



Agenda Item 2A

Convergence - PCAOB

Elimination of Unnecessary Differences Between GAAS and AS16, AS17, AS18

Background

The ASB's Strategic Plan calls for convergence with the standards of the IAASB and avoidance of unnecessary differences with the standards of the PCAOB. Since the ASB completed its auditing standards clarity project, the PCAOB has issued three auditing standards — AS 16, *Communication With Audit Committees*, AS 17, *Supplementary Information*, and AS 18, *Related Parties* — which the ASB has not yet considered to determine if unnecessary differences exist.

The PCAOB Convergence Task Force (the Task Force) that developed this analysis comprised Jan Herringer, Chair; Courtney Drake and Laura Schuetze, with Ahava Goldman as staff.

The Task Force has analyzed AS 16, AS 17 and AS 18 with GAAS in order to

- 1) identify requirements of AS 16-AS 18 that are incremental to GAAS;
- 2) consider whether the incremental requirements are unnecessary differences, and if so,
- 3) consider whether the differences are significant enough to warrant amendments to GAAS.

The Task Force identified differences and made recommendations presented below regarding those requirements it believes are unnecessary differences between the PCAOB auditing standards and GAAS. PCAOB conforming amendments to other standards will be brought to the ASB in July as action on them is contingent on the other amendments accepted.

Criteria Used to Determine an Unnecessary Difference

For each requirement in a PCAOB AS which the Task Force believes does not have an equivalent in GAAS, the Task Force considered the following:

- Does the requirement address something that is common to issuers and rare for non-issuers?
- Is the requirement more prescriptive than appropriate for principle-based standards?
- Does the requirement result in a performance difference?
- Is the requirement scalable?
- Would applying the requirement in GAAS audits result in higher audit quality?

Differences that the Task Force believes are unnecessary are listed in the summary of differences section below. The matrices presented separately include an analysis of requirements as (1) not different, (2) a necessary difference, (3) an unnecessary difference and (4) a difference that is unnecessary but not significant enough to warrant amendment (“not unnecessary”).

Requested of the ASB

1. Does the ASB agree with the proposed amendments?
2. Does the ASB believe, based on the analysis in the matrices, that other amendments are necessary to avoid unnecessary differences? If so, please specify.

Agenda Materials

Presented below:

Summary of Differences and Task Force Recommendations

- I. AS 18, *Related Parties*
- II. AS 16, *Communications With Audit Committees*
- III. AS 17, *Supplementary Information*

In separate files:

- 2A1 All proposed amendments by AU-C section.
- 2A2 Paragraph-by-paragraph comparisons of AS 18 to relevant AU-C sections.
- 2A3 Paragraph-by-paragraph comparisons of AS 16 to relevant AU-C sections.
- 2A4 Paragraph-by-paragraph comparisons of AS 17 to relevant AU-C sections.

Summary of Differences and Task Force Recommendations

I. AS 18, Related Parties

A. AS 18 par. 5, par. 6 and par. 19

PCAOB AS 18, Related Parties	AU-C 550, Related Parties
<p>5. The auditor should inquire of management regarding:^{4/}</p> <ul style="list-style-type: none"> a. The names of the company’s related parties during the period under audit, including changes from the prior period; b. Background information concerning the related parties (for example, physical location, industry, size, and extent of operations); c. The nature of any relationships, including ownership structure, between the company and its related parties; d. The transactions entered into, modified, or terminated, with its related parties during the period under audit and the terms and business purposes (or the lack thereof) of such transactions; e. The business purpose for entering into a transaction with a related party versus an unrelated party; f. Any related party transactions that have not been authorized and approved in accordance with the company’s established policies or procedures regarding the authorization and approval of transactions with related parties; and g. Any related party transactions for which exceptions to the company's established policies or procedures were granted and the reasons for granting those exceptions. <p><i>4/ See also AU sec. 333, Management Representations. Obtaining such representations from management complements the performance of procedures in paragraph 5 and is not a substitution for those inquiries.</i></p> <p>6. The auditor should inquire of others within the company regarding their knowledge of the matters in</p>	<p>14. The auditor <i>should</i> inquire of management regarding <i>the following</i>:</p> <ul style="list-style-type: none"> (a) The identity of the entity’s related parties, including changes from the prior period (Ref: Para. A9-A14) (b) The nature of the relationships between the entity and these related parties (c) Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions. <p>15. The auditor should inquire of management and others within the entity and perform other risk</p>

AS 18, Summary of Differences

paragraph 5 of this standard. The auditor should identify others within the company^{5/} to whom inquiries should be directed, and determine the extent of such inquires, by considering whether such individuals are likely to have knowledge regarding:

- a. The company's related parties or relationships or transactions with related parties;
- b. The company's controls over relationships or transactions with related parties; and
- c. **The existence of related parties or relationships or transactions with related parties previously undisclosed to the auditor.** 6/

5/ Examples of "others" within the company who may have such knowledge include: personnel in a position to initiate, process, or record transactions with related parties and those who supervise or monitor such personnel; internal auditors; in-house legal counsel; the chief compliance/ethics officer or person in equivalent position; and the human resources director or person in equivalent position.

