



Agenda Item 3

Discussion Memo: Proposed Clarified Attestation Standards

This discussion memo addresses both the clarified general Statements on Standards for Attestation Engagements (attestation standards) (chapters 1-4) and the subject-matter-specific attestation standards (chapters 5-7). Don Pallais, Chair of the Attestation Recodification Task Force (task force), will begin the discussion with the subject-matter specific attestation standards, which are addressed on page 5 of this memo.

General Attestation Standards: Chapters 1-4

Objective

1. To discuss
 - a. a draft of chapters 1-4 of the July 24, 2013 exposure draft *Attestation Standards: Clarification and Recodification* (ED), marked from the draft presented to the Auditing Standards Board (ASB) at its October 21-23, 2014 meeting
 - b. a draft of the preface to the attestation standards marked from the ED (The preface was not discussed at the October 21-23, 2014 ASB meeting and is therefore marked from the ED)
2. To obtain a sense from the ASB about whether it believes the January 12, 2015 draft of chapters 1-4 of the proposed clarified attestation standards appropriately reflects the conclusions reached by the ASB during its discussions of issues related to these chapters. (The ASB will not be asked to vote to ballot chapters 1-4 at this meeting.)

Background

In clarifying the attestation standards, the ASB began by clarifying the general attestation standards, which provide a framework for performing and reporting on examination, review, and agreed-upon procedures engagements. The requirements and application guidance in chapter 1, "Concepts Common to All Attestation Engagements," of the proposed clarified attestation standards are applicable to any attestation engagement. Examination, review, and agreed-upon procedures engagements are addressed in separate chapters (chapter 2, "Examination Engagements;" chapter 3, "Review Engagements;" and chapter 4, "Agreed-Upon Procedures Engagements"). These chapters build on the common concepts chapter and include performance and reporting requirements and application guidance tailored to the specific type of engagement. The subject-matter specific chapters (chapters 5-7) build on chapters 1-4.

The term *chapters* rather than *sections* is used in the ED; however, ultimately the clarified chapters will be codified in AICPA *Professional Standards*, and will be referred to as AT sections.

Agenda Materials

The agenda materials for the discussion of the ED are the following:

- Item 3A: Chapter 1, "Concepts Common to All Attestation Engagements," marked from the October 21, 2014 draft
- Item 3B: Chapter 2 "Examination Engagements," marked from the October 21, 2014 draft
- Item 3C: Chapter 3 "Review Engagements," marked from the October 21, 2014 draft
- Item 3D: Chapter 4 "Agreed-Upon Procedures Engagements," marked from the October 21, 2014 draft
- Item 3E: "Preface to the Attestation Standards," marked from the ED

Issues Related to the July 24, 2013 ED

1. Management's Assertion and Written Representations in an Agreed-Upon Procedures Engagement

Revised chapter 4 reflects the following conclusions reached by the ASB at its October 2014 meeting.

- The practitioner should request a written assertion from the responsible party in all agreed-upon procedures engagements, regardless of whether the engaging party is the responsible party.
- In all agreed-upon procedures engagements, if the responsible party is unwilling to provide the practitioner with a written assertion, the practitioner may perform the engagement, but would be required to indicate in the practitioner's report that the responsible party did not provide the practitioner with a written assertion. Doing so enables the specified parties to consider such information in determining whether the engagement met their objectives, for example, they might determine that additional procedures or an examination or review engagement needs to be performed. (It should be noted that even when the practitioner obtains a written assertion, it is rarely shared with the specified parties.)
- In all agreed-upon procedures engagements the practitioner would be required to request the written representations included in paragraph 4.27. (The representation in paragraph 4.27a is the same as management's assertion.)

If the responsible party is the engaging party and the responsible party is unwilling to provide one or more the written representations in paragraph 4.27, or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, the practitioner would not be required to withdraw from the engagement but would be required to

- discuss the matter with the appropriate party(ies)
- reevaluate the integrity of those from whom the representations were requested or received and the effect, if any, on the engagement
- take appropriate actions, including determining the possible effect on the practitioner's report.

If the responsible party is not the engaging party and the responsible party is unwilling to provide one or more of the written representations in paragraph 4.27, the practitioner

would be required to make inquiries of the responsible party about, and seek oral responses to the matters in paragraph 4.27. If one or more of the requested representations are not provided in writing or orally from the responsible party, the practitioner is directed to determine the effect on the practitioner's report.

Paragraph 4.A14 has been added to chapter 4 to indicate that written representations that include the assertion are sufficient to fulfill the requirement to obtain a written assertion and that a separate written assertion is necessary only when called for by the engagement circumstances. Similar paragraphs have been added to chapters 2 and 3 in paragraphs 2.A6 and 3.A6, respectively.

Using the Work of Internal Auditors

Chapter 2 contains the following requirements regarding using the work of internal auditors:

2.39 When the practitioner expects to use the work of the internal audit function, the practitioner should determine whether the work of the internal audit function can be used for purposes of the examination by

- a. evaluating
 - i. the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors;
 - ii. the level of competence of the internal audit function; and
 - iii. the application by the internal audit function of a systematic and disciplined approach, including quality control.
- b. performing sufficient procedures, including reperformance, on the body of work of the internal audit function that the practitioner plans to use to evaluate whether such work is adequate for the practitioner's purposes. (Ref: par. 2.A41-2.A43)

2.40 When using internal auditors to provide direct assistance to the practitioner, the practitioner should direct, supervise, and review the work of the internal auditors.

