Auditing Management Assertions: The Impact of SAS No. 106

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The Auditing Standards Board (ASB) of the AICPA recently issued eight new statements on auditing standards (SASs), which are effective for audits of financial statement periods beginning on or after Dec. 15, 2006. Included within this new set of audit standards is SAS No. 106: Audit Evidence, which provides guidance on the use of management assertions in obtaining audit evidence.

The New Risk Assessment Standards
SAS Nos. 104-111, adopted by the ASB of the AICPA in 2006, are known as the “risk assessment standards,” and collectively they make up a new AU§RAS of the AICPA audit guidance. These SASs, effective for audits of financial statement periods beginning on or after Dec. 15, 2006, address a variety of topics, including evidence, risk and materiality, planning and supervision, risk of material misstatement, sampling and evaluation of evidence, among others. SAS No. 106: Audit Evidence defines audit evidence, defines relevant assertions and discusses their use in the audit, discusses qualitative aspects that the auditor considers when determining sufficiency and appropriateness of audit evidence and describes procedures for obtaining audit evidence. Of specific interest in this article is the SAS 106 guidance that specifically addresses management assertions.

Guidance Prior to 2006
Five basic management assertions, as set forth in SAS No. 31: Evidential Matter (as amended by SAS No. 80) have been widely recognized in audits of financial statements for more than 25 years. These familiar assertions are shown in Figure 1. SAS No. 31 presents these five assertions as a bulleted list in paragraph .03, while the discussion that follows in paragraphs .04-.08 provides definitional information, as well as information about their applicability to transactions, account balances and disclosures.

New Guidance
SAS No. 106: Audit Evidence, contains guidance about the use of assertions in obtaining audit evidence. Paragraph 15 sets forth 13 management assertions grouped within three main categories: assertions about classes of transactions and events for the period under audit, assertions about account balances at the period end and assertions about presentation and disclosure. Each assertion enumerated in paragraph 15 includes a brief definition. These assertions are consistent with the management assertions included in International Standard on Auditing (ISA) 500. Figure 2 provides a list of these assertions by category.

What’s the Difference?
At first glance, SAS No. 106 looks very different from SAS No. 31. The important question for practicing auditors is whether these differences create significant changes in the practical application of the guidance. Some of the most obvious differences in the SAS No. 106 guidance on assertions, as compared to SAS No. 31, are (1) the inclusion of three distinct categories for classifying assertions, (2) the inclusion of definitions within the listing of assertions and (3) an increase in the number of assertions. A closer inspection of each of these issues shows that the guidance on assertions provided in SAS No. 106 is not all that different from the guidance in SAS No. 31.

SAS No. 106 sets forth three distinct categories of assertions (transaction-related, account balance-related and presentation and disclosure-related), whereas the guidance in SAS No. 31 lacks a formal classification scheme. Similarly, the list of management assertions in SAS No. 106 includes some brief definitions, whereas the bulleted list of assertions in SAS No. 31 does not. The specification of three distinct categories of assertions and the inclusion of definitions within the assertion list appears to be a significant change until one considers that SAS No. 31 included this information in the discussion in paragraphs .04-.08, it just omitted it from the assertion.
listing in paragraph .03. While the 13 assertions included in SAS No. 106 is a significant increase in number from the five assertions in SAS No. 31, the substance of the collective body of assertions is essentially the same. The increase in number can be explained primarily by the repetition of the same concepts in multiple categories in SAS No. 106. For example, while “completeness” appears as one assertion in SAS No. 31, it appears as three separate assertions in SAS No. 106 – once as a transaction-related assertion, once as a balance-related assertion and once as a sub-component of presentation and disclosure. Figure 3 shows how the 13 assertions from SAS No. 106 map neatly into the five assertions from SAS No. 31. In short, the 13 assertions enumerated in SAS No. 106 cover the same basic information that was previously covered more concisely in SAS No. 31.

While SAS No. 106 does not break much new ground in the management assertion area, the standard does provide a few enhancements to the prior guidance. One notable contribution is in the area of presentation and disclosure. The new guidance provides some additional detail about presentation and disclosure, and adds “understandability” as a component of presentation and disclosure. While presumably “understandability” has been an underlying assertion, this guidance makes that assertion explicit. Similarly, while the concepts of transaction-related assertions, balance-related assertions and presentation and disclosure-related assertions are not new, the use of a formal classification scheme makes these more explicit.

Differential Guidance for Audits of Issuers vs. Audits of Non-Issuers

In 2003, the Public Company Accounting Oversight Board (PCAOB) took over responsibility for promulgating auditing standards for the audits of public companies (issuers), while the ASB of the AICPA continues to promulgate standards for the audits of non-public companies (non-issuers). Initially, the differences in the two sets of standards were minimal, since the PCAOB elected to adopt, on an interim basis, the then-existing auditing standards. However, every time either the PCAOB or the ASB issues new authoritative guidance, the gulf between the two sets of standards gets larger. This issue is particularly problematic for audit firms who conduct audits of both issuers and non-issuers, since keeping track of two distinct sets of audit standards could be confusing. So how will the differential management assertion guidance created by SAS No. 106 affect practitioners?

For audits of issuers, SAS No. 31 continues to provide the applicable guidance on management assertions, while SAS No. 106 is now the guidance applicable to audits of non-issuers. Fortunately, as the preceding examination of the two standards has shown, the practical differences in the two are minimal, so the potential for confusion should also be minimal. Practitioners should not see any real differences in the use of management assertions to obtain audit evidence. If anything, the guidance in SAS No. 106 serves to clarify and
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sharpen concepts that existed, but were not explicitly stated, in the previous SAS No. 31 guidance. That is good news for practitioners, as they prepare to enter the first audit season under the new management assertion guidance.

Endnotes:
1. The only notable difference between the assertions enumerated in SAS 106 and the assertions enumerated in ISA 500 involves assertion c. i., related to presentation and disclosure. Whereas ISA 500 makes an assertion about “disclosed events, transactions, and other matters” the corresponding assertion included in SAS No. 106 is limited to “disclosed events and transactions.”

References:

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