6/ For purposes of this standard, the phrase "related parties or relationships or transactions with related parties previously undisclosed to the auditor" includes, to the extent not disclosed to the auditor by management: (1) related parties; (2) relationships or transactions with known related parties; and (3) relationships or transactions with previously unknown related parties.

assessment procedures considered appropriate to obtain an understanding of the controls, if any, that management has established to:

- a) Identify, account for, and disclose related party relationships and transactions
- b) Authorize and approve significant transactions and arrangements with related parties
- c) Authorize and approve significant transactions and arrangements outside the normal course of business.

A15. Others within the entity are those considered likely to have knowledge of the entity's related party relationships and transactions and the entity's controls over such relationships and transactions. These may include, to the extent that they do not form part of management, *the following*:

- Those charged with governance
- Personnel in a position to initiate, *authorize*, process, or record transactions that are both significant and outside the entity's normal course of business and those who supervise or monitor such personnel
- Internal auditors
- In-house legal counsel
- The chief ethics officer or equivalent person
- *Chief compliance officer*

A16. The audit is conducted on the premise that management and, when appropriate, those charged with governance have acknowledged and understand that they have responsibility for the preparation *and fair presentation* of the financial statements in accordance with the applicable financial reporting framework *and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation* of financial statements that are free from material misstatement, whether due to fraud or error.⁵ Accordingly the preparation of the financial statements requires management, with oversight from those charged with governance, to design, implement and maintain adequate controls over related party relationships and transactions so that these are identified and appropriately accounted for and disclosed . In their oversight role, those charged with governance monitor

AS 18, Summary of Differences

	how management is discharging its responsibility for such controls. <i>Those</i> charged with governance may, in their oversight role, obtain information from management to enable them to understand the nature and business rationale of the entity’s related party relationships and transactions.
19. ... The auditor also should communicate other significant matters arising from the audit regarding the company's relationships and transactions with related parties including, but not limited to: e. The identification of significant related party transactions that appear to the auditor to lack a business purpose.	No equivalent requirement; however, AU-C 550.A52 addresses other communications with Those Charged with Governance.

Analysis:

► **AS 18 paragraphs 5 and 6** include detailed requirements that are not explicitly stated in AU-C 550. (See the red text in the left hand column above). Specifically, AU-C 550 paragraph 14 does not include explicit requirements included in AS 18.5 to inquire regarding

- Background information (AS 18, par. 5b)
- Modified or terminated transactions (AS 18, par. 5d)
- The “business” purpose of RPTs (AS 18, par. 5e)
- Unauthorized transactions (AS 18, par. 5f)
- Exceptional transactions (AS 18, par. 5g)

AS 18.6 paragraph 6c adds consideration of the existence of related parties or relationships or transactions with related parties previously undisclosed to the auditor. Additionally, AS 18.19e also contains a reference to business purpose of the RPT.

Task Force Recommendation: Amend requirements to incorporate AS18.5 *d* .and *e*. Amend application material to address AS18.5*b, f-g* and AS 18.19e

Basis for Recommendation:

Requiring an understanding of the business purpose of the RPT and whether the entity modified or terminated any transactions would lead to a higher quality audit (understanding the business purpose may detect fraudulent transactions, and knowing whether transactions were modified or terminated may detect material misstatements). The amendments to the application material are helpful guidance that would be overly prescriptive as requirements.

Draft of potential amendments:

To incorporate AS18.5d and AS18.5e:

AS 18, Summary of Differences

- 14.** The auditor *should* inquire of management ***and others within the entity*** regarding *the following*:
- (a) The identity of the entity's related parties, including changes from the prior period (Ref: Para. A9-A14)
 - (b) The nature of the relationships between the entity and these related parties ***and the business purpose of entering into a transaction with a related party versus an unrelated party.***
 - (c) Whether the entity entered into, ***modified, or terminated*** any transactions with these related parties during the period and, if so, the type and purpose of the transactions.

To incorporate AS18.6c:

A15. Others within the entity are those considered likely to have knowledge of the entity's related party relationships and transactions and the entity's controls over such relationships and transactions, ***as well as the existence of related parties or relationships or transactions with related parties previously undisclosed to the auditor.*** These may include, to the extent that they do not form part of management, the following:

- Those charged with governance
- Personnel in a position to initiate, *authorize*, process, or record transactions that are both significant and outside the entity's normal course of business and those who supervise or monitor such personnel
- Internal auditors
- In-house legal counsel
- The chief ethics officer or equivalent person
- Chief compliance officer

To incorporate AS 18 paragraph 5b:

Add a new application paragraph to AU-C 550.14a:

.A13X The inquiry about the identity of the entity's related parties may include background information concerning the related parties (for example, physical location, industry, size, and extent of operations.

