

AUDITING STANDARDS BOARD (ASB)

Meeting Highlights

May 11-13, 2021

Videoconference

MEETING ATTENDANCE

ASB Members

Tracy Harding, *Chair*

Brad Ames

Monique Booker

Patricia Bottomly

Sherry Chesser

Harry Cohen

Jeanne Dee

Horace Emery

Audrey Gramling

Diane Hardesty

Robert Harris

Kathy Healy

Jon Heath

Clay Huffman

Kristen Kociolek

Sara Lord

Maria Manasses

Chris Rogers

Tania Sergott

AICPA Staff

Jennifer Burns, *Chief Auditor*

Linda Delahanty, *Senior Technical Manager—A&A Standards*

Mike Glynn, *Senior Technical Manager—A&A Standards*

Ahava Goldman, *Associate Director—A&A Standards*

Hiram Hasty, *Associate Director—A&A Standards*

Judith Sherinsky, *Senior Technical Manager—A&A Standards*

Teighlor March, *Asst. General Counsel—General Counsel & Trial Board*

Andy Mrakovcic, *Technical Manager—A&A Standards*

Note: The meeting was open to observers, whose names are not listed.

Tracy welcomed the new members who will be joining the ASB and thanked the outgoing members, Monique Booker, Audrey Gramling, Kristen Kociolek, and Sara Lord, for their years of service. He provided an update of recent activities.

Highlights of the January and March ASB meetings were approved unanimously.

1. Specialists/Investments

Ms. Bottomly led the ASB in a discussion of the proposed SAS. The ASB voted unanimously to issue the SAS as a final standard after directing that the following substantive revisions be made, in addition to certain editorial changes:

AU-C section 501

- Paragraph A71, change “paragraph .07 of” to “the evaluation required by AU-C” and insert footnote referring to paragraph 7 of AU-C section 500.
- Par. A72 change “one or more of” to “matters such as”
- Par. A72 last bullet, change to separate subparagraph.

- Paragraphs A84-A86, content substantively unchanged but moved among the three paragraphs for better flow.
 - Par. A88, add “The management’s specialist has a conflict of interest relevant to the specialist’s work.” as a separate bullet.

AU-C section 540

- No amendment to par. A126
- Appendix C, numbered par. 2, delete the second sentence and replace with “Quoted market prices for derivative instruments and securities listed on national exchanges or over-the-counter markets that are obtained from sources such as financial publications, the exchanges, NASDAQ, or pricing services based on sources such as these generally provide sufficient evidence of the fair value of the derivative instruments and securities.”
- Appendix C, numbered paragraphs 3, 4, 12 and 13, delete the phrase “directly or indirectly control or significantly”
- Appendix C, numbered par. 4, change the first sentence to “The procedures performed under section 550, Related Parties, can assist the auditor in evaluating the reliability of the audit evidence obtained from the pricing service by taking into account the ability of management to influence the information obtained from the pricing service through relationships between the entity and the pricing service.”
- Appendix C, numbered par. 13, delete the phrase “considering the entity’s model and considering any contradictory evidence.”
- Appendix C, numbered par. 14, revise to read as follows: “ The procedures performed under section 550, Related Parties, can assist the auditor in evaluating the reliability of the audit evidence obtained from the broker or dealer by taking into account the ability of management to influence the information obtained from the broker or dealer through relationships between the entity and the broker or dealer.”

AU-C section 630

- Par. A30, omit the phrase “including the need for the auditor’s internal specialist to apply professional skepticism.”
- Par. A31, delete “for example, testing the entity's process used to develop an accounting estimate, including when a management's specialist is involved in developing the estimate or developing an independent expectation of an estimate” from last subbullet of second bullet.
- Par. A35, insert “the risk of material misstatement in the matter to which the specialist’s work relates”
- Par. A41, re-order the bullets.

2. Risk Assessment

Ms. Manasses led the ASB in a discussion of issues and proposed changes to proposed Statement on Auditing Standards (SAS) *Identifying and Assessing the Risks of Material Misstatement*

Through Understanding the Entity and its Environment (Proposed SAS), in response to issues raised in the comment letters received on the exposure draft of the proposed SAS.

