



Agenda Item 4

Consideration of Inconsistency in AT-C Section 210

Objective of Agenda Item

To consider an inconsistency between how known misstatements are treated in a review performed in accordance with AT-C section 210, *Review Engagements* and AR-C section 90, *Review of Financial Statements* and AU-C section 930, *Interim Financial Information* and provide direction.

Background

There are three separate bodies of literature with respect to limited assurance engagements:

- AT-C section 210, *Review Engagements*
- AU-C section 930, *Interim Financial Information*
- AR-C section 90, *Review of Financial Statements*

With respect to known misstatements of the subject matter, AU-C section 930 and AR-C section 90 both include a step in which the practitioner considers whether modification of the standard report is sufficient to address the misstatement. If the practitioner concludes that modification of the standard report is not sufficient, then the practitioner is required to withdraw. AT-C section 210 requires the practitioner to jump right to withdrawal when the effects of the matter are material and pervasive and does not permit modification of the standard report.

Issue for Discussion with the ARSC

Consider whether AT-C section 210 should be revised to be consistent with AU-C section 930 and AR-C section 90 as follows:

Misstatement of Subject Matter

.51 A practitioner who is engaged to perform a review engagement may become aware that the subject matter is misstated. If the misstatement is not corrected, the practitioner should consider whether ~~qualification~~ **modification** of the conclusion in the standard practitioner's report is ~~adequate~~ **sufficient** to disclose the misstatement of the subject matter. (Ref: par. .A82)

~~.52~~ When the practitioner ~~qualifies~~ *modifies* the conclusion, the practitioner should include a separate paragraph in the practitioner's report that provides a description of the *nature of the* matter(s) giving rise to the ~~qualification~~ *modification and, if practicable, includes the effects on the subject matter.*

~~.53~~ The practitioner should express a qualified conclusion when the effects of a matter are material but not pervasive. A qualified *modified* conclusion is expressed as being "except for the effects" of the matter to which the ~~qualification~~ *modification* relates. ~~When the effects of a matter are material and also pervasive, the practitioner should withdraw from the engagement, when withdrawal is possible under applicable laws and regulations. (Ref: par. A83)~~

~~.54~~ If the practitioner has concluded that the *modification of the conclusion in the standard practitioner's report is sufficient to address the misstatement of the subject matter*, ~~material misstatement results in a qualified conclusion~~, the practitioner should report directly on the subject matter, not on the assertion, even when the assertion acknowledges the misstatement.

~~.55~~ If the practitioner believes that ~~qualification~~ *modification* of the conclusion in the standard practitioner's report is not ~~adequate~~ *sufficient* to ~~indicate~~ *address* the misstatements in the subject matter, the practitioner should withdraw from the engagement *and provide no further services with respect to the subject matter.*

~~.56~~ The practitioner's conclusion on the subject matter or assertion should be clearly separated from any paragraphs emphasizing matters related to the subject matter or any other reporting responsibilities.

~~.57~~ When the conclusion is ~~qualified~~ *modified*, reference to an external specialist is permitted when such reference is relevant to an understanding of the ~~qualification~~ *modification* to the practitioner's conclusion. The practitioner should indicate in the practitioner's report that such reference does not reduce the practitioner's responsibility for that conclusion.

Modified Conclusions (Ref: par. .51)

~~A82~~ A practitioner may issue an unmodified conclusion only when the engagement has been conducted in accordance with the attestation standards. Such standards will not have been complied with if the practitioner has been unable to apply all the procedures that the practitioner considers necessary in the circumstances.

~~A83~~ Pervasive effects on the subject matter are those that, in the practitioner's professional judgment

~~a. are not confined to specific aspects of the subject matter;~~

~~b. if so confined, represent or could represent a substantial proportion of the subject matter; or~~

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~~e. in relation to disclosures, are fundamental to the intended users' understanding of the subject matter.~~

Alternately, the ARSC may conclude that the attestation literature is appropriate and that AR-C section 90 should be revised to be consistent with it.

For convenience, the full text of the applicable sections from AU-C section 930 and AR-C section 90 are presented as an exhibit to this memorandum.

The Audit Issues Task Force considered the same issue and concluded that there is sufficient concern to warrant a project and exposure draft should changes be proposed. The AITF noted that AT-C section 210 is consistent in this regard with AT-C section 205, *Examination Engagements*. The issue becomes whether it is more appropriate for the attestation engagement to be consistent or the review literature.

Action Requested of ARSC

The ARSC is asked to consider and provide feedback as to whether AT-C section 210 should be revised so as to be consistent with the requirements and guidance in AU-C section 930 and AR-C section 90 with respect to how known misstatements are treated (or, alternatively, whether AR-C section 90 should be revised to be consistent with AT-C section 210).

If the ARSC concludes that AT-C section 210 should be revised, the Committee is asked whether such revision should be (a) included as part of the Auditing Standards Board project to consider amending the attestation standards for examination, review and agreed-upon procedures engagements to address situations in which a responsible party does not provide a written assertion to the practitioner or (b) exposed for public comment earlier.

Alternatively, if the ARSC concludes that AR-C section 90 should be revised, the proposed revision could be included in the Omnibus-2018 ED.

Agenda Items Presented:

None.

