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# In Our Opinion...



*The Newsletter of the AICPA Auditing Standards Division*

Volume 3 Number 1

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## 1986-1987 ASB PROFILE

Recently, to fill vacancies arising from the annual rotation of ASB members and to increase the size of the ASB from 15 to 21 members (see "Restructure of the ASB," October 1986) 11 new members were appointed to the ASB. Here are profiles of the new members of the 1986-1987 Auditing Standards Board; profiles of continuing members are included in "ASB Profile," January 1986.

**Barry Barber**, a partner in Grant Thornton, joined its New York Office in 1968. He is presently assigned to his firm's national office, where he functions as Regional Director of Accounting and Auditing and is a member of his firm's National Accounting and Auditing Group. He has experience in SEC reporting matters and in accounting and auditing matters pertaining to middle market companies. He has previously served on the AICPA's SEC Regulations Committee. Mr. Barber received BA and MBA degrees from Rutgers University, where he was a member of the National Business and Economics Honor Societies.

**James L. Brown** is a partner in the firm of Crowe, Chizek and Company in its South Bend, Indiana office. His client service responsibilities include various bank clients, and he also serves in his firm's technical and quality control functions. Mr. Brown is a member of the FASB's Small Business Advisory Group. He graduated with highest honors from the University of Notre Dame and received the high grade award in Indiana on the 1970 CPA examination.

**Patrick S. Callahan** is a partner in Frederick B. Hill and Company in Norfolk, Virginia. In addition to his responsibilities as a general partner, providing services primarily to closely held businesses, he also serves as his firm's Accounting and Auditing Technical Partner. Mr. Callahan joined his firm in 1969 after receiving a BS degree in accounting from Old Dominion University.

Mr. Callahan has served as director of the Virginia Society of CPAs and president of its Tidewater Chapter. His professional activities include ten years as chairman or member of the Virginia Accounting and Auditing Conference as well as numerous other committee assignments. He has also taught on the adjunct faculty of Old Dominion University. The Virginia Society of CPAs awarded him its gold medal for the November 1969 CPA examination.

**James Clancy** is an audit partner in the Philadelphia office of Price Waterhouse. He has been responsible for examinations in such diverse areas as large and small multinational manufacturing, real estate development, construction and financial services. He has experience with tax shelter syndications and serves as the real estate specialist in his firm's Philadelphia office. Mr. Clancy graduated magna cum laude with a BA degree from Lehigh University in 1966.

**Donald B. Dodson** is managing partner of Gary, Stosch, Walls & Company and is located in its Richmond, Virginia office. Prior to becoming managing partner he was in charge of the audit practice, including his firm's bank and savings and loan association practice. Mr. Dodson joined Gary, Stosch, Walls & Company in 1974 after spending seven years with a national CPA firm, working primarily in the financial institution and real estate areas.

Mr. Dodson received a BS degree from Virginia Commonwealth University. He is past president of the Richmond Chapter of the Virginia Society of Certified Public Accountants. Additionally, Mr. Dodson served as a member of the AICPA Savings and Loan Associations Committee.

**Barbara Hutson Gonzales** is a partner with McElroy, Quirk & Company, a local accounting firm in Lake Charles,

*(continued on p. 2)*

## 1986-1987 ASB PROFILE (continued from p. 1)

Louisiana. She was admitted to partnership in her firm in 1973. She is responsible for the quality control policies and administration of her firm. She has experience in the governmental, bank, and small business accounting and auditing practices. Ms. Gonzales attended McNeese State University in Lake Charles, Louisiana.

Ms. Gonzales has served the Louisiana Society of Certified Public Accountants as a member of the Board of Directors, president of the Lake Charles Chapter, and as a member of various committees. She also served on the Governmental Positive Enforcement Program Committee of the Louisiana State Board of Accountancy.

**Conrad A. Kappel** is Director of Accounting and Auditing for Blum, Shapiro & Company in West Hartford, Connecticut, where he is responsible for the development of his firm's auditing policies and procedures. He has served on various committees and task forces of the AICPA and is presently a member of the Technical Issues Committee of the Private Companies Practice Section and of the Nominations Committee of the SEC Practice Section. Mr. Kappel is also chairman of the Accounting Principles Committee of the Connecticut Society of CPAs and a member of the Society's Auditing Standards Committee. He has been a frequent speaker at seminars and conferences.