Significant comments or observations by the ASB members related to the issues presented were as follows:

Spectrum of Inherent Risk

- The ASB agreed with the addition of a description of the spectrum of inherent risk within the definition of inherent risk factors but suggested adding a separate caption titled *spectrum of inherent risk* within the definition section referring to the definition of inherent risk factors in order to enhance the searchability of the phrase.

Evaluation of Internal Control Components (Excluding Control Activities)—

- ASB members expressed the view, and agreed with the Task Force, that controls that addressed the risks of material misstatement exist within the control activities component. However, such controls could exist in other components as well.
- An ASB member was still concerned that the work effort as articulated by the word “evaluate” is not clear.
- ASB members supported the Task Force’s recommendation that in obtaining an understanding of the control environment, the entity’s risk assessment process, the entity’s process to monitor the system of internal control, and the information system and communication components, inquiry alone may be sufficient.
- ASB members expressed the view that the application material provides sufficient guidance with respect to obtaining an understanding of the entity’s system of internal control, but the Task Force was directed to determine whether guidance can be further enhanced by improving its organization.
 - After discussion, the ASB agreed with the Task Force’s recommendation to edit the requirements in paragraphs 21b, 22b, 24b, and 25c and to clarify the guidance that inquiry alone may be sufficient in obtaining an understanding of the control environment, the entity’s risk assessment process, the entity’s process to monitor the system of internal control, and the information system and communication components of internal control.

The Entity’s Risk Assessment Process and Interplay with AU-C section 240

- The ASB agreed with the Task Force’s recommendation to clarify the requirement in paragraph 22 to specifically refer to understanding the entity’s process for identifying the potential for fraud. This change is intended to align paragraph 22 of the proposed SAS with paragraph 17 of AU-C section 240..

Evaluation of the Information System and Communication

- The ASB agreed with the Task Force’s recommendations to
 - add application material to paragraph 25c referring to Appendix C, which further describes the information system and communication component.

- edit paragraph 25 to include a reference to considering the nature and complexity of the entity.

Separating the Requirements Related to Control Activities

- The ASB agreed with the Task Force’s recommendation to restructure paragraph 26 into separate paragraphs to enhance clarity and readability, in response to comments related to complexity and understandability of the proposed SAS.

Controls over Journal Entries

- The ASB reviewed proposed revisions to paragraph .26(a)(ii) (temporarily renumbered as 26Ab) and conforming amendments to paragraph 32(a)(i) in AU-C section 240. The ASB directed the Task Force to modify the requirement in the proposed SAS, rather than making conforming amendments to AU-C section 240.

Assessing Control Risk

- In response to specific comments about the clarity of paragraph 34, the ASB agreed to edit paragraph 34 so that it reads as follows:

34. For identified risks of material misstatement at the assertion level, the auditor should assess control risk based on the auditor’s understanding of controls and the auditor’s plan to test the operating effectiveness of controls. If the auditor does not plan to test the operating effectiveness of controls, the auditor should assess control risk at maximum such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk.

It was specifically noted that this change was made for purposes of clarifying the language to make the requirement more understandable and does not create a difference in what is required by ISA 315 (Revised 2019) and by the proposed SAS (that is, not ISA-plus, ISA-minus, or ISA-different).

- The ASB also agreed with the addition of guidance that addresses how the auditor’s evaluation of design and determination of implementation of identified controls may impact the nature or timing of the auditor’s further audit procedures.

Clarifying the Concept of Reasonable Possibility

- The ASB agreed with the addition of application material that explains that a reasonable possibility that a risk of material misstatement exists when the likelihood of a material misstatement occurring is more than remote.

Documenting a Combined Assessment of Inherent Risk and Control Risk

- The ASB agreed to include guidance in the proposed SAS explaining that the auditor may, but is not required to, document a combined assessment of inherent risk and control risk.

New “Explanatory Memorandum” or “Wrap” Document

- The ASB directed the Task Force to prepare an executive summary to be issued simultaneously with the final SAS. This nonauthoritative document would be reviewed by the ASB before issuance, similar to the explanatory memorandum that accompanies a proposed standard in an exposure draft.

3. IAASB Update

Wendy Stevens, AICPA-nominated IAASB member, presented an update on IAASB activities.

