



## Agenda Item 1

### Direct Engagements, Discussion Memo and Issues

#### Objective

The Direct Engagements Task Force (task force) has been charged with developing an attestation standard that would enable practitioners to report on an examination or review engagement under the attestation standards without having to request a written assertion from the responsible party. The task force is seeking input from the ASB regarding several issues to assist it in developing the proposed direct engagements attestation standard.

#### Direct Engagements Task Force

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#### Background

Paragraph 10 of AT-C section 105, *Concepts Common to All Attestation Engagements*, defines *assertion* as any declaration or set of declarations about whether the subject matter is in accordance with (or based on) the criteria, and defines *responsible party* as the party responsible for the subject matter. All the clarified attestation standards (AT-C sections 105-320) require the practitioner to request a written assertion from the responsible party. In this paper, engagements for which a practitioner is required to request a written assertion are referred to as *assertion-based engagements* and engagements for which a practitioner is not required to request a written assertion are referred to as *direct engagements*.

Mike Santay, Chair of the ASB, and Chuck Landes, AICPA Vice President, Professional Standards and Services, established the following operating principles for the task force:

- The responsible party will not be required to provide a written or oral assertion.
- The proposed direct engagement standard will address both examination and review direct engagements.
- The practitioner will prepare the subject matter, if applicable, and perform the initial measurement or evaluation of the subject matter against the criteria.

- The requirements and application guidance in the proposed direct engagements standard will focus on engagement execution and reporting.
- The service will be engagement driven meaning that the proposed direct engagements standard will be applicable when the practitioner is engaged to perform that service.
- The task force will develop factors to consider in determining whether to perform the engagement under AT-C 205, *Examination Engagements* (AT-C 210, *Review Engagements*) or whether to perform the engagement under the proposed direct engagements standard.
- The responsible party's inability to provide an assertion may increase the risk that the subject matter is not in accordance with the criteria.
- The GAO's performance audit is not addressed by the proposed direct engagements standard. Such engagements should be performed under Government Auditing Standards or under AT-C section 205.
- The report for a direct engagement may differ from a report under AT-C sections 205 or 210; however, it should address the market needs of users of the report.
- The task forced should consider providing illustrative reports

### **Progress of the Task Force**

At its July 26, 2016 meeting, the task force plans to discuss a document that

- maps the paragraphs in AT-C sections 105; 205, *Examination Engagements*; and 210, *Review Engagements*; to the related paragraphs in Canadian Standard on Assurance Engagements (CSAE) 3001, *Direct Engagements*, which was issued in July 2015;
- uses AT-C sections 105, 205 and 210 as a base;
- shows revisions to the introductory and requirement paragraphs in AT-C sections 105, 205, and 210 to create the introductory and requirement paragraphs of a proposed Statement on Standards for Attestation Engagements (SSAE) entitled *Direct Engagements* that addresses direct examination and review engagements; and
- identifies the paragraphs in CSAE 3001 that are not included in AT-C sections 105, 205 and 210

### **Issues for ASB Discussion**

#### Issue 1. Subject Matter vs. Underlying Subject Matter

CSAE 3001 uses the term *underlying subject matter* and defines that term in paragraph 14w as the phenomenon that is measured or evaluated by applying criteria. Paragraph 10 of AT-C section 105 uses the term *subject matter* and defines that term in the same way CSAE 3001 defines the term *underlying subject matter*. The task force has chosen to use the term *subject matter* in the proposed direct engagement standard, which is consistent with its use in the

clarified attestation standards. Does the ASB believe there is a need for a term other than *subject matter* to refer to the phenomenon that is measured or evaluated by applying criteria in a direct engagement?

Issue 2. Situations in Which the Practitioner Should Be Precluded From Reporting Under the Direct Engagements Standard

The task force tentatively concluded that a practitioner may report on any subject matter (including internal control) under the direct engagements standard as long as the preconditions for the engagement are met. The task force also concluded that if the engaging party is required by the criteria or by contract, law, or regulation to provide an assertion-based attestation report, the practitioner should not perform the engagement under the direct engagements standard. Does the ASB agree with these conclusions? Are there any other preconditions or situations in which the practitioner should be precluded from performing an examination or review under the direct engagements standard?

Issue 3. Practitioner Prepares the Subject Matter and Makes the Initial Evaluation or Measurement of the Subject Matter

The task force has concluded that an attribute of a direct engagement is that the practitioner (rather than the responsible party) will ordinarily prepare the subject matter, if applicable, (for example, a written presentation such as a schedule) and make the initial evaluation or measurement of the subject matter. The practitioner may also develop or select the criteria, unless the criteria are otherwise specified.