**Harold L. Monk, Jr.** is partner in the firm he helped found, Davis, Monk, Farnsworth & Company of Gainesville, Florida. In 1968 he earned a BSBA degree from the University of Florida, where he later served on the adjunct faculty of the School of Accounting.

Mr. Monk is a past president of the North Central Florida Chapter of the Florida Institute of Certified Public Accountants. He has served the FICPA as a member of the Board of Governors and as chairman or member of several committees. Mr. Monk has served the AICPA as a member of the Region IX Trial Board and of several committees, including the CPE Executive Committee. He was also Chairman of the CPE Needs Assessment Subcommittee and CPE Marketing and Distribution Subcommittee. Mr. Monk has had articles published in several professional journals.

**Donald L. Neebes** is a client service partner in Ernst &

Whinney's Washington, D.C. practice office and a member of his firm's SEC Coordination Group. He joined Ernst & Whinney in 1965 upon graduation with honors from Michigan State University with a Bachelor of Arts degree. He has served in Ernst & Whinney's Saginaw, Detroit, and National offices. Mr. Neebes has served the AICPA as the first chairman of the SEC Practice Section Peer Review Committee, as chairman of the Information Retrieval Committee, and as a member of the Federal Government Executive and Quality Control Committees.

**Robert S. Roussey** is a partner in the Chicago world headquarters office of Arthur Andersen & Co., where he is Director, Auditing Procedures and a member of his firm's Management Advisory Committee on Information Systems. Mr. Roussey joined Arthur Andersen & Co. in 1957, spending most of his career in the New York and Tokyo offices, before moving to Chicago to become a member of his firm's Committee on Accounting Principles and Auditing Procedures in 1977.

Mr. Roussey has served on AICPA, state society and International Federation of Accountants committees. He is past Chairman of the AICPA EDP Auditing Standards Committee. Mr. Roussey earned a BS degree in accounting from Fordham University.

**Ernest L. Ten Eyck** is the National Accounting and Auditing Partner of Laventhol & Horwath. Mr. Ten Eyck has overall responsibility for directing the technical support and quality control functions for Laventhol & Horwath's accounting, auditing and SEC practice. He also is active in the firm's litigation support practice and serves as resource partner for a number of audit clients.

Prior to joining Laventhol & Horwath, he was Assistant Chief Accountant with the Securities and Exchange Commission. During his tenure at the SEC, Mr. Ten Eyck was involved in the Commission's accounting-related regulatory and enforcement activities. In addition to serving with another national accounting firm, his professional background also includes positions as Director of Information Services for a business and financial publication and as adjunct faculty member at American University. Mr. Ten Eyck is a graduate of George Washington University.

## TECHNICAL PLAN HIGHLIGHTS

**Errors, Irregularities and Illegal Acts** (AICPA staff: LYNN O'NEILL). The Board is revisiting SAS Nos. 16 and 17 to determine whether existing standards appropriately describe the auditor's responsibility for detection and reporting of errors, irregularities, and illegal acts. The Board agreed that an audit should be designed to detect all material misstatements; however, because of the characteristics of certain irregularities, a properly designed and executed audit may not detect a material irregularity. It is proposing that errors, irregularities, and illegal acts be reported to the entity's board of directors or audit committee. *Schedule:* Draft to be exposed 1Q.1987.

**Auditor Communications** (EILEEN DEMICHELIS). The Board is proposing a number of significant changes to improve communication of the auditor's responsibility, including changes to the auditor's standard report. The Board voted in December

1986 to expose three new standards. Two documents to be exposed are proposed SASs. These proposals address a revised auditor's report and communications with audit committees or others having equivalent responsibility. The third document is a proposed attestation standard on reports on management's discussion and analysis. *Schedule:* Drafts to be exposed 1Q.1987.

