



## Agenda Item 1

### Discussion Memo: Proposed Clarified Attestation Standards

#### Objective of Agenda Item 1

To vote to ballot for final issuance the November 12, 2015 drafts of the preface and chapters 1-4 of the July 24, 2013 exposure draft *Attestation Standards: Clarification and Recodification*, chapters 5-7 of the January 28, 2014 exposure draft *Subject-Matter Specific Attestation Standards: Clarification and Recodification*, and chapter 8 of the September 18, 2014 exposure draft *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting: Clarification and Recodification*.

At its October 13-15, 2015 meeting, the ASB tentatively agreed that it would be willing to vote to ballot the draft attestation standards for issuance as a final standard, subject to revisions to the draft to respond to the ASB's comments and to implement a change in the requirement regarding written assertions. That change would revise chapters 2, "Examination Engagements," and 3, "Review Engagements," to provide that when the responsible party is not the engaging party, the responsible party's refusal to provide a written assertion would not require the practitioner to withdraw from the engagement. Instead, the practitioner would be required to (1) disclose in the practitioner's report that the responsible party refused to provide a written assertion and (2) restrict the use of the report. The ASB's discussion during the November 23 conference call will focus on revisions made to the draft to implement the change to the requirement regarding written assertions.

Revisions to the proposed attestation standards to implement the change in the requirement to obtain a written assertion were developed by a small ad hoc group of ASB members. This discussion memo describes those proposed changes and the rationale for them.

The attached drafts of the preface and chapters 1-8 of the proposed attestation standards have been marked from the October 13, 2015 draft to show proposed changes resulting from the ASB's decision regarding written assertions; the ASB's comments on the draft during its October meeting; and other changes identified by staff, the ASB chair, and ASB task force members. The drafts are provided for context but the discussion is expected to be limited to paragraphs implementing the revised assertion requirement.

#### Approach.

The ASB's decision regarding written assertions is based on the approach taken in the extant attestation standards, and like those standards, permits the practitioner to report in an examination or review engagement without obtaining a written assertion if the responsible party is not the engaging party and use of the report is restricted. Because that decision is not based on a conceptual foundation established elsewhere in the professional literature, its application could not be based on consistency with other existing literature. Nonetheless, the ad hoc group determined that it should not be entirely arbitrary. The group's decision model was to maintain consistency with other decisions the ASB has made during its deliberations over the past 4

years. The ASB's acceptance of the rest of the draft in October and the discussion of the assertion issue at that meeting did not suggest it intended to challenge anything else at this late stage of the project. Accordingly, the items for discussion presented in this paper involve how to apply the decision regarding written assertions to other requirements in the draft that might be affected

**Basic Requirement**

The basic requirement in the proposed attestation standards is to request a written assertion from the responsible party in all examination and review engagements. Refusal to provide an assertion results in the practitioner's withdrawal from the engagement when the responsible party is the engaging party. When the responsible party is not the engaging party, the practitioner may complete the engagement but is required to restrict the use of the report.

The overall requirement is contained in paragraph 2.10 for examinations (as shown below) and an identical requirement is contained in paragraph 3.11 for reviews.

2.10 The practitioner should request from the responsible party a written assertion about the measurement or evaluation of the subject matter against the criteria. When the responsible party is also the engaging party and refuses to provide a written assertion, paragraph 2.79 requires the practitioner to withdraw from the engagement when withdrawal is possible under applicable laws and regulations. When the responsible party is not the engaging party, the responsible party's refusal to provide a written assertion requires the practitioner to disclose that refusal in the practitioner's report and restrict the use of the report to the engaging party.

The detailed requirements for this rule are described in paragraph 2.82-2.84 and analogous guidance is provided in paragraphs 3.59-3.60.

<p><b>Engaging Party is Responsible Party and Refuses to Provide Assertion</b></p> <p>2.82 If the responsible party is also the engaging party and does not provide the practitioner with a written assertion, as required by paragraph 2.10, the practitioner should withdraw from the engagement when withdrawal is possible under applicable laws and regulations. (Ref: par. 2.A110 and 2.10)</p> <p>2.83 If law or regulation does not allow the practitioner to withdraw from the engagement, the practitioner should disclaim an opinion.</p>	<p><b>Engaging Party is Responsible Party and Refuses to Provide Assertion</b></p> <p>2.A110 Paragraph 2.84 addresses situations in which the engaging party is not the responsible party and the responsible party refuses to provide a written assertion. (Ref: par. 2.82)</p>
<p><b>Engaging Party is Not Responsible Party and Refuses to Provide Assertion</b></p> <p>2.84 When the responsible party is not the engaging party and refuses to provide the</p>	<p><b>Engaging Party is Not Responsible Party and Refuses to Provide Assertion</b></p> <p>2.A111 The following is an example of the disclosure required by paragraph 2.64</p>

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practitioner with a written assertion, the practitioner may report on the subject matter but should disclose in the practitioner's report the responsible party's refusal to provide a written assertion. (Ref: par. 2.A111, 2.10, 2.63[iii])

Attestation standards established by the American Institute of Certified Public Accountants require that we request a written statement from [*identify the responsible party*] stating that [*identify the subject matter*] that we examined has been accurately measured or evaluated. We requested that [*identify the responsible party*] provide such a written statement but [*identify the responsible party*] refused to do so. (Ref: par. 2.84)

Paragraph 2.84 makes it explicit that the exception can be used only when reporting on the subject matter; it cannot be used when reporting on the assertion.