To incorporate AS 18 paragraph 5f and g:

Add a new application paragraph to AU-C 550.14c.

Transactions With Related Parties (Ref. Par. 14c)

.A14X Inquiries may include asking about any related party transactions

- ***that have not been authorized and approved in accordance with the company's established policies or procedures regarding the authorization and approval of transactions with related parties.***
for which exceptions to the company's established policies or procedures were granted and the reasons for granting those exceptions.

► **AS 18.19**

To incorporate AS18.19e

Modify AU-C 550.A52 as follows.

AS 18, Summary of Differences

Communicating significant findings and issues arising during the audit in connection with the entity’s related parties helps the auditor establish a common understanding with those charged with governance of the nature and resolution of these matters. Examples of significant related party matters include the following:

- Disagreement with management regarding the accounting for, and disclosure of, significant related party transactions.
- Noncompliance with applicable laws or regulations prohibiting or restricting specific types of related party transactions.
- Difficulties in identifying the party that ultimately controls the entity
- *The identification of significant related party transactions that appear to the auditor to lack a business purpose.*

B. AS18 par. 7 – Inquiries of the audit committee

PCAOB AS 18, Related Parties	AU-C 550, Related Parties
<p style="color: red;">7. The auditor should inquire of the audit committee,^{7/} or its chair, regarding:</p> <p style="color: red;">a. The audit committee's understanding of the company's relationships and transactions with related parties that are significant to the company; and</p> <p style="color: red;">b. Whether any member of the audit committee has concerns regarding relationships or transactions with related parties and, if so, the substance of those concerns.</p> <p>7/ The term "audit committee" has the same meaning as the term used in Auditing Standard No. 16, <i>Communications with Audit Committees</i>.</p>	<p>No equivalent paragraph.</p>

Analysis:

AU-C 550 does not have a requirement equivalent to the requirement in AS 18 for the auditor to make inquiries of the audit committee regarding related party relationships and transactions or concerns that individual audit committee members have regarding such.

Task Force Recommendation: Add a requirement to make this inquiry of those charged with governance.

Basis for Recommendation:

The lack of this requirement in GAAS creates a performance difference between GAAS and PCAOB standards regarding a matter that is not rare for non-issuers.

Draft of potential amendment:

AU-C 550.15A *The auditor should inquire of those charged with governance regarding:*

- a. Their understanding of the company's relationships and transactions with related parties that are significant to the company; and*
- b. Whether any of those charged with governance have concerns regarding relationships or transactions with related parties and, if so, the substance of those concerns.*

C. AS 18 par. 9 - Communications with Component Auditor

PCAOB AS 18, Related Parties	AU-C 550, Related Parties
<p>9. If the auditor is using the work of another auditor, the auditor should communicate to the other auditor relevant information about related parties, including the names of the company's related parties and the nature of the company's relationships and transactions with those related parties.^{9/} The auditor also should inquire of the other auditor regarding the other auditor's knowledge of any related parties or relationships or transactions with related parties that were not included in the auditor's communications.</p> <p><i>9/ See AU sec. 543, Part of Audit Performed by Other Independent Auditors, which describes the auditor's responsibilities regarding using the work and reports of other independent auditors who audit the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements.</i></p>	<p><i>All.</i> In the context of a group audit, <i>section 600, Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)</i> requires the group engagement team to provide each component auditor with a list of related parties prepared by group management and any other related parties of which the group engagement team is aware. Where the entity is a component within a group, this information provides a useful basis for the auditor's inquiries of management regarding the identity of the entity's related parties.</p>

Analysis:

The requirements when using the work of another auditor are similar, but AS 18 requires not only a list of related parties, but also the nature of the company's relationships and transactions with those related parties, which is not explicitly required in GAAS.

Task Force Recommendation: Amend AU-C section 600 to explicitly require this communication.

Basis for Recommendation:

The lack of this requirement in GAAS creates a performance difference between GAAS and PCAOB standards regarding a matter that is not rare for non-issuers.

Draft of potential amendment:

AU-C 600.41 The group engagement team should communicate its requirements to a component auditor on a timely basis. This communication should include the following: ...

- c. A list of related parties prepared by group management and any other related parties of which the group engagement team is aware, ***including the nature of the company's relationships and transactions with those related parties***. The group engagement team should request the component auditor to communicate on a timely basis related parties not previously identified by

AS 18, Summary of Differences

group management or the group engagement team. The group engagement team should identify such additional related parties to other component auditors.

