



## Agenda Item 6

### **Consideration by the Practitioner of the Adequacy of Disclosures under the Proposed Clarified Attestation Standards**

#### **Objective of Agenda Item**

To discuss the possible amendments to the proposed clarified attestation standards to include a requirement regarding the practitioner's consideration of the adequacy of disclosures in the subject matter or assertion when relevant (e.g., when the subject matter or assertion is in the form of a management report or management-prepared presentation that accompanies the practitioner's report).

#### **Background**

In conjunction with the ASB Sustainability Task Force's project to develop a guide/standard on performing attestation engagements on sustainability information, the task force identified what it believes to be an absence of a principle in the attestation standards for the consideration by the practitioner as to the adequacy of disclosures in the subject matter or assertion and brought the matter to the attention of the AITF. The Sustainability Task Force was requested to draft proposed changes to chapters 1-3 for the Attestation Task Force's consideration given the implications for the draft sustainability information guide/standard.

In considering various sustainability-related matters and other attestation engagements, members of the Sustainability Task Force concluded the practitioner needs to consider the adequacy of disclosure even when the criteria do not contain requirements for certain disclosure(s) that may be necessary for users to understand, interpret and use the information.

Some practitioners believe that such lack of disclosure requirements renders the criteria unsuitable. However, it is unlikely that any set of criteria can be developed that will address every practice issue or fact pattern that may arise in an organization using the criteria and, accordingly, the responsible party needs to exercise judgment in determining what additional information is necessary for the presentation or assertion to be understandable, interpretable and useable. This concept is recognized in AU-C 200.14 in the description of 'financial reporting framework', which states that "[t]he term fair presentation framework is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and (a) acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework...."

Adequacy of disclosure is a relevant concern when the subject matter or management's assertion is in the form of a management report or management-prepared presentation that accompanies the practitioner's report. The Sustainability Task Force recognizes that in some

attestation engagements (e.g., SOC 3 reports), there is simply the practitioner's short-form report without any accompanying management report. But in other attestation engagements, such as pro forma financial statements, SOC 2 reports and sustainability reports, the adequacy of disclosure should be a relevant consideration in reaching an opinion or conclusion.

The Sustainability Task Force also identified several places in the auditing standards in which the practitioner is to consider the adequacy of disclosures that go beyond that required by the criteria [e.g., AU-C 800.17 (see extract below)] and in the proposed clarified attestation standards in which the practitioner is effectively required to consider the adequacy of disclosures concerning subsequent events.

### **AU-C Section 800 — Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks**

#### **Fair Presentation (Ref: [par. .A19–A23](#))**

.17 [Section 700](#) requires the auditor to evaluate whether the financial statements achieve fair presentation. In an audit of special purpose financial statements when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the auditor should evaluate whether the financial statements include informative disclosures similar to those required by GAAP. The auditor should also evaluate whether additional disclosures, **beyond those specifically required by the framework**, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation.

The practitioner is also required under paragraphs 2.58 and 3.41 of the draft clarified attestation standards (pre-meeting drafts distributed on June 10, 2015) to evaluate whether the written description of the subject matter or assertion adequately refers to or describes the applicable criteria, which can also be viewed as a form of disclosure.

Additionally, the Sustainability Task Force concluded that the attestation standards should recognize that management has a responsibility to interpret the criteria and determine whether disclosures beyond those required by the criteria may be necessary, which might be accomplished as application guidance to the discussion of criteria in paragraph 1.25 of chapter 1.

### **Issue for ASB Discussion**

Members of the Sustainability Task Force concluded that the practitioner should consider the adequacy of disclosure even when the criteria do not contain requirements for certain disclosure(s) that may be necessary for users to understand, interpret and use the information. Accordingly, it would appear that a general principle of considering the adequacy of disclosures should be included in the attestation standards as a requirement or, at a minimum, as application guidance.

Consider the following straight-forward example of a possible attestation engagement:

**Example:**

The common criteria for reporting the size of floor space is square feet. Such criteria has no specific disclosure requirements yet is considered suitable criteria for measurement; however, the quantity of a particular space is not understandable, interpretable or useful unless additional context is provided (e.g., disclosures) regarding how the criteria is applied (e.g., whether between interior walls vs. exterior walls) and other matters pertinent to the particular situation (e.g., a ranch house that is stated to be 2,000 square feet vs. the same ranch house that is stated to be 2,000 square feet of which 1,000 square feet is a finished basement—the latter would be viewed very differently, particularly by those interested in living space on one level or who don't like basements). How should the practitioner conclude whether the responsible party's assertion that the ranch house is 2,000 square feet is fairly stated if the practitioner only considers the measurement? While one might argue that the requirement in paragraphs 2.59 and 3.42 would require the practitioner, in evaluating the adequacy of the description of the applicable criteria, to consider whether the way in which it is applied is described, it would not require the practitioner to evaluate whether it might be necessary to disclose that half of such space is in the basement of the house.