#### **Rationale for Withdrawal**

Although chapters 2 and 3 require the practitioner to withdraw from the engagement when a responsible party that is also the engaging party refuses to provide a written assertion, they do not describe the rationale for the requirement.

Previous drafts indicated that the refusal resulted in a scope limitation. This seems inconsistent with a conclusion that sufficient appropriate evidence could be obtained when the responsible party is not the engaging party.

Although paragraph 58 of extant AT 101 cautions the practitioner to consider whether without a written assertion sufficient evidence can be obtained, the draft already requires consideration of the sufficiency of evidence. Inclusion of the consideration of the sufficiency of evidence here would not add a substantive requirement. The following paragraphs, for example, discuss this matter in chapter 2 (chapter 3 provides analogous guidance):

2.46 The practitioner should evaluate the sufficiency and appropriateness of the evidence obtained in the context of the engagement and, if necessary, attempt to obtain further evidence. The practitioner should consider all relevant evidence, regardless of whether it appears to corroborate or to contradict the measurement or evaluation of the subject matter against the criteria. (Ref: par. 2.A49–2.A53)

2.47 If the practitioner is unable to obtain necessary further evidence, the practitioner should consider the implications for the practitioner's opinion in paragraphs 2.68-2.81.

2.59 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. In forming that opinion, the practitioner should evaluate

- a. the practitioner's conclusion regarding the sufficiency and appropriateness of evidence obtained; and (Ref: par. 2.A71)
- b. whether uncorrected misstatements are material, individually or in aggregate. (Ref: par. 2.A72)

The direct engagement materials distributed for the October ASB meeting suggested that the reason withdrawal was required in such circumstances was that it violated the preconditions for the engagement.

In proposing the revisions to the draft related to a written assertion, the ad hoc group chose not to state why withdrawal is necessary in order to provide future Boards with maximum flexibility in developing a direct engagement standard.

### **Withdrawal in Reviews**

Although chapter 3 of the draft calls for withdrawal when a responsible party that is also the engaging party refuses to provide a written assertion, in some cases that might not be possible under law or regulation. In the analogous case regarding examinations the practitioner is required to issue a disclaimer. However, as discussed in prior meetings, the concept of a disclaimer in a review engagement does not exist in the extant attestation standards, Statements on Auditing Standards, or Statements on Standards for Accounting and Review Services and it would be inconsistent with existing theory and standards to introduce it here.

The ad hoc group discussed calling for a report that does not provide a conclusion without characterizing it as a disclaimer or otherwise describing what the language of such a report would be. It ultimately concluded that the preferable approach would be to remain silent on how the practitioner should respond when withdrawal from a review engagement is not possible under law or regulation.

### **To Whom Use of the Report Should be Restricted**

The ad hoc group concluded that when the practitioner restricts the use of the report because the responsible party has refused to provide a written assertion, the report should be restricted to the engaging party. It reasoned that the logic underlying this provision in the extant attestation standards is based on the lack of a contractual relationship between the practitioner and the responsible party. It seemed incongruous to designate an uncooperative nonclient as a specified user.

Although there might be situations in which wider use might be appropriate, the ad hoc group was unable to identify an approach that could be generalized to sufficiently protect third-party users. The draft already addresses reports that need to be made available under law or regulation. For example:

2.A100 In some cases restricted-use practitioner reports filed with regulatory agencies are required by law or regulation to be made available to the public as a matter of public record. Also, a regulatory agency as part of its oversight responsibility for an entity may require access to restricted-use practitioner reports in which they are not named as a specified party. (Ref: par. 2.65c)

### **Need for an Oral Assertion**

The draft has long reflected the position that when the lack of a contractual relationship makes obtaining written representations impractical because the engaging party is not the responsible party, the practitioner is required to obtain oral representations about matters such as conformity with the criteria, subsequent events, and the existence of contradictory information. To be consistent with that position, the revised draft requires an oral assertion when the practitioner cannot obtain a written one. In arriving at its decision regarding written assertions

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the ASB did not intend to transform the attestation standards it is developing into standards for direct engagements, so the practitioner’s need for an assertion would be unchanged. It follows that lack of an oral assertion would be treated the same as lack of oral representations.

