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Auditing Standards Board (ASB) meeting, October 15-17, 2013, Scottsdale, AZ; Highlights (ASB) meeting, October 15-17, 2013

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AUDITING STANDARDS BOARD (ASB) MEETING

October 15-17, 2013

Scottsdale, AZ

MEETING ATTENDANCE

ASB Members

Bruce Webb, *Chair*

Hunter Cook (10/15 only)

Sam Cotterell

Jack Fuchs

Sandra Johnigan

Ed Jolicoeur (10/15-16 only)

Ilene Kassman

Ryan Kaye

Barbara Lewis

Carolyn H. McNerney

David Miller

Don M. Pallais

Marc Panucci

Mike Santay

Kay W. Tatum

Kim Tredinnick

Absent

Jim Dalkin

Jennifer Haskell

Chris Smith

AICPA Staff

Mike Buddenbeck, *General Counsel*

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

Sally Ann Bailey, *Deloitte & Touche LLP*

Julie Anne Dilley, *PwC LLP*

Chris Halterman, *Ernst & Young LLP* (10/16 am only)

John Keyser, *McGladrey LLP*

David Johnson, *Ernst & Young LLP*

Susan Jones, *KPMG LLP*

Maria Manasses, *Grant Thornton LLP*

Tammy Mooney, *Thompson Reuters*

Paul Penler, *Ernst & Young LLP*

Megan Zietsman, *Deloitte & Touche LLP* (10/17 only)

Chair's Report

Mr. Landes and Mr. Webb provided an update on matters of interest to the ASB, including the AITF liaison meeting with FASB and GASB on October 11 and recent activities of IAASB.

The ASB approved the July highlights subject to adding that a project to consider an attestation standard to specifically address examinations of internal control would not be under the purview of the Attestation (Clarification) Task Force.

Outgoing members Kim Tredinnick, Sam Cotterell and Ed Jolicoeur were thanked for their years of service.

Liaison Meeting

The ASB met with the Assurance Services Executive Committee and discussed issues of mutual interest.

1. AT 301, Financial Forecasts and Projections

Mr. Pallais, Chair of the Attestation Task Force, presented a ballot draft of proposed clarified AT section 301, “Financial Forecasts and Projections” (chapter 5 of the proposed clarified attestation standards).

The ASB directed the task force to make the following revisions:

- Revise the required representation in paragraph 5.23(b) to indicate that “the assumptions on which the projection is based are appropriate and the assumptions other than the hypothetical assumptions are reasonable and suitably supported.”
- In paragraph 5.25(e)(ii) replace “forecast” with “prospective financial information based on the examination” and delete the rest of the paragraph, starting with the word “about.”
- In paragraph 5.25(f)(ii), replace the phrase “presented in all material respects in conformity with the criteria referenced in the report” with “free from material misstatement based on the AICPA presentation guidelines.”
- Delete the sentence in paragraph 5.25(h) requiring the practitioner to include a paragraph in the practitioner’s report that provides a description of the matter(s) giving rise to the modification. Also delete paragraph 5.A32. Both are redundant with chapter 2, “Examination Engagements” of the exposure draft *Attestation Standards; Clarification and Recodification* (ED).
- Include in paragraph 5.26 a requirement that the practitioner’s report should identify the hypothetical assumptions.
- Clarify in paragraph 5.A7 that the presentation guidelines in paragraph 3.23 of the AICPA Guide *Prospective Financial Information* establish a limitation on the use of a partial presentation, which is in addition to the restricted-use alert in the practitioner’s report on prospective financial information.
- Move the last part of paragraph 5.A12, indicating that- 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- to a separate application paragraph linked to the definition of “financial projection” in paragraph 5.9(b).

- In paragraph 5.A21, delete the words “for which there is no external evidence” and, at the end of the paragraph, add the words “and therefore need to be confirmed by the responsible party.”
- In paragraph 5.A30, add “the failure to disclose a significant assumption” to the list of matters for which a qualified opinion may be difficult to interpret.
- Delete paragraph 5.A31.

The ASB voted unanimously to ballot the proposed standard for exposure.