**Auditing Client Estimates and Judgments** (LYNN O'NEILL). The Board concluded that more guidance is needed regarding auditing client estimates and judgments. Guidance will incorporate some of the concepts in the statement on prospective financial statements. *Schedule:* Draft to be exposed 1Q.1987.

**Internal Accounting Control** (ALAN WINTERS). The Board has developed a comprehensive revision of the standards for the auditor's study and evaluation of internal accounting

(continued on p. 4)

# THE AUDITOR'S STANDARD REPORT

In its efforts to narrow the expectations gap (see "The Auditing Standards Board Responds to Public Expectations," October 1986), the Board has approved the issuance of 10 exposure drafts of proposed SASs. One of these is intended to improve the way auditors communicate the results of their audits. Titled *The Auditor's Standard Report*, the proposed SAS is intended to help the public understand the auditor's role by requiring the auditor's report to more explicitly address:

- the responsibility the auditor assumes
- the procedures the auditor performs
- the assurance the auditor provides

This article explains the differences between the new standard report that the proposed SAS would require and the current auditor's standard report, which is illustrated in SAS No. 2.

## TITLE

The proposed SAS would require the report to be titled and the word **independent** to be included in the title. Including **independent** in the title distinguishes the report from that of the entity's management or internal auditors and clarifies a characteristic of the auditor's work that may not be apparent without such explicit statement.

## INTRODUCTORY PARAGRAPH

The introductory paragraph would include a statement that the financial statements were audited, rather than the currently used word **examined**. The Board considers the word audited to be more descriptive of the audit process and believes it will be better understood by users.

The introductory paragraph would also include a statement that all the information in the financial statements is the representation of management. This statement would give users clearer notice of management's responsibility for the financial statements. It would change neither management's responsibilities nor the existing relationship between management and the independent auditor. This statement would be appropriate whether or not the auditor participated in the preparation of the financial statements; that participation does not change the character of the statements as representations of management.

## SCOPE PARAGRAPH

The scope paragraph would include a statement that the audit is designed to evaluate whether the financial statements are materially misstated. This statement would explain to users the extent of the auditor's responsibility for detecting errors or irregularities.

The Board has suggested using the words **intentionally** or **unintentionally** to explain further that responsibility. The

inclusion or exclusion of these modifying words would not alter the auditor's underlying responsibility. The Board's intention is to explain the auditor's responsibility as clearly as possible.

The report would describe generally steps the auditor takes to achieve reasonable assurance that the financial statements are free of material misstatement. The steps the report would describe include (1) examining on a test basis evidence that supports the amounts included in the financial statements, (2) assessing the appropriateness of the accounting principles management has used and the significant estimates it has made, and (3) assessing the appropriateness of the overall financial statement presentation and disclosures. Including this discussion in the report would achieve two objectives: first, users would be informed that an audit is designed to provide reasonable, not absolute, assurance that the financial statements are free of material misstatement and, second, users would be informed about certain aspects of an audit that may affect their understanding and interpretation of the auditor's opinion.

The scope paragraph would close with a statement that the auditor believes the procedures performed were appropriate in the circumstances to express the opinion presented. In the context of the sentences preceding it, this statement would inform users that, although an audit has inherent limitations, the auditor has formed a positive conclusion about the scope of the audit work performed.

## OPINION PARAGRAPH

The report would express an opinion about whether the financial statements are fairly presented, in all material respects, in conformity with generally accepted accounting principles. The inclusion of the phrase "in all material respects" would inform users that the auditor's opinion does not attest to absolute accuracy of the financial statements.

The report would no longer address the consistent application of accounting principles among the periods presented because generally accepted accounting principles now require footnote disclosure of changes in accounting principles. When the consistency standard was adopted, no formal accounting rule existed for maintaining consistent application of accounting principles or for accounting for changes and disclosing them in the financial statements. The removal of the consistency reference would not change the auditor's existing responsibility to evaluate changes in accounting principles.

## CONCLUSION

The proposed SAS would affect every audit in the U.S. Thus, the Board desires that all interested persons comment on this exposure draft as well as on the exposure drafts of the other SASs the Board has proposed in response to the expectations gap. The availability and product numbers of these exposure drafts will be announced in the *CPA Letter*.