At its October 2014 meeting the ASB considered adapting and adding additional requirements from AU-C 610, *Using the Work of Internal Auditors*, to chapter 2 and was asked to provide suggestions regarding what should be included. The following summarizes the suggestions from three ASB members. (There was no consensus; each suggestion was made by either one or two 2 members.)

- AU-C 610.15: Consider the work already performed or planned by the internal audit function to determine the areas and the extent to which the work of the internal auditors can be used.
- AU-C 610.17: Plan to use less of the internal audit function's work in areas involving more judgment, higher risk of material misstatement, or when the internal audit function is less objective or has a lower level of competence.
- AU-C 610.18: Evaluate whether the use of the work of the internal audit function would result in insufficient auditor involvement in the audit.
- AU-C 610.20: When planning to use the work of the internal audit function to obtain evidence, discuss the planned use with the function to coordinate activities

- AU-C 610.24: Before the conclusion of the audit, evaluate the appropriateness of the auditor's initial conclusions about the internal audit function and the nature and extent to which the auditor should use its work.
- AU-C 610.25: Evaluate the objectivity and competence of internal auditors who will be providing direct assistance.
- AU-C 610.27: Consider the objectivity and competence of the internal auditors, the risk of material misstatement, and the amount of judgment required to perform audit tests when determining the work to be assigned to internal auditors providing direct assistance and their supervision and review.
- AU-C 610.29: Evaluate whether the planned use of internal auditors to provide direct assistance and to obtain evidence would result in insufficient auditor involvement in the audit.
- AU-C 610.30: Prior to using work of the internal audit function for direct assistance, obtain written acknowledgement from management that the entity will not intervene in the work the internal auditors perform for the auditor.
- AU-C 610.31: The auditor should direct, supervise, and review the work of internal auditors providing direct assistance.

Chapter 3 does not have an equivalent discussion of using the work of internal auditors, but paragraph 3.28 states that the practitioner should apply the requirements and application guidance in chapter 2 regarding using the work of internal auditors [and specialists], as appropriate, for a review engagement. To the extent that chapter 2 provides more detailed guidance it might be necessary to more definitively consider how the work of internal auditors could be used in a review. Given that a review service consists largely of inquiries and analytical procedures, it could be argued that the enhanced discussion effectively prohibits any meaningful use of the internal audit function to obtain evidence or for direct assistance in a review engagement.

Question

Should additional material from AU-C 610 be adapted and added to chapter 2 so that it would be applicable to all examination and, indirectly, all review engagements? If so, which requirements and application guidance should be added?

3. Communications

Par 2.77 would require that when the responsible party is not the engaging party, fraud, suspected fraud, internal control deficiencies, and illegal acts be communicated to the engaging party. At the October 2014 ASB meeting, questions were raised regarding whether such communications would violate the confidentiality requirements of the AICPA Code of Professional Conduct. The task force has made inquiries of the AICPA Professional Ethics Executive Committee (PEEC) and will report the ultimate results at the January 2015 ASB meeting.

Subject-Matter Specific Attestation Standards

Objective

1. To discuss a draft of chapters 5-7 marked from the January 28, 2014 exposure draft *Subject-Matter Specific Attestation Standards: Clarification and Recodification ED*.
2. To obtain feedback from the ASB that will enable the Attestation Recodification Task Force to revise the draft.
3. To obtain a sense from the ASB about whether it would be prepared to ballot chapters 5-7 for issuance the January 12, 2015 draft as modified to reflect this discussion. (The vote to ballot would be taken at a future ASB meeting)

Background

To continue the process of clarifying the attestation standards, the ASB issued the January 28, 2014 ED which includes the following chapters of the proposed attestation standards

- Chapter 5, "Financial Forecasts and Projections" (clarifies AT section 301)
- Chapter 6, "Reporting on Pro Forma Financial Information" (clarifies AT section 401)
- Chapter 7, "Compliance Attestation" (clarifies AT section 601)

The titles of the chapters are the same as the titles of the extant AT sections.

Agenda item 3F is a summary of the comments on the January 28, 2014 ED, and agenda items 3G-3I are drafts of chapters 5-7, respectively, marked to show the changes made to the ED in response to certain comments.

The primary changes to the ED are in chapter 5. Those changes include the addition of definitions excepted from, and requirements based on, the AICPA guide *Prospective Financial Information*. In addition, based on certain comments, the task force deleted the option to qualify the opinion in an examination of prospective financial information

**Subject-Matter Specific Attestation Standards Not Included
in the January 28, 2014 ED**

AT section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, 701, *Management's Discussion and Analysis*, and 801, *Reporting on Controls at a Service Organization*, were not included in the January 28, 2014 ED. The ASB is redrafting AT section 501 as a Statement on Auditing Standards (SAS) and moving it to the SASs because it addresses an examination of internal control that is integrated with an audit of financial statements. An ED was issued in September 2014. AT section 701 has not been clarified because practitioners report that they rarely perform these engagements. AT section 701 will be retained in the attestation standards in its current form. AT section 801 was exposed for comment in September 2014 in a separate exposure draft titled, "Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting."

Agenda Materials

The agenda materials for the discussion of the ED are the following:

- Item 3F Summary of Comments on the ED
- Item 3G Chapter 5, "Financial Forecasts and Projections" (clarified AT 301)
- Item 3H Chapter 6, "Reporting on Pro Forma Financial Information" (clarified AT 401)
- Item 3I Chapter 7, "Compliance Attestation" (clarifies AT section 601)

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