2. AT 401, Pro Forma

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

The ASB directed the task force to make the following revisions:

- Indicate in paragraph 6.1 that chapters 1, “Concepts Common to All Attestation Engagements” and 4, “Agreed-Upon Procedures Engagements” of the attestation standards are applicable when a practitioner is performing an agreed-upon procedures engagement related to pro forma financial information.
- Add the term “criteria for the preparation of pro forma financial information” in paragraph 6.6 as a separate term defined as, “The basis disclosed in the pro forma financial information that management used to develop the pro forma financial information.”
- In paragraph 6.8(a), insert the phrase “or such financial statements are readily available” after the word “available.”
- Clarify in paragraph 6.8(b) that in an examination the practitioner should determine whether the historical financial statements on which the pro forma financial information is based have been audited, and in the case of a review, whether the historical financial statements have been audited or reviewed.
- In the last sentence of paragraph 6.8(b) delete the phrase “incorporated by reference” and insert the phrase “is readily available” at the end of the subparagraph.
- Add the following precondition for an examination engagement to paragraph 6.8.

“The practitioner should expect to be able to obtain the understanding of the matters set forth in paragraph 6.11(b) to perform the procedures necessary to report on the pro forma financial information.”

- In paragraph 6.10 insert “or should obtain” after the word “have” and insert the phrase, “or in the case of a business combination” after the word “entity.”
- In paragraph 6.11(h), replace “determine that” with “evaluate whether” and replace the second use of the word “that” with the word “whether.”
- In the last sentence of paragraph 6.11(i) change “applicable” to “permitted.”
- Revise paragraph 6.13(g) as follows
 - A reference to the financial statements from which the historical financial information is derived and a statement that such financial statements were audited ~~or reviewed, and if applicable~~ (The report on pro forma financial information **should** refer ~~a reference~~ to any modification in the practitioner's report on the historical financial statements information.) In the case of a business combination, this paragraph applies only to significant constituent parts of the combined entity.
- Delete the sentence in paragraph 6.13((m) requiring the practitioner to include a paragraph in the practitioner’s report that provides a description of the matter(s) giving rise to the modification. That requirement is already in chapter 2 of the exposure draft *Attestation Standards; Clarification and Recodification* (ED) and is not needed.
- Clarify in paragraph 6.A7 that the reference to AU section 722, *Interim Financial Information* is a reference to the AU section in the PCAOB’s interim auditing standards. Also clarify that for nonissuers, the review may be an interim or annual review as defined in AR Section AR Section 60, *Framework for Performing and Reporting on Compilation and Review Engagements*.
- Delete the last sentence in paragraph 6.A8.
- In the first sentence of paragraph 6.A9 replace the word “assumptions” with the phrase “pro forma adjustments.”
- In paragraph 6.A11 replace the phrase “in some cases” with the phrase “if considered necessary in the circumstances.”
- Redraft paragraph 6.A20 to refer to “a business combination accounted for in a manner similar to a pooling-of-interests” rather than “a pooling of interests” because a business combination for which there is no common control could be accounted for in a manner similar to a pooling of interests. Ryan Kaye will provide wording for that paragraph. Also repeat the revised paragraph as application guidance for paragraph 6.13(j)(ii)(1).
- In paragraph 6.A22, modify the illustrative reports as follows:

- move the phrase “pro forma financial information” in parenthesis to follow the word “ended,” and insert the word “related” before the phrase “pro forma condensed statement of income” in the first paragraph of examples 1-4 and 6.
- replace the phrase “incorporated by reference” with the phrase “and are readily available” in the first paragraph of examples 1-4 and 6.
- replace “financial information” with “amounts” in the second paragraph of example 2.
- insert “X Company’s management is responsible for the pro forma financial information. Our responsibility is to express a conclusion based on our review” at the end of the third paragraph in example 3.
- insert the word “related” before the phrase “pro forma condensed statement of income” wherever that phrase is used in the illustrative reports.
- replace “estimated net realizable value” with “fair value less cost to sell” in the first paragraph of example 5.

The ASB voted unanimously to ballot the proposed standard for exposure.