There are several possible options to deal with this issue in the attestation standards:

1. Include a requirement to evaluate whether disclosures are informative of matters that affect the use, understanding and interpretation of the subject matter or assertion.
2. Incorporate such principle as application guidance concerning evaluating the subject matter or assertion in the clarified attestation standards rather than as a requirement.
3. Do nothing and let the practitioner determine whether there are additional considerations beyond what the standards describe.

**Option 1:**

The Sustainability Task Force favors including the principle as a requirement in the attestation standards as the best option for the profession both in serving the public interest and in guiding the practitioner through engagement risks that might arise from a lack of adequate disclosure. The task force has illustrated how that might be accomplished by the proposed changes to paragraphs 1.25, 2.59 and 3.42 (and related application paragraphs, as well as to paragraphs 2.A16 and 3.A15) of the draft clarified attestation standards shown below. If the ASB members believe that such a principle should be included as a requirement, then it is a matter of determining whether due process on such a requirement is necessary and, if so, whether a separate exposure draft should be prepared on this matter.

The matrices below show existing sections of chapters 1, 2 and 3 (based on the pre-meeting drafts distributed on June 10, 2015) where the task force concluded that requirements and application guidance could be added regarding evaluating whether additional disclosures are necessary to use, understand and interpret the subject matter or assertion. New paragraphs

are underlined; added text to existing paragraphs is shown in bold, underlined text, and proposed deletions are shown in double strikethrough text.

<b>Chapter 1, Concepts Common to All Attestation Engagements</b>	
<b>Requirements</b>	<b>Application and Explanatory Material</b>
<p><b>Preconditions for an Attestation Engagement</b></p> <p>...</p> <p><b>1.25</b> In order to establish that the preconditions for an attestation engagement are present, the practitioner should determine both of the following:</p> <p style="margin-left: 20px;">a. ...</p> <p style="margin-left: 20px;">b. The engagement exhibits all of the following characteristics:</p> <p style="margin-left: 40px;">i. The subject matter is appropriate. (Ref: par. 1.A35–1.A40)</p> <p style="margin-left: 40px;">ii. The criteria to be applied in the preparation and evaluation of the subject matter are suitable and will be available to the intended users. (Ref: par. 1.A41–1.A51)</p>	<p><b>Preconditions for an Attestation Engagement</b></p> <p>...</p> <p><b>1.A46</b> Regardless of who establishes or develops the criteria, the responsible party or the engaging party is responsible for selecting the criteria, and the engaging party is responsible for determining that such criteria are appropriate for its purposes. (Ref: par. 1.25b(ii))</p> <p><b>1.A46a</b> <u>It may be necessary for the responsible party to provide disclosures beyond those specifically required by the criteria. While it is desirable for the criteria to recognize explicitly or implicitly that disclosures other than those specifically provided for in the criteria may be necessary to enable the intended users to use, understand and interpret the subject matter or assertion, the absence of such recognition in the criteria does not make the criteria not suitable. For example, where amounts presented are subject to significant measurement uncertainty, it may be necessary for related disclosures to reflect the extent of uncertainty associated with the amount disclosed, even though such disclosures may not be required by the criteria. Such additional disclosures may be necessary because, although it is assumed that the intended users of the subject matter or assertion understand that inherent measurement uncertainties are involved in measuring or evaluating the subject matter, it cannot be assumed that the intended users are aware of the extent of such uncertainties. (Ref: par. 1.25b(ii)).</u></p> <p>...</p>

<b>Chapter 2, Examination Engagements</b>	
<b>Requirements</b>	<b>Application and Explanatory Material</b>
<p><b>Materiality in Planning and Performing the Engagement</b></p>	<p><b>Materiality in Planning and Performing the Engagement</b></p> <p>...</p> <p><b>2.A16</b> In general, misstatements, including omissions, are considered to be material if,</p>

