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Auditing Standards Board (ASB) meeting, July 30-August 1, 2013, Chicago, IL; Highlights (ASB) meeting, July 30-August 1, 2013

American Institute of Certified Public Accountants. Auditing Standards Board

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AUDITING STANDARDS BOARD (ASB) MEETING

July 30-August 1, 2013

Chicago, IL

MEETING ATTENDANCE

ASB Members

Bruce Webb, *Chair*
Hunter Cook
Sam Cotterell (7/30-31 only)
Jim Dalkin
Jack Fuchs
Jennifer Haskell
Sandra Johnigan
Ed Jolicoeur
Ilene Kassman
Ryan Kaye
Barbara Lewis
Carolyn H. McNerney
David Miller
Don M. Pallais
Marc Panucci
Mike Santay
Chris Smith
Kay W. Tatum
Kim Tredinnick

AICPA Staff

Jim Brackens, *VP - Ethics & Practice Quality* (8/1 only)
Linda Delahanty, *Audit & Attest Standards*
Ahava Goldman, *Audit & Attest Standards*
Hiram Hasty, *Audit & Attest Standards*
Chuck Landes, *Audit & Attest Standards*
Richard Miller, *Special Counsel*
Andy Mrakovcic, *Audit & Attest Standards*
Judith Sherinsky, *Audit & Attest Standards*
Linda Volkert, *PCPS Technical Issues Committee*

Observers and Guests

Dora Burzenski, *Deloitte & Touche LLP*
Julie Anne Dilley, *PwC LLP*
Harrison Greene, *FDIC* (7/30 only)
Diane Hardesty, *Ernst & Young LLP* (by phone)
Susan Jones, *KPMG LLP*
Maria Manasses, *Grant Thornton LLP*
Tammy Mooney, *Thompson Reuters* (by phone)
Paul Penler, *Ernst & Young LLP*

Chair's Report

Mr. Landes and Mr. Webb provided an update on matters of interest to the ASB. Ms. Haskell reported on the work of the Task Force updating AU section 9336, *Using the Work of a Specialist*, interpretation 1, *The Use of Legal Interpretations As Audit Evidence to Support Management's Assertion That a Transfer of Financial Assets Has Met the Isolation Criterion in Paragraphs 7-14 of FASB ASC 860-10-40*.

The ASB approved the May highlights, subject to the addition to the highlights of the ASB's affirmation of the AITF recommendation not to clarify AT 701.

1. AT 301

Mr. Pallais, Chair of the Attestation Task Force, presented a second draft of proposed clarified

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AT section 301, “Financial Forecasts and Projections” (chapter 5, of the clarified attestation standards).

The ASB directed the task force to:

- Add to the draft the following material from the AICPA Guide *Prospective Financial Information*:
 - Paragraph 10.14, which requires the practitioner to consider whether the responsible party has a reasonably objective basis for the forecast and whether sufficiently objective assumptions can be developed for each key factor.
 - Paragraph 7.01P, which indicates that in a financial projection the responsible party need not have a reasonably objective basis for the hypothetical assumptions and that generally, as the number or significance of the hypothetical assumptions increases, the less likely that it is appropriate for the responsible party to present a financial projection.
 - Paragraph. 17.12, which indicates that if the practitioner does not believe that an assumption is suitably supported, the practitioner should assess its effect on the interrelationships of assumptions and on the financial forecast taken as a whole.
- Consider moving the definition of the term *entity* from the “Definitions” section of the draft to an application paragraph because that term may be too generic to be included in the “Definitions” section
- Review the draft and determine whether each use of the term “prospective financial statements” and “prospective financial information” is being used appropriately
- List, in paragraph 5.22, all of the report elements for an examination of prospective financial information and in paragraph 5.30, all of the report elements for an agreed-upon procedures engagement related to prospective financial information. The draft presented to the ASB at its July 30-August 1, 2013 meeting included only those elements that are supplementary to the report elements required by paragraph 2.52 of proposed chapter 2, “Examination Engagements” and paragraph 4.25 of proposed chapter 4, “Agreed-Upon Procedures Engagements.”
- Prepare a revised draft of proposed chapter 5 for discussion at the October 2013 ASB meeting at which time the ASB expects to vote to ballot the draft for comment.