3. AT 501

Maria Manasses, a member of the Attestation Task Force (Task Force), led the ASB in a discussion of issues related to AT section 501, *An Examination of an Entity’s Internal Control Over Financial Reporting That is Integrated with an Audit of Its Financial Statements*, including Interpretation No. 1 of AT section 501, “Reporting Under Section 112 of the Federal Deposit Insurance Corporation Improvement Act” (AT section 9501). The ASB at its July 2013 meeting had instructed the Task Force to consider moving AT section 501 to the auditing standards.

Ms. Manasses reported the following based on her inquiries to the FDIC and GAO. The FDIC has no significant reservations concerning this approach. Ms. Manasses reported that Mr. Dalkin is continuing to seek feedback within the federal government, but the Task Force believes that it can move forward as directed by the ASB.

Based on this feedback, the ASB agreed that

- the content from the attestation standard should be issued as a separate auditing standard and that conforming amendments to the other SASs should be limited to amendments to AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*, and to AU-C sections that already refer to AT 501 or to an audit of internal control audit.
- AU-C 905, *Alert That Restricts the Use of the Auditor’s Written Communication*, would apply to the clarified SAS.

- the proposed SAS should contain guidance about how the auditor would adapt and apply the risk assessment model and certain other SASs to an integrated audit.

The ASB directed Ms. Volkert to ask the AICPA PCPS Technical Issues Committee whether it is aware of situations in practice in which two different CPAs perform a split AT 501 engagement—one reporting on the financial statement audit and the other reporting on the audit of internal control. This will assist the ASB in deciding whether to continue to permit two different practitioners for such engagements. Further, the ASB confirmed its decision to establish a separate task force to develop an internal control examination standard under the attestation standards.

A first draft of the proposed auditing standard is expected to be brought to the ASB in May 2014.

4. AT 601, Compliance Attestation

Mr. Pallais presented a draft of proposed clarified AT section 601, “Compliance Attestation” (chapter 8 of the proposed clarified attestation standards).

The ASB directed the task force to make the following revisions:

- Delete paragraph 8.4(d).
- Revise paragraph 8.6 so that it is consistent with the language in the effective-date paragraphs of the other subject-matter specific chapters.
- Revise paragraph 8.7 so that it begins with the words “In an examination of an entity’s compliance,” and revise the second bullet by inserting the words “in a written report” after the word “opinion.”
- Delete paragraphs 8.13 and 8.A12-A14 because attestation risk is covered in chapter 2.
- Place the heading “Materiality” before paragraph 8.14.
- In paragraphs 8.14 and 8.A14, replace the phrase “in planning and performing the engagement” with “when establishing the overall engagement strategy.”
- In paragraph 8.19, delete the phrase “the following” and add the words “about compliance contained in” to indicate that the practitioner is performing subsequent events procedures that only relate to compliance.
- In paragraph 8.22, replace “applicable” with “permitted.”

- Delete the sentence in paragraph 8.24(g) requiring the practitioner to include a paragraph in the practitioner's report that provides a description of the matter(s) giving rise to the modification because that requirement is already in chapter 2.
- Conform paragraph 8.28 to paragraph 8.15.
- Reinstate, in paragraph 8.29, a requirement to obtain a written representation indicating that the responsible party has performed an evaluation of the entity's compliance and its controls for establishing and maintaining internal control over compliance.
- Insert the words "agreed-upon procedures engagement and the date of the" after the words "covered by the" in paragraph 8.29(f).
- Move paragraph 8.30 into chapter 3, "Review Engagements" of the clarified attestation standards, when that chapter is revised after exposure.
- In paragraph 8.31 indicate that if management is required by law or regulation to have an agreed-upon procedures engagement and will not provide the requested written representations, the practitioner should disclose that fact in his or her report. Also insert the words "related to compliance," after the first use of the word "engagement"
- In paragraph 8.33 (l) delete the sentence that begins "When the engagement is also performed in accordance with government standards."
- Move paragraph 8.A3 to follow the paragraphs that contain the contents of paragraph 8.A4 (see below).
- Restructure paragraph 8.A4 by:
 - ending the paragraph after the sentence "Chapter 1 requires that the criteria be suitable and available"
 - placing the wording that addresses an examination of internal control over compliance in a separate paragraph.
- In paragraph 8.A7 replace the word "Establishing" with the words "Designing, implementing."
- Repeat paragraph 8.A30 (regarding documentation) in an application paragraph after paragraph 8.A9.
- In paragraph 8.A36, modify the illustrative reports as follows:
 - insert the words "on XYZ's compliance" after the word "opinion" in the first paragraph of the report in example 1.