The November draft reflects this position in paragraph 2.56b (and 3.39b) as follows:

<p>2.56 When the engaging party is not the responsible party,</p> <ul style="list-style-type: none"> <li>a. if one or more of the requested representations are not provided in writing by the responsible party, but the practitioner receives satisfactory oral responses to the practitioner’s inquiries performed in accordance with paragraph 2.51 sufficient to enable the practitioner to conclude that the practitioner has sufficient appropriate evidence to form an opinion about the subject matter, the practitioner’s report should contain a separate paragraph that restricts the use of the practitioner’s report to the engaging party. (Paragraphs 2.65-2.66 contain requirements for the contents of such a paragraph) (Ref: par. 2.A65)</li> <li>b. if one or more of the requested representations are not provided in writing or orally from the responsible party, in accordance with paragraph 2.51, a scope limitation exists, and the practitioner should determine the effect on the practitioner’s report, or the practitioner should withdraw from the engagement. (Ref: par. 2.A66)</li> </ul>	<p>2.A66 Paragraph 2.10 provides an exception to the requirement for a written assertion when the engaging party is not the responsible party. Nonetheless, because the assertion is the representation called for by paragraph 2.50a, application of paragraph 2.56a requires the practitioner to obtain an oral assertion. Paragraph 2.56b applies when the responsible party fails to provide neither a written nor oral assertion</p>
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Paragraphs 2.56a and 3.39a require that the practitioner’s report be restricted to the engaging party when the responsible party that is not the engaging party provides only oral representations. In such circumstances, the practitioner is not required to disclose in the report that the responsible party refused to provide written representations, other than the assertion, which is the representation in paragraph 2.50a. Based on its approach to incorporating the ASB’s decision regarding written assertions, the ad hoc group did not challenge the requirement in the existing draft but concluded that the different treatment of the assertion—that is, mentioning it in the report—is consistent with the idea that an assertion is integral to examination and review engagements. Failure to obtain the oral representations (including the assertion) represents a scope limitation.

**Subject Matter Sections**

The subject matter-specific chapters already prohibit the oral-representation alternative to obtaining written representations otherwise permitted in chapters 2 and 3 when the responsible party is not the engaging party. The logic underlying that treatment would argue for also

applying it to written assertions. For example, in chapter 5, “Prospective Financial Information,” a forecast is based on the responsible party’s expectations; the practitioner cannot independently develop a forecast because he or she doesn’t know what the responsible party expects. It seemed anomalous to require certain of these representations in writing but not the overall matter of the assertion.

Accordingly, the revised subject-matter specific chapters require obtaining the written assertion in all cases. For example, the guidance in chapter 5 would say the following (equivalent guidance appears in the other subject-matter specific chapters):

Requesting a Written Assertion	Requesting a Written Assertion
5.18 The practitioner should request from the responsible party a written assertion <del>that the prospective financial information is presented in accordance with AICPA presentation guidelines</del> . If the responsible party refuses to provide a written assertion the practitioner should withdraw from the engagement when withdrawal is possible under applicable laws and regulations. (Ref: par. 5.A13 )	5.A13 The guidance in paragraph 5.18 applies whether or not the responsible party is the engaging party. (Ref: par. 5.18)

**Reexposure of the Revised Standards**

Special legal counsel for the ASB has indicated that he did not believe reexposure is required as a result of the proposed change to the requirement for a written assertion because the change results in the proposed standards being closer to extant standards for engagements in which the responsible party is not the engaging party, the change results in a less stringent requirement than was originally proposed in the standard, the change to require a written assertion was clearly disclosed in the exposure draft affording commenters an opportunity to object or agree with the proposed change, and the decision to make these revisions was debated in open meetings of the ASB. Counsel however, advised that the ASB needs to make its own determination about whether it should reexpose the proposed revisions. The ad hoc group believes that reexposure would not be required.

**Agenda Materials**

The agenda materials for the discussion of the clarified attestation standards are the following: (All of the drafts are marked from the October 13, 2015 drafts

- Item 1A: “Preface to the Attestation Standards”
- Item 1B: Chapter 1, “Concepts Common to All Attestation Engagements”
- Item 1C: Chapter 2 “Examination Engagements”
- Item 1D: Chapter 3 “Review Engagements”
- Item 1E: Chapter 4 “Agreed-Upon Procedures Engagements”
- Item 1F: Chapter 5, “Financial Forecasts and Projections,” which was renamed “Prospective Financial Information” at the January 2015 ASB meeting (clarifies AT section 301)
- Item 1G: Chapter 6, “Reporting on Pro Forma Financial Information,” (clarifies AT section 401)
- Item 1H: Chapter 7, “Compliance Attestation,” (clarifies AT section 601)

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Item 11: Chapter 8, “Reporting on an Examination of Controls at a Service Organization Relevant to user Entities’ Internal Control Over Financial Reporting”

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