D. AS 18.13 – Intercompany balances

<p>13. The auditor should perform procedures on intercompany account balances as of concurrent dates, even if fiscal years of the respective companies differ.</p> <p>Note: The procedures performed should address the risks of material misstatement associated with the company's intercompany accounts.</p>	<p>No equivalent paragraph.</p>
--	---------------------------------

Task Force Recommendation: While it may seem obvious to perform the procedures as of concurrent dates, a company can hide or cause an error through not consolidating entities at the same time (e.g., when they consolidate 2 months in arrears) or in instances where intercompany transactions do not eliminate in their entirety due to accounting rules (e.g., transfer pricing, deferred tax implications of products not sold). Add a requirement.

Basis for Recommendation:

The lack of this requirement in GAAS creates a performance difference between GAAS and PCAOB standards regarding a matter that is not rare for non-issuers.

Draft of potential amendment:

AU-C 550.15B *The auditor should perform procedures on intercompany account balances as of concurrent dates, even if fiscal years of the respective companies differ. The procedures performed should address the risks of material misstatement associated with the company's intercompany accounts.*

E. AS18.14 – Identification of Related Parties

PCAOB AS 18, Related Parties	AU-C 550, Related Parties
<p>14. The auditor should evaluate whether the company has properly identified its related parties and relationships and transactions with related parties. Evaluating whether a company has properly identified its related parties and relationships and transactions with related parties involves more than assessing the process used by the company. This evaluation requires the auditor to perform procedures to test the accuracy and completeness of the related parties and relationships and transactions with related parties identified by the company, taking into account the information gathered during the audit.^{15/} As part of this evaluation, the auditor should read minutes of</p>	<p>.16 During the audit, the auditor should remain alert when inspecting records or documents for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. In particular, the auditor should inspect the following for indications of related party relationships or transactions that management has not previously identified or disclosed to the auditor:</p> <p style="padding-left: 20px;">a. Bank and legal confirmations obtained as part of the auditor's procedures</p>

AS 18, Summary of Differences

<p>the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.</p> <p>15/ Information obtained from identifying and evaluating a company's significant unusual transactions and obtaining an understanding of a company's financial relationships and transactions with its executive officers could indicate that related parties or relationships or transactions with related parties previously undisclosed to the auditor might exist.</p>	<p>b. Minutes of meetings of shareholders and of those charged with governance</p> <p>c. Such other records or documents as the auditor considers necessary in the circumstances of the entity.</p>
--	---

Analysis:

AS18.14 requires the auditor to *evaluate* accuracy and completeness whereas AS-C 550.16 requires the auditor to *remain alert* for evidence to the contrary. While the procedures performed to address each requirement would generally be equivalent; the requirement to 'evaluate' has the potential to result in a more proactive approach.

Task Force Recommendation: Amend the requirement to include evaluation concept, and add application material to address that concept.

Basis for Recommendation:

The lack of this requirement in GAAS creates a performance difference between GAAS and PCAOB standards regarding a matter that is not rare for non-issuers. The amendments to the application material are helpful guidance that would be overly prescriptive as requirements.

Draft of potential amendment:

AU-C 550.16 During the audit, the auditor should ~~remain alert~~ ***evaluate whether the entity has properly identified its related parties and relationships and transactions with related parties by performing procedures to test the accuracy and completeness of the related parties and relationships and transactions with related parties identified by the company, taking into account the information gathered during the audit.*** ~~when inspecting records or documents for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor.~~ In particular, the auditor should inspect the following for indications of related party relationships or transactions that management has not previously identified or disclosed to the auditor:

- a. Bank and legal confirmations obtained as part of the auditor's procedures
- b. Minutes of meetings of shareholders and of those charged with governance
- c. Such other records or documents as the auditor considers necessary in the circumstances of the entity.

AS 18, Summary of Differences

~~***Maintaining Alertness for***~~ Evaluating Accuracy and Completeness of ***Related Party Information When Reviewing Records or Documents***

Records or Documents That the Auditor May Inspect (Ref: [par. .16](#))

- .A22** *Evaluating whether a company has properly identified its related parties and relationships and transactions with related parties involves more than assessing the process used by the company.* During the audit, the auditor may inspect records or documents that indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. Examples of those records or documents include the following:

II. AS 16, *Communications With Audit Committees*

A. AS 16, par. 8

AS 16	AU-C 250, <i>Consideration of Laws and Regulations in an Audit of Financial Statements</i>
8. The auditor should inquire of the audit committee about whether it is aware of matters relevant to the audit, including, but not limited to, violations or possible violations of laws or regulations.	<p>.14 The auditor should perform the following audit procedures that may identify instances of noncompliance with other laws and regulations that may have a material effect on the financial statements (see paragraph .06b): (Ref: par. .A12-.A15)</p> <p><i>a.</i> Inquiring of management and, when appropriate, those charged with governance about whether the entity is in compliance with such laws and regulations</p>

Analysis:

AS 16, paragraph 8 requires the auditor to inquire of the audit committee in all circumstances about violations or possible violations; GAAS (AU-C section 250, *Consideration of Laws and Regulations*) requires inquiry of TCWG “when appropriate” about whether the entity is in compliance with laws and regulations, which is a somewhat different inquiry.

