitions:

<i>Magnitude of misstatement that occurred, or could have occurred</i>	Likelihood of misstatement	
	<i>More Than Remote</i>	<i>Remote</i>
Quantitatively or qualitatively material	<b>Material weakness</b>	Control deficiency but not a significant deficiency or a material weakness
More than inconsequential but less than material	<b>Significant deficiency</b> but not a material weakness	Control deficiency but not a significant deficiency or a material weakness
Inconsequential (i.e., clearly immaterial)	<b>Control deficiency</b> but not a significant deficiency or a material weakness	Control deficiency but not a significant deficiency or a material weakness

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## Auditing Standards – Major Changes SAS 112 Communicating Internal Control Related Matters

Controls Significant Deficiencies Examples (Where a lack of the following could indicate a significant deficiency):

- Controls over the selection and application of accounting principles that are in conformity with generally accepted accounting principles. Having sufficient expertise in selecting and applying accounting principles is an aspect of such controls.
- Antifraud programs and controls.
- Controls over nonroutine and nonsystematic transactions.
- Controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger; initiate, authorize, record, and process journal entries into the general ledger; and record recurring and nonrecurring adjustments to the financial statements.

## Auditing Standards – Major Changes SAS 112 Communicating Internal Control Related Matters

Controls Material Weaknesses Examples:

- Ineffective oversight of the entity's financial reporting and internal control by those charged with governance.
- Restatement of previously issued financial statements.
- Identification by the auditor of a material misstatement in the financial statements for the period under audit that was not initially identified by the entity's internal control.
- 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 very large or highly complex entities.
- 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 previously communicated to them and either correct it or conclude that it will not be corrected.

## Auditing Standards – Major Changes SAS 114 The Auditor's Communication with those Charged with Governance

- The auditor should communicate with those charged with governance the following matters:
  - The auditor's views about qualitative aspects of the entity's:
    - significant accounting practices, including accounting policies,
    - accounting estimates, and
    - financial statement disclosures
  - Any significant difficulties encountered in dealing with management related to the performance of the audit

## How is UA Affected?

The University has been affected by the auditing standards changes primarily through increased staff time necessary to support:

- a) Responding to the increased amount of questioning by the external auditors
- b) Responding to the increased documentation requested by the external auditors
- c) Spending time with the external auditors to assist with their transaction walk-through processes

## How has UA Prepared for these Changes? Internal Controls/Control Environment

UA has prepared for the auditing standards changes by responding to the external auditor needs and by taking measures to improve overall internal controls and accounting guidance. The next several slides outline these measures in general as they pertain to internal controls and the control environment and in regards to specific auditing standards.

### In General:

The Controller's office has started a project to review and update the Statewide Accounting Manual

The Fund Accounting manager researches all problems identified during the external audit and reports them to the appropriate management

The Fund Accounting department provides an oversight function by monitoring balance sheet account reconciliations and depository reconciliations

## How has UA Prepared for these Changes? SAS 106 – Audit Evidence

### SAS 106 – Audit Evidence

UA has provided an increased amount of staff time to answer auditor inquiries and provide requested documentation to support the increased inspection and observation requirements faced by the auditors.

- Walk through billing and cash receipts process at UAF and UAA grants and contracts offices.
- Walk through payroll transactions in human resources.
- Trace expenditures from Banner through work papers & Banner reports to the financial statements
- Trace student receivables from printed billings to Banner receivables and Banner revenue.
- Compare student classes on the billings to course catalogs. Re-compute tuition based on lower/upper level division courses and credit hours.
- More testing of transactions - accounts payables, cash disbursements, expenditures, journal entries in grants and contracts and auxiliaries.
- Test reconciliations and journal entries for controls - supervisory approval.
- Expanded account test work in capital accounts.



## How has UA Prepared for these Changes? SAS 107 & SAS 109

### SAS 107 – Audit Risk and Materiality

UA has provided an increased amount of staff time to answer auditor inquiries and provide requested documentation to support the increased testing of transactions in areas deemed as higher risk - accounts payables, cash disbursements, expenditures, journal entries in grants and contracts and auxiliaries.

### SAS 109 – Understanding the Entity and its Environment

This standard expands on the idea that the auditor must obtain a sufficient understanding of the entity and its environment and is related to the 'Tone at the top', or assessing management's views on the importance of implementing and enforcing internal controls.

## Auditing Standards – Major Changes Summary Conclusion

To summarize the major impact of the auditing standards changes:

1. An increase in communication between the auditors and management
2. An increase in documentation required
3. Auditors are performing more tests of transactions and conducting walk-throughs from source documents to the entry on financial statements
4. Less reliance on inquiry alone
5. Risk-based planning and audit strategy
6. Key reporting definitions have been modified - may cause issues to be reported that otherwise were not reported or to be classified differently
7. A longer audit process overall

Note: Slide content was obtained partially from NACUBO, National Association of College and University Business Officers