Exhibit

Relevant section from AU-C section 930

Modification of the Auditor's Review Report

.34 When the interim financial information has not been prepared in accordance with the applicable financial reporting framework in all material respects, the auditor should consider whether modification of the auditor's review report on the interim financial information is sufficient to address the departure from the applicable financial reporting framework. (Ref: par. .A44–.A47)

.35 If the auditor concludes that modification of the standard review report is sufficient to address the departure, the auditor should modify the review report. The modification should describe the nature of the departure and, if practicable, should state the effects on the interim financial information. If the departure is due to inadequate disclosure, the auditor should, if practicable, include the information in the report that the auditor believes is necessary for adequate disclosure in accordance with the applicable financial reporting framework. (Ref: par. .A48)

.36 If the auditor believes that modification of the review report is not sufficient to address the deficiencies in the interim financial information, the auditor should withdraw from the review engagement and provide no further services with respect to such interim financial information.

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Modification of the Auditor's Review Report (Ref: par. .34–.35)

.A44 Departures from the applicable financial reporting framework include inadequate disclosure and changes in accounting policies that are not in accordance with the applicable financial reporting framework.

.A45 Section 700 addresses the reporting requirements when the circumstances contemplated by the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct are present.

.A46 If the interim financial information adequately discloses the existence of substantial doubt about the entity's ability to continue as a going concern (see paragraph .16) or a lack of consistency in the application of accounting principles affecting the interim financial information, the auditor may, but is not required to, include an emphasis-of-matter paragraph in the auditor's review report.

.A47 Exhibit C, "Illustrations of Example Modifications to the Auditor's Review Report Due to Departures From the Applicable Financial Reporting Framework," contains illustrative examples of paragraphs modifying the auditor's review report.

.A48 The information necessary for adequate disclosure is influenced by the form and context in which the interim financial information is presented. For example, the disclosures considered necessary for interim financial information presented in accordance with the minimum disclosure requirements of FASB ASC 270-10-50-1, which is applicable to condensed financial statements of public companies, are considerably less extensive than

those necessary for annual financial statements that present financial position, results of operations, and cash flows in accordance with the applicable financial reporting framework. FASB ASC 270-10-50-3 states that a presumption exists that users of summarized interim financial data will have read the latest published annual report, including the financial disclosures required by GAAP and management's commentary concerning the annual financial results, and that the summarized interim data will be viewed in that context.

Relevant section from AU-C section 930

Known Departures From the Applicable Financial Reporting Framework

- .56** When the accountant becomes aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements and if the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departure.
- .57** If the accountant concludes that modification of the standard report is adequate, the departure should be disclosed in a separate paragraph of the report under the heading “Known Departures From the [*identify the applicable financial reporting framework*],” including disclosure of the effects of the departure on the financial statements if such effects have been determined by management or are known to the accountant as the result of the accountant's procedures. (Ref: par. .A101 and .A106)
- .58** If the effects of the departure have not been determined by management or are not known to the accountant as a result of the accountant's procedures, the accountant is not required to determine the effects of a departure; however, in such circumstances, the accountant should state in the report that such determination has not been made.
- .59** If the accountant believes that modification of the standard report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant should withdraw from the review engagement. (Ref: par. .A102)
- .60** The accountant should not modify the standard report to include a statement that the financial statements are not in accordance with the applicable financial reporting framework. (Ref: par. .A103–.A105)

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Known Departures From the Applicable Financial Reporting Framework (Ref: par. .57 and .59–.60)

- .A101** Examples of headings that an accountant may use to disclose departures from an applicable financial reporting framework in the accountant's review report include the following:

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- Known Departures From Accounting Principles Generally Accepted in the United States of America
 - Known Departures From International Financial Reporting Standards as Promulgated by the International Accounting Standards Board
 - Known Departures From the Cash-Basis of Accounting
 - Known Departures From the Tax-Basis of Accounting
- .A102** Prior to withdrawing from a review engagement in those circumstances when the accountant believes that modification of the standard report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant may wish to consult with legal counsel.
- .A103** Including a statement that the financial statements are not in accordance with the applicable financial reporting framework would be tantamount to expressing an adverse opinion on the financial statements. Such an opinion can be expressed only in the context of an audit engagement. Furthermore, such a statement in an accountant's review report may confuse users because it would contradict the statement required in paragraph .39f about whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework.
- .A104** Depending on the accountant's assessment of the possible dollar magnitude of the effect of the departures, the significance of the affected items to the entity, the pervasiveness and overall impact of the misstatements, and whether disclosure has been made of the effect of the departures, the accountant may, in accordance with paragraphs .52–.55, include a separate paragraph in the accountant's review report stating the limitations of the financial statements. The following is an illustration of such a separate paragraph with respect to an accountant's review report on financial statements prepared in accordance with accounting principles generally accepted in the United States of America:

Limitations of the financial statements

Because the significance and pervasiveness of the matters described in the Known Departures From Accounting Principles Generally Accepted in the United States of America paragraphs makes it difficult to assess their impact on the financial statements, users of the accompanying financial statements should recognize that they might reach different conclusions about the company's financial position, results of operations, and cash flows if they had access to revised financial statements prepared in accordance with accounting principles generally accepted in the United States of America.

- .A105** Inclusion of a separate paragraph, such as that illustrated in paragraph .A104 in the accountant's review report is not a substitute for disclosure of the specific departures or the effects of such departures if such effects have been determined by management or are known as a result of the accountant's procedures.

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- .A106** Exhibit C, "Illustrations of Accountant's Review Reports on Financial Statements," contains an illustrative example of an accountant's review report that discloses a departure from the applicable financial reporting framework.