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Setting the Standard for the New Auditor's Report:
An Analysis of Attempts to Influence the
Auditing Standards Board

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Introduction

This monograph discusses two different but related subjects that affect virtually all practicing CPAs—standards for audit reports and how the AICPA's Auditing Standards Board (ASB) works. The issuance of *SAS 58, Reports on Audited Financial Statements*, is the latest event in the long and sometimes controversial history of audit reporting. This monograph traces that history and provides practitioners with insights into the political and practice issues that have shaped the evolution of audit reporting. Armed with these insights, practitioners will better appreciate changes in audit report language that have occurred over the last several decades and have a clearer understanding of why today's audit report reads as it does.

Practitioners will also obtain a detailed knowledge of the process that the ASB follows in establishing authoritative auditing standards. The author observed the process at work by attending meetings of the ASB and its task force as *SAS 58* was developed. In addition, the author discussed the process with individual board and task force members and AICPA staff. He also reviewed comment letters on the proposed reporting standard and was able to identify issues and monitor the deliberations of those issues at various ASB and task force meetings.

The result of this observation and analysis provides interesting and useful insights into the steps the ASB follows, the factors that influence standard-setting, and how practitioners' comments during the exposure period for a proposed standard affect the final standard.

For practitioners who seek a better understanding of audit reporting standards and the audit standard-setting process, this monograph is invaluable reading.

Dan M. Guy
Vice-President—Auditing
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Overview

In 1988, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) 58, *Reports on Audited Financial Statements*. This monograph describes the ASB's procedures in establishing the final version of SAS 58 and attempts to depict the salient influences on the board throughout the standard-setting process. The researcher was involved with the ASB during the entire process by attending the relevant ASB meetings and by conducting numerous interviews with ASB members and individuals at the AICPA involved with the project. The researcher also examined written responses to the Exposure Draft (ED) released for comment in 1987, proposing a new standard audit report wording. The project also examines the general evolution of the auditor's report in the United States, as well as the existing research on auditor's reports. The following summary presents the project's major conclusions.

- The majority of the influence on the ASB in arriving at the ED in 1987 was internal to the AICPA—ASB members and the AICPA's Auditor Communications Task Force (TF). The Securities and Exchange Commission (SEC), however, was also noted to affect the wording proposed in the ED by influencing the ASB to eliminate the contemplated reference to "standards established by the AICPA" from the ED. In regard to the letters of comment to the ED, the general reaction to the need for a new audit report was largely positive. Some of the strong overall preferences indicated by commentators were: (1) eliminate from further consideration "intentionally or unintentionally," (2) retain a statement regarding management's role in financial reporting, (3) modify "materially misstated" in the scope paragraph, (4) continue not to mention client's system of internal control in the report, (5) retain additions of "independent" to the title, "reasonable assurance" to the scope paragraph and "in all material respects" to the opinion paragraph, (6) retain "fairly" in the opinion paragraph, (7) retain change from "examined" to "audited," and

(8) restructure the scope paragraph to make it easier to read and understand. Additionally, reaction was largely mixed on the deletion of the reference to consistency in the opinion paragraph. The respondents also noted a marginal agreement with the elimination of the “subject to” qualified report, but indicated that a new report on uncertainties should better emphasize the uncertainty and appropriate footnote disclosures contained in the financial statements.

- It was found that the TF was responsive to the concerns of the ED respondents and offered to the ASB a modified auditor’s report that substantially addressed and potentially resolved these concerns. The exposure process was found to have worked as intended, in that the ASB actually listened to the respondents and gleaned new insight into the potential SAS based on the response letters.

- Outside influences such as the Treadway Commission, SEC, and Financial Executives Institute (FEI) were noted to have affected the board’s discussions, and eventually affected the final wording of the standard report adopted in SAS 58.

- Early research on SAS 58 has been generally favorable regarding the newly adopted report. However, continued research on user’s behavior and perceptions of auditor responsibility is warranted. Research continues to be needed in regard to the SEC’s concern with addressing consistent application of generally accepted accounting principles in the auditor’s report, the elimination of the “subject to” report qualification for uncertainties, and how the new reports affect user understanding and the capital markets.

- Finally, more longitudinal studies similar to this one need to be performed in order to gain additional insight into the standard-setting process at the AICPA in particular, and in accounting in general.

Preface

This research examines the Auditing Standards Board in its process of developing and finalizing *Statement on Auditing Standards (SAS) 58, Reports on Audited Financial Statements*. Very little research has been conducted on how current standard-setters in accounting and auditing arrive at their final adopted standards. The intent of this study has been to present in detail the process of the Auditing Standards Board and the significant influences on the board in establishing this one SAS in the hope that a richer understanding of the standard-setting process would emerge.

Along with studying the standard-setting process, this monograph discusses the development of audit reporting in the United States, as well as provides a thorough review of the research conducted on the auditor's report. The chapter on the evolution of the audit report serves to frame *SAS 58* in its historical context. The literature review has been presented in annotated bibliography format and should serve as a resource for anyone interested in research conducted on audit reports.

I would like to express my appreciation to all of my colleagues in the Pennsylvania State University Ph.D. program for their assistance and willingness to serve on the panels as coders. I am also deeply indebted to Mark Dirsmith and Jim Thies at the Pennsylvania State University for their intellectual stimulation during the project and contributions on earlier drafts. In addition, I am grateful for the financial support provided by Price Waterhouse and Company. I would also like to thank the individuals at the American Institute of Certified Public Accountants, and especially Mimi Blaco-Best, Hank Jaenicke, David Landsittel and Jerry Sullivan for their time and candid participation. I am thankful to the American Accounting Association and American Institute of Certified Public Accountants for granting permission to use parts of this study that were previously published in summary form in *Auditing: A Journal of Practice & Theory* and the *Journal of Accountancy*, respectively. Finally, I want to thank my wife, Sue, for her enduring support and encouragement throughout the project.

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