



Agenda Item 3

Direct Engagements

The Direct Engagements Task Force (task force) has been charged with developing attestation standards that would enable a practitioner to perform attestation engagements without the practitioner obtaining a written assertion. These standards are intended to address market needs for assurance and attestation services when an assertion is not obtained. To date, AICPA staff has developed the following direct engagement chapters of the proposed clarified attestation standards, which are included in the agenda materials as agenda items 3A-3C

- Item 3A: Chapter 1, "Concepts Common to All Attestation Engagements," of the proposed clarified attestation standards, modified to accommodate chapters 9 and 10
- Item 3B: Chapter 9, "Direct Examination Engagements," of the proposed clarified attestation standards (This is a reasonable assurance engagement.)
- Item 3C: Chapter 10, "Specified Procedures Engagements," of the proposed clarified attestation standards. (This engagement is similar to an agreed-upon procedures engagement; however, either the practitioner or the responsible party may designate the procedures, and use of the report would not be restricted (The task force has not yet discussed this chapter)

The following additional agenda materials are being provided to the ASB:

- Item 3D: Final Canadian Standard on Assurance Engagements (CSAE) 3001, *Direct Engagements*
- Item 3E: Staff Q&A regarding the applicability of AICPA standards to GAO performance audits

Paragraph 1.3 of modified chapter 1 states, "A direct attestation engagement is one in which the practitioner measures or evaluates the subject matter against the criteria. In a direct engagement there is no requirement for the practitioner to request a written assertion from the responsible party."

The draft direct examination standard (Item 3B) includes principles and concepts from chapter 2, "Examination Engagements," of the proposed clarified attestation standards and from CSAE 3001, which has been provided for reference and context.

The Canadian assurance standards include a general assurance standard (CSAE 3000) patterned after International Standard on Assurance Engagements (ISAE) 3000, *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*, and a direct-engagements assurance standard (CSAE 3001) which contains requirements and application guidance for direct reasonable and limited assurance engagements. Per discussions with staff of the Chartered Professional Accountants of Canada, the Canadian Auditing and Assurance Standards Board (AASB) considered whether to make the direct engagement standard an "add on" to CSAE 3000, or to create a standard with distinct requirements. The Canadian AASB

decided on the latter approach so that a practitioner performing a direct engagement would not need to refer to ISAE 3000.

The Canadians, like some in the US, believe direct-engagement standards are necessary to meet market needs when an assertion is not obtained. For example, a direct engagement standard is needed when a small or medium sized entity (SME) does not have the ability to provide an assertion or, in the case of a three party engagement, when the responsible party and the practitioner do not have a relationship. [Note - ISAE 3000 requires the practitioner to request an assertion, but if the practitioner does not receive an assertion, the practitioner may use professional judgment in determining whether to modify the report].

To help the task force move forward, the task force is seeking input from the ASB regarding certain topics and concepts.

Questions for the ASB

Scope Questions:

Question for the ASB

1. Should direct-engagement standards prohibit a practitioner from performing a direct examination or a specified-procedures engagement on certain subject matter? If so, what would be the basis for such a prohibition?

Obviously, when a practitioner is engaged to report on management's assertion the assertion-based standards would apply. A benefit of prohibiting certain subject matter would be that it would help distinguish direct engagement standards from assertion-based standards. A negative is that the direct-engagement standards need to be flexible enough to allow attestation in most any circumstance in which there is (a) a responsible party other than the practitioner and (b) suitable criteria.

Question for the ASB

2. Should direct-engagement standards be exclusive to direct-examination and specified-procedures engagements or should, similar to CSAE 3001, the direct engagement standards provide for both reasonable and limited-assurance engagements?

If the standards are exclusive to direct examination and specified procedures engagements that would not solve the issue that many practitioners may have with SME clients who request a review engagement but are unable to provide an assertion. In addition, with SMEs there may be more of a demand for review (limited assurance) rather than examination engagements.