Task Force Recommendation: Because this is addressed in the NOCLAR project, no change is proposed here.

Basis for Recommendation: “Possible violations” is comparable to “suspected noncompliance”. NOCLAR project introduces the concept of “identified or suspected” noncompliance into AU-C 250.

B. AS 16, par. 10

AS 16	AU-C 260
-------	-----------------

AS 16, Summary of Differences

<p>10. As part of communicating the overall audit strategy, the auditor should communicate the following matters to the audit committee, if applicable:</p> <p>a. The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks;</p>	<p>.A20 Matters communicated may include the following:</p> <ul style="list-style-type: none"> • How the auditor proposes to address the significant risks of material misstatement, whether due to fraud or error • The auditor’s approach to internal control relevant to the audit including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial reporting • The application of materiality in the context of an audit, as discussed in section 320, <i>Materiality in Planning and Performing an Audit</i> • If the entity has an internal audit function, the extent to which the auditor will use the work of internal audit and how the external and internal auditors can best work together
---	---

Analysis:

AS 16, paragraph 10a, requires, as part of communicating the overall audit strategy, communicating the nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks. GAAS does not address this.

Task Force Recommendation: Add application material addressing this.

Basis for Recommendation: The amendments to the application material are helpful guidance that would be overly prescriptive as requirements.

Draft of Potential Amendment:

.A20 Matters communicated may include the following:

- How the auditor proposes to address the significant risks of material misstatement, whether due to fraud or error, ***including the nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results related to significant risks***
- The auditor’s approach to internal control relevant to the audit including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial reporting
- The application of materiality in the context of an audit, as discussed in section 320,

C. AS 16, par. 11

AS 16	AU-C 260
11. The auditor should communicate to the audit committee significant changes to the planned audit strategy or the	No comparable requirement.

significant risks initially identified and the reasons for such changes.	
--	--

Task Force Recommendation: Add a requirement to communicate significant changes and application material regarding the reasons for such changes.

Basis for Recommendation: Significant changes to the planned audit strategy is not rare for non-issuers. The amendments to the application material are helpful guidance that would be overly prescriptive as requirements.

Draft of Potential Amendment:

.12 The auditor should communicate with those charged with governance (Ref: [par. .A23](#))

...

b. **Significant changes to the planned audit strategy initially identified and significant difficulties, if any, encountered during the audit.** (Ref: [par. A26](#))

.A26 The auditor may communicate the reasons for the significant changes to the planned audit strategy. Significant difficulties encountered during the audit may include matters such as

- significant delays in management providing required information.
- an unnecessarily brief time within which to complete the audit.
- extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- the unavailability of expected information.
- restrictions imposed on the auditor by management.
- management's unwillingness to provide information about management's plans for dealing with the adverse effects of the conditions or events that lead the auditor to believe there is substantial doubt about the entity's ability to continue as a going concern.

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.

D. AS 16, par. 12d and 13d

AS 16	AU-C 260
-------	-----------------

<p>Accounting Policies and Practices, Estimates, and Significant Unusual Transactions</p> <p>12. The auditor should communicate to the audit committee the following matters:</p> <p>...</p> <p>d. Significant unusual transactions.</p> <p>(1) Significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature; and</p> <p>(2) The policies and practices management used to account for significant unusual transactions</p> <p>Auditor’s Evaluation of the Quality of a Company’s Financial Reporting</p> <p>13. The auditor should communicate to the audit committee the following matters:</p> <p>... d. Significant unusual transactions. The auditor's understanding of the business rationale for significant unusual transactions.</p>	<p>.A47 Appendix—Qualitative Aspects of Accounting Practices</p> <p>The communication required by paragraph .12a and discussed in paragraphs .A24–.A25 may include such matters as the following:</p> <p>Related Matters</p> <ul style="list-style-type: none"> • The extent to which the financial statements are affected by unusual transactions, including nonrecurring amounts recognized during the period, and the extent to which such transactions are separately disclosed in the financial statements
---	---

Analysis:

AS 16, paragraphs 12d and 13d, require communication relating to significant unusual transactions, including the auditor's understanding of the business rationale for significant unusual transactions. GAAS, like the ISAs, does not have this requirement.

Task Force Recommendation: Add a requirement and additional application material.

Basis for Recommendation: Significant unusual transactions are indications of a fraud risk. This requirement is common for both issuers and non-issuers.

Draft of Potential Amendment:

.12 The auditor should communicate with those charged with governance (Ref: par. .A23)

a. the auditor’s views about qualitative aspects of the entity’s significant accounting practices, including accounting policies, accounting estimates, ~~and~~ financial statement disclosures, **and significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature.** When applicable, the auditor should (Ref: par.