## TECHNICAL PLAN (continued from p. 2)

control (AU Section 320). The revision emphasizes the importance of internal control to audit planning and updates the guidance to incorporate the audit risk and audit evidence concepts that have evolved in practice and in SASs issued after AU Section 320. *Schedule:* Draft to be exposed 1Q.1987.

**Reporting on Internal Accounting Control (ANTHONY DALESSIO).** The Board has developed a proposed SAS that would make auditors' reports on internal accounting control more responsive to the needs of boards of directors and others. The proposed SAS provides guidance in identifying and reporting deficiencies in an entity's control structure. The proposed SAS would supersede SAS No. 20, *Required Communication of Material Weaknesses in Internal Accounting Control*, and sections of SAS No. 30, *Reporting on Internal Accounting Control*. *Schedule:* Draft to be exposed 1Q.1987.

**Continued Existence (KURT PANY).** The Board has approved a proposed SAS that would establish a responsibility in all audits to consider whether audit procedures performed raise a question about an entity's ability to continue in existence. The proposed SAS would require modified audit reports, regardless of whether there is a question about recoverability of assets or classification of liabilities, whenever there is substantial doubt as to continued existence. The proposed SAS would supersede SAS No. 34, *The Auditor's Considerations When a Question Arises About an Entity's Continued Existence*. *Schedule:* Draft to be exposed 1Q.1987.

**Reporting on Pro Forma Financial Statements (EILEEN DEMICHELIS).** The Board is considering developing an attestation standard that would provide guidance on reporting on pro forma financial statements. That guidance would include concepts presented in the June 1984 exposure draft of a proposed SAS that dealt with this subject. *Schedule:* Board to discuss applicability and form of guidance at its March 1987 meeting; a

timetable will be developed after those decisions are made.

**Analytical Procedures (PEG FAGAN).** The Board has developed a proposed SAS that would require the use of analytical procedures at the planning and final review stages of an audit and would provide additional guidance on evaluating the effectiveness of analytical procedures. The proposed SAS would supersede SAS No. 23, *Analytical Review Procedures*. *Schedule:* Draft to be exposed 1Q.1987.

**GASB Authority (CAMRYN CARLETON).** The Board agreed to revise SAS No. 5, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles" in the Independent Auditor's Report*, and SAS No. 27, *Supplementary Information Required by the Financial Accounting Standards Board*, to recognize the GASB's authority to set accounting standards under rule 203 of the AICPA code of ethics and to set standards for supplementary financial information under rule 204. The basic guidance in the two SASs will not change as a result of the revision. *Schedule:* Draft to be exposed 2Q.1987.

**Corporate Codes of Conduct (ALAN WINTERS).** The Board is developing guidance under the attestation standards for auditors who are requested to report on the adoption and implementation of policies and programs for compliance with an entity's established code of business ethics and conduct. The board will discuss this guidance in 1Q. 1987.

**Revision of Standard Bank Confirmation Form (CAMRYN CARLETON).** The Board is considering revising the standard bank confirmation form in response to the SEC's release on oral guarantees and to update the form for current banking transactions. The Board will discuss this issue in 2Q. 1987.

**Compliance Auditing (PEG FAGAN).** The ASB is considering the need to develop additional guidance on auditing compliance with laws, regulations, and contractual terms. It will discuss an issues paper on this subject in 2Q. 1987.

## RECENT DIVISION PUBLICATIONS

In the January *Journal of Accountancy* the division published an interpretation of SAS No. 30. Titled "Compliance with the Currency and Foreign Transactions Reporting Act," the interpretation provides guidance to auditors on the procedures and form of report that are necessary to comply with the requirements of the Federal Home Loan Bank Board's T-Memorandum 53-7, *Currency and Foreign Transactions Reporting Act: FHLBB Explanations of Compliance Requirements*.

In October, the division, in conjunction with the AICPA Committee on Banking, published an Auditing Procedure Study titled *Auditing the Allowance for Credit Losses of Banks*. This study includes information that will assist auditors in planning to audit allowances for credit losses and describes methods for evaluating the adequacy of such allowances. The study (product no. 021050) can be obtained through the AICPA's Order Department (212/575-6426).

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