2. AT 401

Mr. Pallais presented a first draft of proposed clarified AT section 401, “Reporting on Pro Forma Financial Information” (chapter 6 of the clarified attestation standards).

The ASB directed the task force to do the following:

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- Consider whether there are requirements for the content of pro forma financial information outside of those established by article 11 of Regulation S-X.
- Consider whether International Standard on Assurance Engagements (ISAE) 3420, *Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus*, provides requirements for criteria that should be incorporated or adapted for AT 401.
- Consider whether there are elements of the practitioner's understanding required by ISAE 3420 that should be incorporated in AT 401.
- For paragraphs related to examinations of pro forma financial information, wherever the text states that the assumptions should provide a reasonable basis for presenting the significant effects directly attributable to the transaction (or event), also indicate that the assumptions should be suitably supported.
- Add an application paragraph linked to paragraph 6.4(a) that explains what "suitably supported" means.
- Replace the word "management" in paragraph 6.4 with "responsible party" and indicate in an application paragraph that in chapter 6, the responsible party is management of the entity whose pro forma financial information the practitioner is reporting on.
- Indicate in an application paragraph linked to paragraph 6.5 that in a review of pro forma financial information, the practitioner is not responsible for concluding that the assumptions are suitably supported. However management is responsible for having suitable support for its assumptions.
- Confer with Dan Noll, Director AICPA Accounting Standards, to develop a definition of "pro forma adjustments."
- Add an application paragraph linked to paragraph 6.8 based on paragraph A9 of AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, to explain what the phrase "readily available" means with respect to historical interim financial information.
- Retitle the heading above paragraph 6.9 to state: "Understanding the Entity's Accounting and Financial Reporting Policies."
- Make the following revisions to paragraph 6.9:
 - Indicate that the practitioner reporting on the pro forma financial information should have an appropriate level of knowledge of the accounting and financial reporting practices of the entity (each significant constituent part of a combined entity).

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- Delete the words indicating that an appropriate level of knowledge is one that ordinarily would have been obtained by a practitioner auditing or reviewing historical financial statements of each entity for the most recent annual or interim period for which the pro forma financial information is presented.
- Clarify that the audit or review performed by another practitioner would have been for the most recent annual or interim period for which the pro forma financial information is presented (or the most recent annual or interim period of a significant constituent part of a combined entity)
- Reinstate paragraph 15 of AT section 401, which addresses pro forma financial information prepared using the pooling of interests method because ASC 805, *Business Combinations*, contains scope exclusions, for example a combination between entities under common control for which the acquisition method of accounting method would not be applicable.
- List in paragraph 6.12 all of the report elements for an examination of pro forma financial information and in paragraph 6.13, all of the report elements for a review of pro forma financial information. The draft presented to the ASB at its July 30-August 1, 2013 meeting included only those elements that are supplementary to the report elements required by paragraph 2.52 of proposed chapter 2, “Examination Engagements” and paragraph 3.43 of proposed chapter 3, “Review Engagements”. The ASB directed that this revision be reflected in all topic-specific chapters.
- Prepare a revised draft of proposed chapter 6 for discussion at the October 2013 ASB meeting.

3. AT 501

Maria Manasses, a member of the Attestation Task Force, presented a first draft of proposed clarified AT section 501, *An Examination of an Entity’s Internal Control Over Financial Reporting That is Integrated with an Audit of Its Financial Statements* (chapter 7 of the clarified attestation standards). The ASB directed the task force to do the following:

- Redraft AT section 501 as an auditing standard with the intention of moving it out of the attestation standards, provided that the GAO and FDIC do not have significant reservations concerning this approach. Harrison Greene of the FDIC, who attended the ASB meeting, offered to consult with FDIC legal counsel and the other federal banking agencies to determine whether moving AT section 501 from the attestation standards to the auditing standards would require a change in law (Section 36 of the FDI Act) or regulation (Part 363). Jim Dalkin also offered to hold some discussions with the GAO on this matter.