.A24–.A25)

- i. explain to those charged with governance why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be most appropriate to the particular circumstances of the entity and

AS 16, Summary of Differences

- ii. determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of those estimates.

.A47 Appendix—Qualitative Aspects of Accounting Practices

The communication required by paragraph .12a and discussed in paragraphs .A24–.A25 may include such matters as the following:

Significant Unusual Transactions

- *The policies and practices management used to account for significant unusual transactions.*
- *The auditor's understanding of the business rationale for significant unusual transactions.*

E. AS 16, par. 13f

AS 16	AU-C 260
<p>13. The auditor should communicate to the audit committee the following matters:</p> <p style="padding-left: 20px;">f. New accounting pronouncements. Situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting.</p>	<p>.A47 Appendix—Qualitative Aspects of Accounting Practices</p> <p>The communication required by paragraph .12a and discussed in paragraphs .A24–.A25 may include such matters as the following:</p> <p>Accounting Policies</p> <ul style="list-style-type: none"> • The initial selection of, and changes in, significant accounting policies, including the application of new accounting pronouncements (the communication may include the effect of the timing and method of adoption of a change in accounting policy on the current and future earnings of the entity, and the timing of a change in accounting policies with regard to expected new accounting pronouncements)

Analysis:

AS 16 requires communication of situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting. GAAS does not require this communication; AU-C 260 notes in the appendix, *Qualitative Aspects of Accounting Practices*, that the communication may include the effect of the timing and method of adoption of a change in accounting policy on the current and future earnings of the entity, and the timing of a change in accounting policies with regard to expected new accounting pronouncements.

AS 16, Summary of Differences

Task Force Recommendation: Because accounting policy can have a material effect on the financial statements, elevate this to application material from the appendix.

Basis for Recommendation: This is not rare for non-issuers.

Draft of Potential Amendment: **A24** Financial reporting frameworks ordinarily allow for the entity to make accounting estimates and judgments about accounting policies and financial statement disclosures. Open and constructive communication about qualitative aspects of the entity’s significant accounting practices may include comment on the acceptability of significant accounting practices, *including concern regarding management’s anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting*. The [appendix](#), "Qualitative Aspects of Accounting Practices," identifies matters that may be included in this communication.

F. AS 16, paragraph 15

AS 16	AU-C 260-
<p>15. The auditor should communicate to the audit committee matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process.</p>	<p>12. The auditor should communicate with those charged with governance</p> <p>d. Other findings or issues, if any, arising from the audit that are, in the auditor’s professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process. (Ref: par. .A27)</p>

Analysis:

GAAS does not have a requirement or application material that addresses matters for which the auditor consulted outside the engagement team.

Task Force Recommendation: Add application material addressing matters for which the auditor consulted outside the engagement team and are relevant to those charged with governance’s oversight of the financial reporting process.

Basis for Recommendation: Because accounting policy can have a material effect on the financial statements, elevate this to application material from the appendix.

Draft of Potential Amendment:

.12 The auditor should communicate with those charged with governance (Ref: [par. .A23](#))

- ...
- d. other findings or issues, if any, arising from the audit that are, in the auditor’s professional judgment, significant and relevant to those charged with governance

AS 16, Summary of Differences

regarding their responsibility to oversee the financial reporting process. (Ref: [par. .A27 – A27A](#))

A27A. Other findings and issues may include

- *matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process.*

G. AS 16, par. 18

AS 16	AU-C 260
<p>18. The auditor should provide the audit committee with the schedule of uncorrected misstatements related to accounts and disclosures that the auditor presented to management. The auditor should discuss with the audit committee, or determine that management has adequately discussed with the audit committee, the basis for the determination that the uncorrected misstatements were immaterial, including the qualitative factors considered.</p> <p>The auditor also should communicate that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.</p>	<p>.13 The auditor should communicate with those charged with governance (Ref: par. .A29–.A30)</p> <p><i>a.</i> uncorrected misstatements accumulated by the auditor and the effect that they, individually or in the aggregate, may have on the opinion in the auditor’s report. The auditor’s communication should identify material uncorrected misstatements individually. The auditor should request that uncorrected misstatements be corrected.</p> <p><i>b.</i> the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.</p> <p>.A30 The auditor may discuss with those charged with governance the reasons for, and the implications of, a failure to correct misstatements, taking into account the size and nature of the misstatement judged in the surrounding circumstances, and possible implications with regard to future financial statements.</p>

Analysis:

AS 16 requires communication that that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit. AU-C 260 includes application material (par. A29) that the auditor may discuss with those charged with governance the reasons for, and the implications of, a failure to correct misstatements, taking into account the size and nature of the

AS 16, Summary of Differences

misstatement judged in the surrounding circumstances, and possible implications with regard to future financial statements.

Task Force Recommendation: Because this is best practice, elevate to a requirement.

Basis for Recommendation: Applying the requirement in GAAS audits would result in higher audit quality.