<p><b>2.16</b> When establishing the overall engagement strategy, the practitioner should consider materiality for the subject matter. (Ref: par. 2.A14-2.A20)</p>	<p>individually or in the aggregate, they could reasonably be expected to influence relevant decisions of intended users that are made based on the subject matter. The practitioner’s consideration of materiality is a matter of professional judgment and is affected by the practitioner’s perception of the common information needs of intended users as a group. In this context, it is reasonable for the practitioner to assume that intended users</p> <ul style="list-style-type: none"> <li>a. have a reasonable knowledge of the subject matter and a willingness to study the subject matter with reasonable diligence.</li> <li>b. understand that the subject matter is measured or evaluated and examined to appropriate levels of materiality and have an understanding of any materiality concepts included in the applicable criteria.</li> <li>c. understand <del>any</del> <b>that</b> inherent uncertainties <b>may be</b> involved in measuring or evaluating the subject matter, <b>although the intended user may not be aware of the extent of such uncertainties.</b></li> <li>d. make reasonable decisions on the basis of the subject matter taken as a whole.</li> </ul> <p>Unless the engagement has been designed to meet the particular information needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered. (Ref: par. 2.16)</p> <p>...</p>
<p><b>Forming the Opinion</b></p> <p><b>2.59</b> The practitioner should form an opinion about whether the subject matter is in accordance with [or based on] the criteria, in all material respects, or the assertion is fairly stated, in all material respects, whether due to error or fraud. In forming that opinion, the practitioner should evaluate</p> <ul style="list-style-type: none"> <li>a. the practitioner’s conclusion regarding the sufficiency and appropriateness of evidence obtained; <del>and</del> (Ref: par. 2.A69)</li> <li>b. <b><u>whether disclosures are informative of matters that affect the use, understanding and interpretation of the subject matter or assertion; and</u></b> (Ref: par. 2.A69a)</li> <li>c. whether uncorrected misstatements are material, individually or in aggregate. (Ref: par. 2.A70)</li> </ul>	<p><b>Forming the Opinion</b></p> <p><b>2.A69</b> The practitioner’s professional judgment regarding what constitutes sufficient appropriate evidence... (Ref: par. 2.59a)</p> <p><b>2.A69a</b> <u>In forming the opinion, the practitioner considers whether the subject matter or assertion is informative of matters that affect the use, understanding and interpretation of such subject matter or assertion, including whether it may be necessary for the responsible party to provide disclosures beyond those specifically required by the criteria.</u><sup>1</sup> (Ref: par. 2.59b)</p> <p><b>2.A70</b> An examination engagement is a cumulative and iterative process... (Ref: par. 2.59<b>bc</b>)</p>

**Chapter 3, Review Engagements**

<sup>1</sup> Paragraph 1.A46a of chapter 1, “Concepts Common to All Attestation Engagements.”

Requirements	Application and Explanatory Material
<p><b>Materiality in Planning and Performing the Engagement</b></p> <p><b>3.14</b> The practitioner should consider materiality when</p> <ul style="list-style-type: none"> <li>• planning and performing the review engagement, including when determining the nature, timing, and extent of procedures.</li> <li>• evaluating whether the practitioner is aware of any material modifications that should be made to the subject matter in order for it to be in accordance with the criteria.</li> </ul> <p>(Ref: par. 3.A13-3.A18)</p>	<p><b>Materiality in Planning and Performing the Engagement</b></p> <p>...</p> <p><b>3.A15</b> In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence relevant decisions of intended users that are made based on the subject matter. The practitioner’s consideration of materiality is a matter of professional judgment and is affected by the practitioner’s perception of the common information needs of intended users as a group. In this context, it is reasonable for the practitioner to assume that intended users</p> <ul style="list-style-type: none"> <li>a. have a reasonable knowledge of the subject matter and a willingness to study the subject matter with reasonable diligence.</li> <li>b. understand that the subject matter is measured or evaluated and reviewed to appropriate levels of materiality and have an understanding of any materiality concepts included in the applicable criteria.</li> <li>c. understand <del>any</del><b>that</b> inherent uncertainties <b>may be</b> involved in measuring or evaluating the subject matter, <b>although the intended user may not be aware of the extent of such uncertainties</b>.</li> <li>d. make reasonable decisions on the basis of the subject matter taken as a whole.</li> </ul> <p>Unless the engagement has been designed to meet the particular information needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered.</p> <p>(Ref: par. 3.14)</p> <p>...</p>
<p><b>Forming the Conclusion</b></p> <p><b>3.42</b> The practitioner should form a conclusion about whether the practitioner is aware of any material modifications that should be made to the subject matter in order for it to be in accordance with the criteria or to the assertion. In forming that conclusion, the practitioner should evaluate</p> <ul style="list-style-type: none"> <li>a. the practitioner’s conclusion regarding the sufficiency and appropriateness of the review evidence obtained; <del>and</del> (Ref: par. 3.A52)</li> <li>b. <b><u>whether disclosures are informative of matters that affect the use, understanding and interpretation of the</u></b></li> </ul>	<p><b>Forming the Conclusion</b></p> <p><b>3.A52.</b> The practitioner’s professional judgment regarding what constitutes sufficient appropriate review evidence.... (Ref: par. 3.42a)</p> <p><b>3.A52a</b> In forming the conclusion, the practitioner considers whether the subject matter or assertion is <u>informative of matters that affect the use, understanding and interpretation of such subject matter or assertion, including whether it may be necessary for the responsible party to provide disclosures beyond those specifically required by the criteria.</u><sup>2</sup> (Ref: par. 3.42b)</p> <p><b>3.A53.</b> A review engagement is a cumulative and</p>

<sup>2</sup> Paragraph 1.A46a of chapter 1, “Concepts Common to All Attestation Engagements.”