4. Direct review engagements

The Board continued its discussion of whether to revise the attestation standards to (a) provide for direct review engagements, and (b) eliminate the prohibitions on reviews of some or all of the following: prospective financial information, internal control, and compliance with requirements of specified laws, regulations, rules, contracts, or grants. After discussion of issues, including the perceived inflexibility of extant standards, the Board directed that the Attestation Standards Task Force focus on broad issues related to attestation review engagements such as relevance, reporting issues, and practice issues, and in doing so explore further the implications for removing the previously mentioned prohibitions. The Board charged the Task Force with developing a consultation paper intended to elicit input from practitioners and other stakeholders regarding the extent to which extant attestation standards limit a practitioners ability to perform engagements in response to needs in the marketplace. The Accounting and Review Services Committee will be asked for input given that committee's expertise with review engagements and the concept of limited assurance.

5. Group Audits

Ms. Burzenski, Chair of ASB's Group Audits Task Force and a member of the IAASB's ISA 600 Task Force, led the ASB in a discussion of proposed International Standard on Auditing (ISA) 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (ED). The ASB is monitoring the changes being made to the ED in anticipation of converging AU-C 600 with ISA 600 (Revised). Dora Burzenski presented the changes that the IAASB had directed be made to the ED at their March 2021 meeting. The topics that were discussed were the scope and applicability of the proposed ISA, definitions, communications with component auditors, materiality, and the risk-based approach.

Significant comments by ASB members were as follows:

- The proposed ISA is not always clear about what documentation needs to reside in the group auditor's file and what documentation needs to reside in the component auditor's file. Ms. Burzenski noted that it is unlikely that the proposed ISA will include more detailed guidance in this area because the ISA is intended to be

principles-based; implementation guidance on this topic may need to be provided in a document outside the ISA

- The revision to the example in paragraph A5 is helpful because it clarifies that the three entities are being aggregated into a single component for the purpose of performing audit procedures because they are similar (e.g., they have a common system of internal control and are under common management), and not solely for the purpose of reducing the amount of testing.
- Paragraph 44*h* requires the group auditor to request that the component auditor communicate matters relevant to the group auditor's conclusion with regard to the group audit, such as the component auditor's overall findings, conclusions, or opinion. Paragraph A112B indicates that although an overall summary memorandum or report from the component auditor, including the component auditor's overall findings, conclusions, or opinion, may provide audit evidence about the work performed by the component auditor, such information typically is not sufficient on its own. This statement may create an expectation by the group auditor of a communication that is more detailed than what is required.
- Paragraph A52*b* indicates that a factor that contributes to two-way communication is "clarity of the instructions to the component auditor, particularly when the component auditor is from another firm and may not be familiar with the policies and procedures of the group auditor." An ASB member commented that it would not be practical to communicate the policies and procedures of the group auditor's firm to a component auditor from a non-network firm, and in some cases, even a network firm. The member believes that a component auditor need not follow the group auditor's policies and procedures in order for the group auditor to obtain sufficient appropriate audit evidence to express an opinion on the group financial statements.
- An ASB member requested guidance on the application of component performance materiality and tolerable misstatement and also guidance on the application of component performance materiality related to an equity method investment.
- In paragraph 25, the words "results of those procedures" at the end of the sentence refers to the component auditor's evaluation of the risks of material misstatement of the group financial statements. As worded, the paragraph would require the group auditor to "evaluate the component auditor's evaluation" of the risks of material misstatement of the group financial statements. To avoid the notion of evaluating an evaluation, it was suggested that the words "shall evaluate" be changed back to "shall consider."
- The application guidance regarding materiality (paragraphs A73-A74) linked to paragraph 29 may cause regulators to expect excessive documentation about how the auditor mitigated aggregation risk, for example in an audit of a large disaggregated

group. Some of the guidance in these paragraphs relates to methodology and would be more appropriate in implementation guidance.

- Paragraphs A78-A79A indicate that in applying ISA 315, the group auditor develops an initial expectation about the potential risks of material misstatement and may, and often will, involve component auditors in risk assessment procedures. An ASB member believes that these application paragraphs may establish an expectation that the group auditor will communicate initial thoughts about the risk assessment, the component auditor will provide feedback, and a series of back and forth communications will follow. Because risk assessment is performed at the group level, the proposed standard should not establish such an expectation.