Draft of potential amendment:

.13 The auditor should communicate with those charged with governance (Ref: par. A29–A30)

a. uncorrected misstatements accumulated by the auditor and the effect that they, individually or in the aggregate, may have on the opinion in the auditor’s report. The auditor’s communication should identify material uncorrected misstatements individually. The auditor should request that uncorrected misstatements be corrected.

b. the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole, **and possible implications with regard to future financial statements.**

.A30 The auditor may discuss with those charged with governance the reasons for, and the implications of, a failure to correct misstatements, taking into account the size and nature of the misstatement judged in the surrounding circumstances, and ~~possible implications with regard to future financial statements~~ **that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.**

H. AS 16, par. 24

AS 16	AU-C 260
<p>24. The auditor should communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process. This communication includes, among other matters, complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters.^{40/}</p>	<p>12. The auditor should communicate with those charged with governance:</p> <p>d. Other findings or issues, if any, arising from the audit that are, in the auditor’s professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process.</p>

Analysis:

The requirement in AS 16, par. 24, to communicate other matters arising from the audit includes “complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters.”

GAAS does not include this specificity.

AS 16, Summary of Differences

Task Force Recommendation: Add application material.

Basis for Recommendation: This requirement is more prescriptive than appropriate for principle-based standards but would be useful guidance.

Draft of potential amendment:

A27A. Other findings and issues may include complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters

I. AS 16, par. 25

AS 16	AU-C 260
<p>Note: If, as part of its communications to the audit committee, management communicated some or all of the matters identified in paragraphs 12 or 18 and, as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor must include a copy of or a summary of management's communications provided to the audit committee in the audit documentation.</p>	<p>.A2 Although the auditor is responsible for communicating specific matters in accordance with this section, management also has a responsibility to communicate matters of governance interest to those charged with governance. Communication by the auditor does not relieve management of this responsibility. Similarly, management's communication of these matters to those charged with governance does not relieve the auditor of the responsibility to also communicate them. However, communication of these matters by management may affect the form or timing of the auditor's communication.</p>

Analysis:

AS 16 states, in a Note, that if management communicated some or all of the matters identified in paragraphs 12 or 18 and, as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor must include a copy of or a summary of management's communications provided to the audit committee in the audit documentation. AU-C 260 does not address this.

Task Force Recommendation: Enhance application material to address documentation of management's communication with those charged with governance, if communication by management affected the form of the auditor's communication.

Basis for Recommendation: This requirement is more prescriptive than appropriate for principle-based standards but would be useful guidance.

Draft of potential amendment:

A47. Documentation of oral communication may include a copy of minutes prepared by the entity as part of the audit documentation if those minutes are an appropriate record of the communication. ***If communication by management affected the form of the auditor's***

AS 16, Summary of Differences

communication with those charged with governance, a copy of or summary of management’s communications provided to those charged with governance may be included in the audit documentation.

J. AS 16, par. 26

AS 16	AU-C 260
<p>26. All audit committee communications required by this standard should be made in a timely manner and prior to the issuance of the auditor's report. The appropriate timing of a particular communication to the audit committee depends on factors such as the significance of the matters to be communicated and corrective or follow-up action needed, unless other timing requirements are specified by PCAOB rules or standards or the securities laws.</p>	<p>Timing of Communications .18 The auditor should communicate with those charged with governance on a timely basis.</p>

Analysis:

AS 16 specifies that required communications are required to be made prior to the issuance of the auditor’s report. GAAS does not specify this.

Task Force Recommendation: Consider adding application material that all communications be made at least orally prior to the issuance of the auditor’s report.

Basis for Recommendation: This requirement is more prescriptive than appropriate for principle-based standards but would be useful guidance.

Draft of potential amendment:

.A42 The appropriate timing for communications will vary with the circumstances of the engagement. Considerations include the significance and nature of the matter and the action expected to be taken by those charged with governance. The auditor may consider communicating

- planning matters early in the audit engagement and, for an initial engagement, as part of the terms of the engagement.
- significant difficulties encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor in overcoming the difficulties or if the difficulties are likely to lead to a modified opinion.
- *all matters required to be communicated by this section, at least orally if not in writing, prior to the release of the auditor’s report.*

III. AS 17, *Supplementary Information*

a. Summary of Differences and Task Force Recommendations

A. AS 17, par. 7-8 (Misstatements)

AS 17	AU-C 450
<p>7. The auditor should accumulate misstatements regarding the supplemental information identified during performance of audit procedures on the supplemental information and in the audit of the financial statements.^{6/} The auditor should communicate accumulated misstatements regarding the supplemental information to management on a timely basis to provide management with an opportunity to correct them.</p> <p>8. The auditor should evaluate whether uncorrected misstatements related to the supplemental information are material, either individually or in combination with other misstatements, taking into account relevant quantitative and qualitative factors.</p> <p>Note: The auditor should evaluate the effect of uncorrected misstatements related to the supplemental information in evaluating the results of the financial statement audit.^{7/}</p>	<p>Misstatement. A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error. (Ref: par. .A1)</p> <p>Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the auditor’s professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.</p>

