

SAS Update and SAS 117: The New Compliance Standard

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What this session will cover

- ASB Clarity Project
- SAS 117, Compliance Audits
- SAS 118, Other Information in Documents Containing Audited Financial
- SAS 119, Supplementary Information in Relation to the Financial Statements as a Whole
- SAS 120, Required Supplementary Information

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Clarity Project

- Goals:
 - Address concerns over length and complexity of standards
 - Make standards easier to read, understand, and implement
 - Will lead to enhancements in audit quality

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Clarity Project

- Format of Clarified Statements:
 - Introduction and applicability
 - Objectives
 - Definitions
 - Terms used in SAS are defined
 - Establish separate glossary of terms
 - Requirements and application materials

Clarity Project

- Standards will not become effective piecemeal.
- With limited exceptions, all “clarified standards” will become effective at the same time.
- Once finalized, clarified standards will be issued in one SAS that will be codified in “AU section” format.

Clarity Project

- Effective Date
 - Periods beginning on or after December 15, 2010 (December 31, 2011 or June 30, 2012)
 - May be delayed one year to allow for more time for updating firm methodologies and training.

Clarity Project

- For more information – visit AICPA website
 - Explanatory Memorandum
 - Questions and Answers
 - Exposure Draft
 - Final Standards
 - Mapping of Existing AU Sections to Clarity Statements

SAS No. 117

- Why was SAS No. 117 issued
 - To revise SAS No. 74 to:
 - Update and clarify compliance auditing requirements
 - Provide guidance to auditors auditing and reporting on an entity's compliance with applicable compliance requirements
- Respond to federal study on single audit quality (PCIE report)

What SAS No. 117 Does

- Clarifies which generally accepted auditing standards apply to a compliance audit
- Identifies auditor requirements and provides guidance that are unique to a compliance audit
- Defines terms related to a compliance audit
- Provides guidance in evaluating whether an entity has materially complied with the applicable compliance requirements
- Updates the elements to be included in an auditor's report on compliance

SAS No. 117 Applicability

- SAS 117 applies when all of the following are required
 - Generally accepted auditing standards (GAAS)
 - Financial audit standards for *Government Auditing Standards (Yellow Book)*
 - A governmental audit requirement that requires the auditor to express an opinion on compliance

SAS No. 117 Applicability (continued)

- Does not apply to financial statement audit
- Does not apply to examination of internal control over compliance
- Does not apply when Attestation Standards are specified

SAS No. 117 Objectives

- Obtain sufficient appropriate audit evidence to form an opinion and report at the level specified by the government audit requirement on whether the entity complied in all material respects with the applicable compliance requirements
- Identify audit and reporting requirements specified in the governmental audit requirement that are supplementary to GAAS and GAGAS and perform procedures to address those requirements

SAS No. 117 Definitions

- Terms Unique to Compliance Audit Environment
 - Applicable Compliance Requirements
 - Governmental Audit Requirement
 - Compliance Audit
- Terms Adapted for Compliance Audit Environment from Financial Audit Standards
 - Audit Risk of Non-compliance
 - Risk of Material Non-compliance
 - Significant Deficiency in Internal Control over Compliance
 - Material Weakness in Internal Control over Compliance



SAS No. 117 Requirements and Guidance

- Adapting and Applying GAAS
- Materiality
- Identifying Governmental Programs and Applicable Compliance Requirements
- Performing Risk Assessment Procedures
- Assessing the Risks of Material Non-compliance
- Performing Further Procedures in Response to Assessed Risks



SAS No. 117 Requirements and Guidance (continued)

- Supplementary Audit Requirements
- Written Representations
- Subsequent Events
- Evaluating Evidence and Forming an Opinion
- Reporting
- Documentation
- Report Reissuance
- Appendix – AU Sections That Are Not Applicable



SAS No. 117 Requirements

Adapt and apply AU sections to compliance objectives

- What are the key ones?
 - Materiality
 - Risk assessment process
 - Required do the tests – internal controls, tests of compliance, analytical procedures – sufficient to give an opinion
 - Reporting
 - Documentation

SAS No. 117 Materiality

- Materiality set based on governmental audit requirement, GAAS and GAGAS supplement how
 - Different levels of materiality
 - Different nature
 - Unique qualitative & quantitative factors

Risk Assessment Auditing Standards Apply to Compliance

- SAS 117 clarifies that SAS 107, *Audit Risk and Materiality* also applies to a Circular A-133 audit
- Risk that auditor expresses inappropriate audit opinion on compliance when material non-compliance exists
 - Risks of material non-compliance
 - Detection risk of non-compliance

SAS No. 117 - Risk Assessment Procedures

- Gaining an understanding
 - First, which programs, which requirements?
 - Inquiries, past experience, federal regulations
 - What are the risk factors?
 - Newness, complexity, knowledge, nature of services, level of oversight, past external and internal reports, management's corrective actions
 - What are the internal controls?
 - Five elements of COSO

SAS No. 117 - Risk of Material Non-compliance

- Assess risks of material non-compliance for each applicable compliance requirement (A-N)
- Consider whether any risks are pervasive – could they affect compliance with many compliance requirements?
- Factors relative to the applicable compliance requirements when assessing this risk.

SAS No. 117 - Matching Controls with Related Risks

- Value of control depends on compliance risk it offsets
- Risk assessment process
 - Identify compliance risk
 - Identify controls that reduce risk
 - Determine if risk is reduced sufficiently (a relatively low level)
 - Do deficiencies exist? Impact on compliance tests?

Performing Further Procedures

- Risk assessment procedures, tests of controls, and analytical procedures alone are not sufficient to address a risk of material non-compliance.

