

**Agenda Item 5**

---

---

**Standing Advisory Group Meeting**

**June 21-22, 2004**

**Revision of the GAAS Hierarchy**

---

---

**Introduction**

This memorandum provides members of the Standing Advisory Group ("SAG") with information about the hierarchy of interim auditing standards and interpretive guidance included in the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") interim standards and about the issues associated with reviewing that hierarchy as the PCAOB reviews the interim standards.

**Hierarchy of Auditing Standards and Other Resource Information**

Auditing standards, in general, define a measure of audit quality and establish the objectives the auditor is expected to achieve. Auditing standards also include an explanation of how to achieve the objectives in order to perform a high quality audit.

Prior to the creation of the PCAOB, the American Institute of Certified Public Accountants ("AICPA") developed and issued Statements on Auditing Standards ("SAS") that were regarded by the auditing profession as generally accepted auditing standards ("GAAS"). The AICPA also developed and issued a wide variety of other auditing publications. These included auditing interpretations of the SASs, auditing guidance in AICPA Audit and Accounting Guides, Auditing Statements of Position, Audit Risk Alerts, Auditing Practice Releases, and other non-authoritative practice alerts and implementation guides. Some of these publications were issued under the authority of the ASB, while others were developed and published by other AICPA divisions. A number of

This paper was developed by the staff of the Office of the Chief Auditor in order to foster discussion among the members of the SAG. It is not a statement of the Board; nor does it necessarily reflect the views of the Board or PCAOB staff.

## **BRIEFING PAPER**

third parties also publish auditing guidance in the form of textbooks, implementation guides, audit programs, and audit checklists.

The Public Oversight Board's Panel on Audit Effectiveness (the "Panel"), reviewed the state of auditing literature, and, in 2000, it observed that there was no organized framework establishing the relative authority of the vast array of guidance that was available to auditors. Specifically, the Panel noted that –

**2.220** Various forms of guidance in addition to the SASs are provided to auditors by the AICPA, for the most part under the auspices of the ASB. For example, the ASB's Audit Issues Task Force ("AITF") issues auditing interpretations on the application of the SASs. While these interpretations are reviewed by the ASB, they are not as authoritative as the SASs. In addition, the AICPA from time to time issues other forms of auditing guidance, such as audit and accounting guides, auditing practice releases and statements of position. These other forms of guidance often are related to specific industry issues or accounting pronouncements. Guidance also is provided by the AICPA through other communications (e.g., audit risk alerts), conferences and seminars (e.g., an annual conference on SEC developments), and other means. Textbooks, reference materials, and training materials and courses also are available to auditors from a wide variety of sources.

**2.221** The guidance to auditors in the SASs alone is formidable. Yet many SASs lack imperatives that compel auditors to take definitive steps in specified circumstances. For example, in some cases an SAS may impose an imperative on an auditor by indicating what an auditor definitely "should" do, while in other cases an SAS might only indicate what an auditor "should consider," allowing significant latitude for the exercise of judgment based on the circumstances of the engagement and on the auditor's assessment of risk and materiality.

**2.222** Furthermore, the SASs do not indicate in an organized fashion the vast array of other guidance discussed above that is available to auditors from the AICPA. In addition, some of that other auditing guidance is not readily accessible to auditors, although the AICPA has made efforts to improve retrieval of some of its literature via its website. As a result, auditors might feel less compelled to comply with auditing guidance that goes beyond the SASs and related AITF auditing interpretations. In summary, there

## BRIEFING PAPER

is no formal GAAS "hierarchy" that establishes the authoritative status of auditing pronouncements.<sup>1/</sup>

The Panel recommended that the Auditing Standards Board clearly set forth the body of auditing literature to which auditors would be held. The Panel also recommended that the ASB ensure distribution and accessibility of ASB pronouncements for auditors' use.

The ASB responded to the Panel's recommendations in December 2001 with SAS No. 95, *Generally Accepted Auditing Standards*,<sup>2/</sup> which ascribed one of three cascading levels of authority to each category of then-existing auditing literature, as follows –

**(1) Auditing standards.** Auditing standards consist of the general, fieldwork, and reporting standards approved and adopted by the AICPA membership in 1947 and 1948 (the 10 standards), as amended by the Auditing Standards Board, and the SASs. SAS No. 95 ascribed the highest level of authority to this category.

**(2) Interpretative publications.** Interpretative publications consist of –

- Auditing Interpretations of the SASs, adopted by the ASB;
- Appendices to the SASs, adopted by the ASB;
- Auditing guidance included in AICPA Audit and Accounting Guides created under the supervision of the ASB; and
- AICPA Auditing Statements of Position.

SAS No. 95 ascribed second-tier authority to this category, providing that an "auditor should be aware of and consider" certain interpretive publications and that, if an auditor does not follow guidance in an applicable interpretive publication "the auditor should be prepared to explain how he or she complied with the SAS provisions addressed by such auditing guidance."

**(3) Other auditing publications.** Other auditing publications include AICPA auditing publications not considered to be interpretive publications, auditing articles in the *Journal of Accountancy* and other professional

---

<sup>1/</sup> See "The Panel on Audit Effectiveness, Report and Recommendations, August 31, 2000," pages 69-71.

<sup>2/</sup> SAS No. 95 is located in AICPA, *Professional Standards*, vol. 1 (AU sec. 150), page 81.

## **BRIEFING PAPER**

journals; auditing articles in *The CPA Letter*, continuing professional education programs and other instruction materials, textbooks, guide books, audit programs, and checklists; and other auditing publications from state CPA societies, other organizations, and individuals. While the ASB described these publications for purposes of considering the full panoply of literature available on auditing, the ASB did not ascribe an "authoritative status" to such publications. Instead, SAS No. 95 merely recommended that auditors consider such publications to "help the auditor understand and apply the SASs."

The Sarbanes-Oxley Act changed this landscape dramatically, by shifting the authority to establish auditing and related professional practice standards for the preparation and issuance of audit reports of public companies to the PCAOB. Those requirements that the PCAOB adopts as standards require SEC approval and thus have the effect of federal law.

In order to provide for an orderly transition, the Board adopted as interim standards the AICPA's auditing standards, as described in SAS No. 95 and as they existed on April 16, 2003. (See PCAOB Rule 3200T.) Thus, although a variety of sources may publish new auditing literature, auditors' obligation under SAS No. 95 to comply with the SASs and to consider interpretative publications extends only to those SASs and interpretive publications that were adopted by the ASB on or before April 16, 2003.

The PCAOB has begun developing new and amended standards to address those areas of auditing in which the Congress specifically demanded improvement. Over time the PCAOB will also develop new and amended standards in other areas, based, among other things, on the SAG's review of the interim standards. In addition to considering new substantive auditing and related professional practice issues, however, the PCAOB also will need to consider what sorts of other guidance should be available to auditors to promote a high level of understanding about appropriate application of PCAOB standards.

### **Discussion Questions –**

1. What kind of guidance should be available to help auditors and others interpret PCAOB standards?
2. How should we manage the fact that there is existing guidance on interim standards that has some authority today but may become superseded or outdated over time?