Analysis:

AS 17 requires the auditor to accumulate misstatements regarding the supplemental information and evaluate the effect of uncorrected misstatements related to the supplemental information in evaluating the results of the financial statements audit. AU-C 725 does not address misstatements. AU-C 450, *Evaluation of Misstatements Identified During the Audit*, does not address supplemental information; however, misstatements regarding the supplemental information identified during performance of audit procedures on the supplemental information are encompassed in the requirements of AU-C section 450.

Task Force Recommendations: Add application material to par. A14 of AU-C 725 that refers to the applicability of AU-C section 450.

AS 17, Paragraph Comparison

Basis for Recommendation: This requirement is more prescriptive than appropriate for principle-based standards but would be useful guidance.

Draft of potential amendment:

.A14 The auditor may consider whether it is appropriate to address the supplementary information in procedures that the auditor performs in auditing the financial statements, including, but not limited to, the following:

a. Evaluating misstatements regarding the supplemental information identified during performance of audit procedures in accordance with section 450, Evaluation of Misstatements Identified During the Audit

b. Obtaining an updated representation letter, in accordance with section 580, Written Representations

~~*b.*~~ Performing subsequent events procedures, in accordance with section 560

~~*d.*~~ Sending a letter of audit inquiry to the client’s lawyer specifically regarding the information contained in the supplementary information, in accordance with section 501, *Audit Evidence—Specific Considerations for Selected Items*

B. AS 17 par 10e and 10f (Auditor’s report)

AS 17	AU-C 725
<p>a. A statement that in forming the auditor's opinion, the auditor evaluated whether supplemental information, including its form and content, complies, in all material respects, with the specified regulatory requirements or other criteria, if applicable.</p> <p>b. A statement, if applicable, that the supplemental information is presented on a basis that differs from the financial statements and is not prescribed by regulatory requirements. When such a statement is made, the report should describe the basis for the supplemental information presentation.</p>	<p>No comparable requirements</p>

Task Force Recommendation:

Supplemental information that is derived from the underlying accounting and other records used to prepare the financial statements can be presented on a basis that differs from the financial statements (for example, cash basis when the financial statements are GAAP-basis.)

Basis for Recommendation: This requirement may not be rare for non-issuers and results in a reporting difference.

Draft of potential amendment:

.09 When the entity presents the supplementary information with the financial statements, the auditor should report on the supplementary information in either (a) an other-matter paragraph in accordance with [section 706](#), *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, or (b) in a separate report on the supplementary information.^{fn 2} The other-matter paragraph or separate report should include the following elements:

- a. A statement that the audit was conducted for the purpose of forming an opinion on the financial statements as a whole
- b. A statement that the supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements
- c. A statement that the supplementary information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements
- d. A statement that the supplementary information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America
- e. ***A statement that in forming the auditor's opinion, the auditor evaluated whether supplemental information, including its form and content, complies, in***

^{fn 2} [Paragraph .08](#) of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

AS 17, Paragraph Comparison

all material respects, with the specified regulatory requirements or other criteria, if applicable.

- f. A statement, if applicable, that the supplemental information is presented on a basis that differs from the financial statements and is not prescribed by regulatory requirements. When such a statement is made, the report should describe the basis for the supplemental information presentation.*
- g. If the auditor issues an unmodified opinion on the financial statements and the auditor has concluded that the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, a statement that, in the auditor’s opinion, the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole*
- fh. If the auditor issues a qualified opinion on the financial statements and the qualification has an effect on the supplementary information, a statement that, in the auditor’s opinion, except for the effects on the supplementary information of (refer to the paragraph in the auditor’s report explaining the qualification), such information is fairly stated, in all material respects, in relation to the financial statements as a whole*

C. AS 17, par. 15

AS 17	AU-C 725
15. ...Note: If the supplemental information consists of two or more schedules, and the auditor is able to obtain sufficient appropriate audit evidence to support an opinion on some but not all schedules, the auditor may express an opinion on only those schedules for which he or she obtained sufficient appropriate evidence but should disclaim an opinion on the other schedules.	No comparable requirement

Task Force Recommendation: If other amendments are made to AU-C 725, consider adding this guidance as well.

Basis of Recommendation: This requirement may not be rare for non-issuers.

Draft of potential amendment under the Reporting Section of the standard:

A17. If the supplemental information consists of two or more schedules, and the auditor is able to obtain sufficient appropriate audit evidence to support an opinion on some but not all schedules, the auditor may express an opinion on only those schedules for which sufficient appropriate evidence was obtained and disclaim an opinion on the other schedules.