



Bringing Focus to the New Clarity Standards

BY GERRY BOAZ

In issuing its October 2011 Statement on Auditing Standards No. 122, *Clarification and Recodification*, the goal of the American Institute of Certified Public Accountants (AICPA) Auditing Standards Board (ASB) was to make auditing standards easier to read, understand, and apply, and to establish a more principles-based approach to standard setting.¹ The underlying driving force behind the change to auditing standards generally accepted in the United States was to bring together U.S. auditing standards with those of the International Standards on Auditing, issued by the International Auditing and Assurance Standards Board.² The change should result in more consistent application of the standards.

SAS 122 reduces the complexity of previous statements and prominently lays out the requirements auditors “must” or “should” perform, along with useful application and other explanatory material (some of which focuses on the government environment). It is not an earth-shattering alteration of auditing standards, and many of the substantive to current audit practices are in the group audits area, as well as changes to the auditor’s report format and management representation letters.

THE NEW CLARITY FORMAT

The first noticeable change an auditor will see in SAS 122 is a new drafting convention called the clarity format (see sidebar).³ This new format is clear, consistent, and easy to understand. The ASB redrafted all its standards in accordance with the following conventions:⁴

- Establishing objectives for each clarified standard.
- Including a definitions section, where relevant, in each clarified standard.
- Separating requirements from application and other explanatory material.
- Numbering application and other explanatory material paragraphs using an A- prefix and presenting them in a separate section that follows the requirements section.
- Using formatting techniques such as bulleted lists to enhance readability.
- Including, where appropriate, special considerations relevant to audits of smaller, less complex entities within the text of the clarified standard.

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- Including, where appropriate, special considerations relevant to audits of governmental entities within the text of the clarified standard.

SUBSTANTIVE, CLARIFYING, AND FORMATTING CHANGES

First is the ever-revolving wheel of terminology changes. The clarified SAS 122 introduces the following new terminology:⁵

- *Applicable financial reporting framework*, which includes international financial reporting standards and generally accepted accounting principles (e.g., the Governmental Accounting Standards Board).
- *Emphasis-of-matter* and *other-matter* paragraphs replace explanatory paragraphs.
- The terms *group engagement partner* and *component auditor* replace *principal auditor* and *other auditor*, respectively.

Next, some AU-C section changes are considered likely to affect an audit organization’s audit methodology and engagements because they contain substantive or other changes, defined as having one or both of the following characteristics:⁶

- A change or changes to an audit methodology that may require effort to implement.
- A number of small changes that, although not individually significant, may affect audit engagements. (Substantive changes to the following areas will affect audit methodologies and engagements: consideration of laws and regulations; and communicating matters related to internal control, related parties, group audits, and auditor’s reports.)⁷

The 800-pound gorilla in SAS 122 is the topic of group audits (AU Section 600). The group audit requirements will likely result in substantive changes to methodologies, reporting, and engagement documentation. In cases where the government audit organization is the component auditor as well as the group auditor, the degree of changes will not be as extensive as it will be for organizations with different circumstances. All audit organizations should thoroughly study the group audit section of SAS 122 and related AICPA guidance to determine its impact on engagement planning, performance, and reporting. The AICPA provides two excellent publications to help organizations prepare for implementation

(Audit Risk Alerts, *Understanding the New Clarified Auditing Standards* and *Understanding the Responsibilities of Auditors for Audits of Group Financial Statements*). The extent to which this will change audit practice depends on each audit organization's current methodologies.

Finally, in the superseded or amended standards, some requirements were implicit, and SAS 122 makes those requirements explicit: determining whether the applicable financial reporting framework is acceptable; having management agree to their responsibilities at the onset of engagement; and applying quality control procedures at the audit engagement level.⁸ Furthermore, additional requirements address the following: changes to the wording of the auditor's reports, including the use of paragraph headings and expanding the description of management's responsibilities; more specific procedures to detect illegal acts; and opening balances in initial audits.