- delete the words “management’s assertion” in parentheses in the first paragraph of the report in example 2.

The ASB voted unanimously to ballot the proposed standard for exposure.

5. AT 801

Mr. Pallais, Chair of the Attestation Task Force (Task Force), presented a draft of proposed clarified AT section 801, “Reporting on Controls at a Service Organization”.

The ASB concluded that revisions to the draft to align with proposed AU-C section AU-C 610, *Using the Work of Internal Auditors*, should not be made until that AU-C section is finalized. The ASB also confirmed that the alternative to obtaining the required written representations provided for in paragraph 2.42(b) of the proposed clarified attestation standards should not be permitted in an AT 801 engagement and that management of the service organization’s refusal to furnish the written required representations constitutes a limitation on the scope of the engagement.

The ASB directed that the Task Force to make the following revisions:

- Clarify that management’s assertion may be attached to or included in the description of the system.
- Delete appendix B, which contains illustrative reports with qualified opinions. Those reports will be included in the AICPA Guide *Service Organizations: Reporting on Controls at a Service Organization Relevant to User Entities’ Internal Control Over Financial Reporting*.
- Revise paragraphs 10.3 and 10.A4 of the draft to refer the service auditor to chapter 2 of the proposed clarified attestation standards for reporting guidance when (1) a user entity (rather than management of a service organization) defines the controls and (2) management of the service organization will not provide an assertion about the suitability of the design of the controls.
- Revise paragraphs 10.39 and 10.40 to require, for situations in which a service organization uses the carve-out method to present a subservice organization, that the service auditor’s report include a statement disclaiming an opinion on controls at the subservice organization.
- Reinstate paragraph 42 of extant AT 801 which addresses subsequent events, and include an application paragraph explaining that paragraph 42 is more restrictive than paragraph 2.39 of the proposed clarified attestation standards which requires only that the practitioner take appropriate action in the circumstances.
- In the third bullet of paragraph 10.A37, change the word “emphasis” to “explanatory.”

- In the paragraph of the illustrative report in example 1 of appendix A that describes the service auditor's responsibilities, delete the words "in all material respects" to conform with the report requirements in chapter 2 and make the same change wherever that phrase is included in the paragraph describing the service auditor's responsibilities.

Mr. Haltermann, Chair of the AICPA Trust Services/Data Integrity Task Force provided input on certain issues. The ASB voted to ballot the proposed standard for exposure, subject to discussions with the Service Organizations Guide Task Force about certain revisions.

6. Internal Auditors

Megan Zietsman, chair of the Internal Auditors Task Force ("Task Force"), led the ASB in a discussion of the major issues arising from the comment letters received in connection with the exposure of AU-C 610, *Using The Work of Internal Auditors*.

The following is a summary of the matters discussed.

Background

Ms. Zietsman provided a brief background of the project. The proposed SAS was issued for exposure in April 2013. The exposure period ended in July 2013, and the Task Force received 23 comment letters.

Issues

Use of Terms

Responders to the exposure draft raised the issue that the terms used to describe the internal audit function and internal auditors used in a direct assistance capacity were not clear and in some cases were used inconsistently throughout the proposed SAS. In response, the Task Force made amendments to the terms and headers in the proposal to make it clearer. The term *Internal Audit Function* was amended by the Task Force to "*Internal Audit Function in Obtaining Audit Evidence*." The ASB discussed the edits to the term, and after discussion, agreed with the edits suggested by the Task Force.