Question for the ASB

3. Should the direct-engagement standards include guidance on performing nonattest services in conjunction with performing a direct engagement? If so, what is the rationale for adding such guidance to the direct engagement standards when it is not included in chapters 2 and 3, "Review Engagements," of the proposed clarified attestation standards nor in the auditing literature?

Some members of the task force believe that when performing a direct engagement, there is a greater likelihood that the practitioner will also be engaged to prepare subject matter information for the client. Although the term *subject matter information* is not used in the standard, the term is used to refer to information that might describe the subject matter and would be included along with the practitioner's report, for example, a summary of contract terms in an engagement in which the practitioner is engaged to assist a client in preparing or drafting a summary of contract terms that will be tested for compliance. Additionally, the practitioner may be engaged to prepare the financial forecast that is subject to examination. Other members of the task force do not believe that direct engagements will result in a greater likelihood that the practitioner will also be engaged to prepare the subject matter information; they believe that this will depend on the size and competence of the client rather than whether the practitioner is performing an assertion-based or direct engagement. The ASB has typically not provided specific guidance on the effect of performing nonattest services when also performing attest services for a client, other than to refer the practitioner to the AICPA Code of Professional Conduct, specifically the threats and safeguards that the AICPA Professional Ethics Executive Committee (PEEC) has issued relative to nonattest services.

Content Questions

Question for the ASB

4. Should the direct engagement standards use terminology that is different from the terminology used in the assertion-based standards?

Because some direct engagements will be performed for governmental entities, the task force discussed making some modifications to the standards to make them more relevant to such engagements. For example, the direct engagement standards could refer to a material deviation, rather than a material misstatement. Proposed chapter 1 already recognizes that the two terms may be used interchangeably (see the definition of the term *misstatement* in paragraph 1.11 *q*), so the question is whether to use different terms and will those differences be understood. Other task force members believe that the same terms as those used in the assertion-based standards should be used so that there is consistency throughout the standards.

Question for the ASB

5. Other than possible terminology differences, should there be differences in performance requirements between two standards that require the same level of assurance? If so, what is the logic and theory of why one engagement might require additional procedures?

The task force agrees that application material will need to be different in the two sets of standards, but is split on whether there should be additional requirements. For example, in a direct engagement the responsible party may not have effective controls to measure or otherwise determine if the subject matter is presented in accordance with the criteria.

Application material would discuss this effect on the practitioner's risk assessment. As a result, the practitioner would need to have an understanding of those control risks and would need to be able to design other procedures that would respond to potential higher risks of misstatement. This is very similar to audits of many SMEs that do not maintain effective controls over financial reporting.

Question for the ASB

6. If, after answering question 5 above, it is agreed that the performance requirements would be essentially the same for the two types of engagements, should the direct engagement standards repeat all of the requirements from the assertion-based standards or should the direct engagement standards be an add-on to the assertion-based standards?

Reporting Questions

Question for the ASB

- 7 Should the direct-engagement standards prohibit a practitioner from expressing an opinion in a direct-examination report?"

In most assertion-based engagements, the practitioner comes to a conclusion (an opinion in U.S standards) about whether the subject matter is in accordance with the criteria (often referred to in international standards as a "short- form report"). In some direct engagements, especially for governmental entities, it might be preferable for the practitioner to convey multiple conclusions along with multiple other findings and recommendations that may go well beyond the subject matter. It also might be preferable for these reports to contain far more language describing the procedures performed, information about the responsible party, and the criteria (often referred to as a "long form report").

It should be noted that nothing in chapters 2 or 3, of the proposed clarified attestation standards would prohibit a long-form report, as long as the report contained all of the required reporting elements.

Although the task force is in agreement that a long-form report should be encouraged and illustrated, there is some disagreement about whether the direct-engagement standards should prohibit the practitioner from expressing an opinion in a direct-examination report.

Some favor prohibiting an opinion in order to clearly delineate assertion-based reports from direct reports. Others argue that we can't prohibit a practitioner from forming an opinion if the practitioner has obtained reasonable assurance. Although those same members would not require an opinion.