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- With respect to references to COSO, refer to the framework more broadly. The examples may refer to the 2013 COSO framework. In addition, include a reference to the GAO's "Standards for Internal Control in the Federal Government" (Green Book) as additional acceptable criteria for internal control.
- Discuss with the Internal Audit Task Force the interplay between the proposed auditing standard related to using the work of internal audit and the requirements and guidance related to using the work of internal audit and others currently in AT section 501.
- Drop the option to examine and report on management's assertion. The auditor should be required to examine and report directly on internal control.

In consideration of moving AT section 501 to the auditing standards, the ASB directed that a task force be formed to consider developing a generic attestation standard that addresses reporting on internal control, other than internal control over financial reporting.

The ASB also had the following observations, in addition to certain other editorial comments. The Board recognized that the comments provided may not fully apply if AT section 501 is moved to the auditing standards.

- In paragraph 7.3, reference paragraph 7.A2 in the first bullet. Also, correct the reference to chapter 8, which does not address the examination of controls over compliance.
- In paragraph 7.6, add an objective related to the auditor's communication responsibilities, considering the objectives in chapter 2.
- In paragraph 7.9, refer to "an engagement to examine internal control" in lieu of "an examination of internal control." Consider such references throughout. Also, with respect to management's support for its assertion, refer to management's evaluation procedures in addition to management's documentation.
- In paragraph 7.12, remove the reference to "simultaneously." Also, consider whether references to the "period-end" throughout the proposed standard should be replaced with a clearer reference to the date of management's assertion.
- In paragraph 7.A22, add additional guidance with regard to the "period of reliance" as it relates to a financial statement audit.
- In paragraph 7.A29, consider aligning the language more closely with the extant language to be clearer as to the auditor's consideration of deficiencies.
- In paragraph 7.A30, clarify the meaning of "separate evaluations."
- Move paragraph 7.31 to the application guidance and reference the related requirement within the auditing standards.

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- In paragraph 7.A55, use a different term other than “alternative” controls.
- Delete paragraph 7.A56.
- Revise paragraph 7.A66 to essentially indicate that an individual control does not necessarily have to operate without any deviation to achieve its control objective and be considered effective.
- Move paragraph 7.42 to the application guidance and link it to paragraph 7.41; consider the guidance in 7.A72
- Make paragraph 7.47 a subset of paragraph 7.46.
- In paragraph 7.A85, indicate that compensating controls “need to” operate at a level of precision that would prevent, or detect and correct, a material misstatement.
- Delete the last sentence of paragraph 7.56.
- Insert the word “reasonable” before the word “assurance” in paragraph 7.61
- In paragraph 7.62, include a comprehensive list of the reporting elements; the current draft of AT section 501 contains only the report elements supplementary to the report elements in chapter 2. In addition, align the language with the changes proposed in the illustrations (e.g., management’s responsibility for designing, implementing, and maintaining internal control).
- In paragraph 7.75 (and throughout), refer to the group engagement team in lieu of “auditor,” as applicable.
- Include application guidance related to the requirement in paragraph 7.77 to clarify what is meant by disclosing the magnitude of the portion of internal control audited by the component auditor.
- After the word “if,” insert the words “the auditor believes” in paragraph 7.79
- In paragraph 7.80, keep the reference to the requirements in chapter 2 related to other information and material misstatements of fact.
- Consider use of the term “conditions” versus “facts” in reference to subsequent events within paragraph 7.81-7.83. This includes considering the guidance in AU-C 560, *Subsequent Events and Subsequently Discovered Facts*.
- Reconsider paragraph 7.A113 so that it does not contradict 7.A116; the paragraphs may need to be closer and aligned with the top-down approach.