Direct Assistance - Excluded or Significantly Modified ISA 610 Requirements

At the ASB's direction, the following requirements from ISA 610, *Using the Work of Internal Auditors*, were either not included in the proposed SAS or the requirements included in the proposed SAS were significantly modified from the corresponding ISA paragraphs: ISA 30 (excluded), ISA 31 (amended), and ISA 33 (excluded). With respect to the ISA paragraphs 30 and ISA 31, the ASB reaffirmed its previous decisions, and no further changes to the paragraphs were made. With respect to paragraph 33, after discussion, the ASB made the following decisions:

- Paragraph 33a – The ASB decided to reinsert the requirement of the ISA which will require the auditor that prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor will be required to obtain a written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor’s instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor. Additionally, the ASB instructed the Task Force to develop application material that explains that the written agreement may be included in the engagement letter or other forms of agreement.
- Paragraph 33b – The ASB instructed the Task Force to include as application guidance the notion to obtain a written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.
- Paragraph 32 – The ASB agreed with the Task Force’s suggestion to reinsert the paragraph in the proposed SAS.

References to Threats and Safeguards

In response to comments received, the Task Force considered and analyzed all the use of “threats and safeguards” term in the proposed SAS. The Task Force made certain editorial changes to better align the wording in the proposed SAS with the terminology used in Section ET 100-1, but did not make any additional changes based on prior discussions with the ASB on this topic. The ASB agreed with the Task Force’s suggested edits.

Next Steps

The Task Force intends to present a revised SAS to the ASB at the January 2014 meeting for the purpose of voting out the proposed SAS as a final standard.

7. AU-C section 315 Amendments

Mr. Hiram Hasty led a discussion of the proposed amendments to AU-C 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AUC 315), as a result of the issuance in May 2013 of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control – Integrated Framework.

The following is a summary of the matters discussed.

Issues

Mr. Hasty explained that since 1992, the COSO Framework has been referred to in the SASs, specifically AU-C 315 and its predecessors. The Task Force raised the issue whether AU-C 315 should be framework neutral or aligned to the COSO Framework. The issue is particularly

important in assessing the need to incorporate the concept of principles introduced in the COSO Framework.

The ASB discussed that the reference to the COSO Framework in the SASs was intended to be neutral, that is, the SASs did not preclude entities and auditors to use another framework. After discussion, the ASB decided that AU-C 315 should continue to be framework-neutral.

With respect to the notion of principles, Mr. Landes explained that the focus of the COSO Framework is to provide guidance to entities in establishing an *effective* internal control. In that context, the principles are an integral part of the COSO Framework. This is distinguished from the requirement in AU-C 315 which is for the auditor to obtain an understanding of internal control and *evaluate its design* and determine whether it is in operation. After discussion, the ASB decided that no requirement for the auditor to consider the principles should be included in AU-CAUC 315. The ASB instructed the Task Force consider adding the principles as application guidance.

The ASB discussed that AT 501 is also affected by the COSO Framework, and it directed that Task Force to address the issue.

8. Auditor's Reports and Going Concern

Mr. Santay, Chair of the Auditor Reporting Task Force, provided the ASB with an update on the IAASB and PCAOB auditor reporting projects and presented a draft comment letter on the IAASB's exposure draft *Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing (ISAs)*.

The ASB provided the task force with the following feedback:

Cover Letter

- Consider including an additional consideration in the ASB's framework set forth in the cover letter that states changes need to be capable of consistent and clear application.

Key Audit Matters

- Because the ASB's purview is that of audits of nonissuers, the comments on key audit matters (KAM) should be limited.

Going Concern

- Consider whether further details should be included in the going concern section that expand on the reasons for requesting the IAASB to delay their changes until the proposed changes to the accounting standards have been vetted and finalized.

Independence

- Consider adding a statement that disclosing the source of independence and ethical requirements would have limited value to users of the auditor's report.

Name of the Engagement Partner

- Consider adding a discussion about the litigious environment in the United States.

The ASB asked to see a revised draft of the comment letter before the letter is submitted.

Mr. Panucci provided an update on the current status of the FASB's going concern project, as described by the FASB at the liaison meeting with AITF on October 11, 2013.

The meeting adjourned at 1pm.