The remaining changes to other clarified standards are primarily clarifying or formatting, not substantive, changes to requirements in the following areas: audit documentation;

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risk assessment standards; analytical procedures; auditing accounting estimates; subsequent events; auditor's communication with those charged with governance; external confirmations; audit sampling; written representations; and consideration of omitted procedures after the report release date. Thus, any impact to audit methodologies should be minimal.

HOW TO PREPARE FOR THE TRANSITION

Now is the time for all auditors to start preparing for the transition to the clarified standards, which are effective for calendar year 2012 audits or for fiscal years ending June 30, 2013. A smooth transition requires information, education, and training. Here are some important steps to take in preparing for the clarified standards:⁹

- Familiarize yourself with the clarified standards, including the application material, appendixes, and exhibits.
- Read the summary of changes between existing and clarified standards.¹⁰
- Appoint a person or team to be in charge of the transition.
- Consider establishing small task forces of staff at different levels to develop revisions to audit methodologies, including policies and procedures.
- Include training for all audit staff.

In addition to determining any changes needed to audit procedures and training in accordance with the audit organization's quality control documents, it will also be necessary to revise guidance, audit programs, and policies and procedures to refer to the clarified standards. The key to implementation is not to procrastinate. The sooner the implementation planning process begins, the better. Organizations might also consider testing your changes on a pilot audit to work out any issues that might arise, in addition to discussing methodologies with the state audit organization community in other states (i.e., as part of networking opportunities through the National Association of State Auditors, Comptrollers, and Treasurers).

CONCLUSIONS

The new streamlined clarity format is a major improvement over prior standards. The new standards are more auditor-

Clarity Format Outline

- Introduction — explains the purpose and scope of the standard.
- Objective — defines the context in which the requirements are set.
- Definitions — included where relevant to explain specific meanings of terms in the standards.
- Requirements — set out what the auditor is required to do (i.e., "should" and "must") to achieve the objective of the standard.
- Application and Other Explanatory Material — provide further explanation of, and guidance for, carrying out the requirements of the standard. These paragraphs, which are cross-referenced to the requirements, are an integral part of the standard, and the auditor is required to read and understand the entire text of the standard.

friendly and, frankly, make more sense. The application and other explanatory material give auditors a clearer sense of the ASB's intent. The number of standards with substantive changes is manageable. With assistance from the wealth of guidance on the AICPA's website (<http://www.aicpa.org/frc>), implementing the new clarity standards should be relatively easy, so long as auditors start planning for these changes immediately. ■

Notes

1. "Summary of Changes in Requirements from Statements on Auditing Standards No. 1 through No. 120 to Clarified SASs," as of December 2010 and revised January 2012, the AICPA Audit and Attest Standards Team.
2. AICPA Codification of Statements on Auditing Standards (Vol. 2), as of January 2012, AU-C Introduction — Foreword.
3. "The AICPA's Guide to Clarified and Converged Standards for Auditing and Quality Control," AICPA Financial Reporting whitepaper.
4. AICPA Codification.
5. AICPA Guide to Clarified and Converged Standards whitepaper.
6. Understanding the Clarified Auditing Standards—2012, paragraph 23, AICPA Audit Risk Alert.
7. Ibid, paragraphs 25-74.
8. AICPA Financial Reporting whitepaper.
9. Ibid, paragraph 15.
10. Use the AICPA "Clarity Learning and Implementation Plan" as a timeline tool for implementation planning. It is available at http://www.aicpa.org/InterestAreas/FRC/AuditAttest/DownloadableDocuments/Clarity/Clarity_Learning_Plan.pdf.

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**AICPA Resource Center —
The SAS Clarity Project**

(www.aicpa.org/frc)

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 - Understanding the New Clarified Auditing Standards
 - Understanding the Responsibilities of Auditors for Audits of Group Financial Statements
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