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- In paragraph 7.A111 replace the term “practitioner’s” and replace with “auditor’s.” Search for the appropriate use of the terms throughout the proposal.
- In paragraph 7.87, consider the use of the term “equity method investment components.”
- In paragraph 7.89, clarify that management has also chosen to exclude the acquired entity (that is, management has chosen the regulatory exemption).
- In paragraph 7.94, add application guidance related to clarify complementary versus redundant controls. In addition, clarify the related requirement.
- In paragraph 7.96, provide guidance with respect to what constitutes a “significant period of time.” Consider whether this is addressed in the PCAOB’s questions and answers documents.
- Clarify the intent of the guidance in paragraph 7.A137.
- In Example 4 of Exhibit A, reconsider the format of the disclaimer of opinion, including the use of headers (the Board was concerned with separating the disclaimer from the material weakness and also indicating that all material weakness may not have been identified).
- In Example 5 of Exhibit A, consider language that refers to the use of the work of other auditors in the last paragraph that references the financial statement audit report.
- In the illustrative communication of significant deficiencies and material weaknesses in Exhibit B, include the definition of material weakness. Make the illustration as consistent as possible with AU-C 265, including addressee and signature blocks.
- Move Exhibit C, “Reporting Under Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA),” to an appendix. Also, further clarify why the report is restricted when reporting on controls at the IDI level and the financial statement audit is performed at the holding company level (consider the views of the AICPA Financial Institutions Expert Panel).
- In Exhibit D, refer to the “framework” in general within the example, and provide a footnote illustrating a more specific reference (similar to the illustrative auditor’s reports).

The intent is to present a revised standard at the October 2013 ASB meeting. However, this will be dependent on the timing of the GAO’s and FDIC’s feedback regarding whether AT section 501 can be moved to the auditing standards.

4. AT 601

Mr. Pallais presented a draft of proposed clarified AT section 601, “Compliance Attestation”

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(chapter 8 of the clarified attestation standards).

The ASB directed the task force to do the following:

- In paragraph 8.1(c) and elsewhere in the document delete the words “effectiveness of” in the phrase “effectiveness of an entity’s internal control over compliance” because the engagements in AT section 601 do not address that subject matter. (AT section 601 provides for an agreed-upon procedures engagement related to an entity’s internal control over compliance but not the effectiveness of such internal control.) Also delete paragraph 8.A5 which addresses criteria for evaluating the effectiveness of internal control.
- Delete paragraph 8.A8 because the topic of accumulating sufficient appropriate evidence to restrict attestation risk is already covered in chapter 2, “Examination Engagements,” of the exposure draft *Attestation Standards: Clarification and Recodification* (ED).
- Revise paragraph 8.7, which contains the objective of an agreed-upon procedures engagement related to compliance, to conform to paragraph 4.6 of the ED.
- Add an application paragraph to the definition of *material noncompliance* in paragraph 8.8(c) to indicate that governments or other requirements may contain a specific definition of *material noncompliance* for the purpose of the particular engagement.
- Align the language in paragraph 8.12, which addresses reasonable assurance, with text in the clarified auditing standards that addresses the same topic.
- Delete paragraphs 8.28–8.31 and the related application paragraphs because they address the requirement to obtain a written assertion in an agreed-upon procedures engagement related to compliance. The ASB concluded that although paragraph 11 of extant AT section 601 requires an assertion in an agreed-upon procedures engagement related to compliance, it should not be required in clarified AT section 601. (A written assertion is not required by chapter 4, “Agreed-Upon Procedures Engagements,” of the ED for other agreed-upon procedures engagements.) Also, delete from paragraph 8.32 the representations in items *c* and *d* because they relate to a written assertion in an agreed-upon procedures engagement related to compliance.
- Prepare a revised draft of proposed chapter 8 for discussion at the October 2013 ASB meeting at which time the ASB expects to vote to ballot the draft for comment.

5. AT 801

Due to time restrictions, the discussion of AT 801 was deferred to the October 2103 ASB meeting.

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6. IAASB Update

Hiram Hasty provided an update on the activities of the IAASB. Mike Santay and Linda Delahanty provided an update on the IAASB's project on auditor's reporting. The ASB discussed methods of obtaining input to the ASB's comment letter on the IAASB exposure draft; task force members will speak to interested parties, such as TIC.

Marc Panucci and Mr. Hasty discussed going concern, including the FASB and IAASB projects on this topic.

Susan Jones provided an update on the work of the IAASB Other Information (section 720) Task Force.

7. Executive Session

Mr. Brackens gave a presentation on the future of practice monitoring.

The meeting adjourned at 12:30 pm on Thursday, August 1, 2013.