Performing Further Procedures

- Pervasive risks
- Financial Statements
 - Look at both overall and at assertion level;
 - Respond to risks at both
- Compliance
 - What affects multiple programs/requirements
 - Respond to overall risk

Performing Further Procedures

- Tests of compliance
 - Tests of details, tests of transactions
- Tests of internal control, if:
 - Risk assessment is based on expectation that controls are operating effectively
 - Substantive procedures alone won't provide sufficient appropriate audit evidence, or
 - Required by governmental audit requirement (A-133)
 - Portions of AU 318 related to evidence of operating effectiveness obtained in prior audits are not applicable to compliance audits

Performing Further Procedures

- New chapter about sampling in audit guide, *Government Auditing Standards and A-133 Audits*
- Perform any supplementary audit requirements
 - e.g., specific procedures to identify major programs
 - e.g., assess reasonableness of summary schedule of prior audit findings
- Where analytical procedures fit in?
 - For planning
 - As tests of compliance
 - Other evidence

SAS No. 117 - How Does Fraud Fit In?

- It does!...Focus – Impact of fraud risks on non-compliance
- Fraud triangle in a compliance environment
- SAS 99 documentation requirements apply

Forming an Opinion

- Do you have enough relevant evidence to determine whether an entity materially complied? Consider:
 - The frequency of the non-compliance
 - The nature of the non-compliance
 - The adequacy of the entity's system for monitoring compliance
 - Whether any identified non-compliance resulted in likely questioned costs that are material to the government program

Forming an Opinion

- Making the decision about material non-compliance
 - Is it big enough (per the governmental audit requirement (GAR)) to be:
- A finding?
 - Look to the GAR – could be noncompliance, internal control deficiencies, questioned costs
- Material to the requirement?
 - \$ or % for monetary transactions or % for nonmonetary
- Material to the program
 - Significance of requirement to program; degree to which requirement was not complied with

SAS No. 117 – Management Representation

- 12 specific representations included in paragraph 23 of SAS No. 117 to be included in management representation letter

SAS No. 117 Reporting and Reports

- Reporting
 - Opinion on compliance
 - Other required reporting per the governmental audit requirement (e.g. instances of non-compliance, internal control deficiencies, questioned costs)
- Reports
 - Report on compliance
 - Report on internal control over compliance
 - Can be combined

SAS No. 117 - Reissuing a Compliance Report

- Explanatory paragraph describing reason for reissuance or report and changes made
- Dating
 - Update if all programs affected
 - Dual date if not all programs affected
- A need to reissue auditor-prepared documents referred to in the compliance report is considered to be a reissuance of the report itself

SAS No. 118, Other Information in Documents Containing Audited Financial Statements

- Effective for audits of financial statements for periods beginning on or after December 15, 2010 (December 31, 2011 or June 30, 2012)
- Other Information – information that is included in a document containing audited financial statements and the auditor's report thereon, excluding required supplementary information

SAS No. 118

- Eliminates the distinction between other information that is in an auditor submitted versus client prepared documents
- Make arrangements with those charged with governance to obtain the other information prior to the report release date.
- Read the other information that the auditor is aware of in order to identify material inconsistencies with audited financial statements

SAS No. 118

- If a material inconsistency is identified prior to the report release date and management refuses to make a revision:
 - Include an explanatory paragraph in the auditor's report
 - Withhold the audit report
 - Withdraw, if possible

SAS No. 119, Supplementary Information in Relation to the Financial Statements as a Whole

- Effective for audits of financial statements for periods beginning on or after December 15, 2010 (December 31, 2011 or June 30, 2012)

SAS No. 119

- In order to opine on whether supplementary information (SI) is fairly stated, all of the following conditions must be met:
 - SI was derived from the underlying accounting and other records used to prepare the financial statements
 - SI relates to the same period as financial statements
 - The financial statements were audited and the auditor served as the principal auditor on the engagement.
 - Neither an adverse nor disclaimer opinion was issued on the financial statements
 - The SI will accompany the entity's audit

SAS No. 119 - Requirements

- In order to provide an “in relation to” opinion, the auditor must:
 - Inquire of management about the purpose of the SI and the criteria used by management to prepare the SI.
 - Determine whether the form and content of the SI complies with the applicable criteria
 - Obtain and understanding of the methods of preparing the SI

SAS No. 119 – Requirements (continued)

- In order to provide an “in relation to” opinion, the auditor must:
 - Compare and reconcile the SI to the underlying accounting records used in preparing the financial statements.
 - Inquire of management of significant assumptions or interpretations
 - Evaluate the appropriateness and completeness of the SI
 - Obtain written representations from management

SAS No. 119

- When the SI is presented with the audited financial statements, the auditor reports on SI either:
 - In an explanatory paragraph in the report
 - In a separate report
- Report of SI can not be dated earlier than when the procedures are performed

SAS No. 120, Required Supplementary Information

- Effective for audits of financial statements for periods beginning on or after December 15, 2010 (December 31, 2011 or June 30, 2012)

SAS No. 120

- Required Supplementary Information (RSI)
 - Information that a designated accounting standard setter requires to accompany the basis financial statements
 - Authoritative guideline for methods of measurement and presentation of the information have been established.

SAS No. 120 – Required Procedures

- Inquire of management about the methods of preparing the information
- Compare the information for consistency with the basis financial statements or other knowledge obtained during the audit
- Obtain written representation from management

SAS 120 – Auditor’s Report

- Include an explanatory paragraph in the auditor’s report on the financial statements referring to the RSI



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