<p><b>subject matter or assertion; and (Ref: par. 3.A52a)</b></p> <p>c. whether uncorrected misstatements are material, individually or in the aggregate. (Ref: par. 3.A53)</p>	<p>iterative process.... (Ref: par. 3.42g)</p>
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Option 2:

If the application guidance route is taken, in addition to the changes to par. 1.A46a, 2.A16c and 3.A15c proposed in Option 1 above, the following proposed changes to chapter 2 and 3 are suggested to incorporate the principle of adequate disclosure as application guidance rather than as an explicit requirement.

Chapter 2, Examination Engagements	
Requirements	Application and Explanatory Material
<p><b>Forming the Opinion</b></p> <p><b>2.59</b> The practitioner should form an opinion about whether the subject matter is in accordance with [or based on] the criteria, in all material respects, or the assertion is fairly stated, in all material respects, whether due to error or fraud. In forming that opinion, the practitioner should evaluate</p> <ul style="list-style-type: none"> <li>a. the practitioner’s conclusion regarding the sufficiency and appropriateness of evidence obtained and (Ref: par. 2.A69)</li> <li>b. whether uncorrected misstatements are material, individually or in aggregate. (Ref: par. 2.A70)</li> </ul> <p>(Ref: par. 2.A69-2.A71)</p>	<p><b>Forming the Opinion</b></p> <p><b>2.A69</b> The practitioner’s professional judgment regarding what constitutes sufficient appropriate evidence is...</p> <p>(Ref: par. 2.59a)</p> <p><b>2.A69a</b> <u>In forming the opinion, the practitioner may consider whether the subject matter or assertion is informative of matters that affect the use, understanding and interpretation of such subject matter or assertion, including whether it may be necessary for the responsible party to provide disclosures beyond those specifically required by the criteria.</u> (Ref: par. 2.59a)</p> <p><b>2.A70</b> An examination engagement is a cumulative and iterative process...</p> <p>(Ref: par. 2.59b)</p>

Chapter 3, Review Engagements	
Requirements	Application and Explanatory Material
<p><b>Forming the Conclusion</b></p> <p><b>3.42.</b> The practitioner should form a conclusion about whether the practitioner is aware of any material modifications that should be made to the subject matter in order for it to be in accordance with the criteria or to the assertion. In forming that conclusion, the practitioner should evaluate</p> <ul style="list-style-type: none"> <li>a. the practitioner’s conclusion regarding the sufficiency and appropriateness of the review</li> </ul>	<p><b>Forming the Conclusion</b></p> <p><b>3.A52.</b> The practitioner’s professional judgment regarding what constitutes sufficient appropriate review evidence.... (Ref: par. 3.42a)</p> <p><b>3.A52a</b> <u>In forming the conclusion, the practitioner may consider whether the subject matter or assertion is informative of matters that affect the use, understanding and interpretation of such subject matter or assertion, including whether it may be</u></p>

<p>evidence obtained; and (Ref: par. 3.A52) b. whether uncorrected misstatements are material, individually or in the aggregate. (Ref: par. 3.A53)</p>	<p><u>necessary for the responsible party to provide disclosures beyond those specifically required by the criteria.</u><sup>3</sup> (Ref: par. 3.42a)  <b>3.A53.</b> A review engagement is a cumulative and iterative process.... (Ref: par. 3.42b)</p>
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Option 3:

The Sustainability Task Force concluded that doing nothing does not serve either the profession or the public interest well. Although this has implications on attest engagements for many different types of subject matters, more importantly, the lack of such a requirement or application guidance in chapters 1 through 3 makes it difficult to include either a requirement or application guidance in the draft sustainability information guide/standard regarding the consideration of the adequacy of disclosure.

**Questions for the ASB:**

1. Do you agree that option 1 is the best option and, if so,
  - a. Are the proposed changes to chapters 1-3 of such a magnitude that exposure of the proposed changes is necessary?
  - b. If exposure is necessary, should a separate exposure draft be constructed or conforming amendments be exposed in conjunction with any possible exposure draft on sustainability information and, if so, who should take responsibility for such drafting and analysis of responses?
2. Alternatively, is option 2 preferred by the ASB members and, if so, are the proposed changes to chapters 1-3 appropriate for inclusion in the version of the attestation standards to be balloted for issuance?

<sup>3</sup> Paragraph 1.A46a of chapter 1, "Concepts Common to All Attestation Engagements."