The preparation of the subject matter would be considered a separate engagement (non-attest service) and would not be a part of the direct engagement. Management would be required to assume all management responsibilities, oversee the service by designating an individual, preferably within senior management, who possesses suitable skills, knowledge, and/or experience to evaluate the adequacy and results of the service and accept responsibility for the service (AICPA Code of Professional Conduct, ET section 1.295.040.01)

Does the ASB agree that in all direct engagements, the practitioner would be the preparer of the subject matter, if applicable, and initial measurer or evaluator of the subject matter?

If the ASB agrees with this premise, engagements in which the responsible party prepares or makes the initial measurement or evaluation of the subject matter would always be performed under the assertion-based attestation standards (The answer to this question affects Question 2.)

Issue 4. Engagement Letter

Should there be a provision in the engagement letter acknowledging that the responsible party is not required to make an assertion and that the practitioner is responsible for preparing the subject matter, if applicable, and performing the initial measurement or evaluation of the subject matter?

Issue 5. Self-Review Threat and Misstatements in Subject Matter Prepared by the Practitioner

A direct engagement, like any attestation engagement, requires that the practitioner be competent and sufficiently knowledgeable about the subject matter to perform the engagement in accordance with professional standards. Assuming the practitioner has prepared the presentation of the subject matter, it would be unlikely that the practitioner would prepare a presentation that is materially misstated. However that could occur. With that in mind some of the requirements in the clarified attestation standards do not seem logical for a direct engagement, for example, paragraph 45 of AT-C section 205 states:

The practitioner should accumulate misstatements identified during the engagement other than those that are clearly trivial.

If there were misstatements in the practitioner-prepared subject matter, would the practitioner be able to identify them? If the practitioner did identify them, is the expectation that the practitioner would then correct them?

Would the practitioner ever issue a qualified or adverse opinion on subject matter for which they performed the initial measurement or evaluation? Could there be a situation in which the subject matter does not conform to the criteria and the practitioner does not correct the subject matter?

6. Request to Change From Assertion-Based to Direct Engagement

After being engaged to perform an attestation engagement under the assertion-based attestation standards, the responsible party might request that the practitioner change the engagement to a direct engagement. Should the practitioner be permitted to do so? Should the reasons for the request be a factor in the practitioner's decision? The following are some possible reasons for the request:

- The responsible party states that it misunderstood the terms of the engagement, which the responsible party believes were not sufficiently specific with respect to the assertion.
- During the course of the engagement, the practitioner identifies misstatements in the subject matter that the responsible party was not aware of. The responsible party is no longer confident in its assertion or does not wish to provide an assertion that identifies the misstatements.

Issue 7. Differences Between a Direct Engagement Report and an Assertion-Based Engagement Report

There is general agreement that a report resulting from a direct engagement should be distinguishable from a report resulting from an assertion-based engagement. How different should the two reports be? Should the report include a statement that the practitioner prepared the subject matter, if applicable, and performed the initial measurement or evaluation of the subject matter? Should there also be a statement that the responsible party did not and was not required to provide a written assertion?

The following is the illustrative examination report on subject matter included in AT section 205, with two possible changes. What other changes might be made to the practitioner's report?

*[Appropriate Addressee]*

We have examined *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*. XYZ Company's management is responsible for *[identify management's responsibility for the subject matter, for example, maintaining accurate and complete records that enable presenting the presentation of the schedule of investment returns]* in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*. Our responsibility is ~~to~~ *[identify the practitioner's responsibility, for example, to prepare the schedule of investment returns in accordance with [identify the criteria, for example, the ABC criteria set forth in Note 1, and]* express an opinion on *[identify the subject matter, for example, the schedule of investment returns]* based on our examination.

Our examination was conducted in accordance with the direct attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is in accordance with (or based on) the criteria, in all material respects. An examination involves performing procedures to obtain evidence about *[identify the subject matter, for example, the schedule of investment returns]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of *[identify the subject matter, for example, the schedule of investment returns]*, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

The direct attestation standards do not require us to request from XYZ Company, or XYZ Company to provide us with a written statement about whether [identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX] is in accordance with the [identify the criteria, for example, the ABC criteria set forth in Note 1]. Accordingly, XYZ Company did not provide us with such a statement.

*[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]*

*[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]*

In our opinion, *[identify the subject matter, for example, the schedule of investment returns of XYZ Company for the year ended December 31, 20XX or the schedule of investment returns referred to above]*, is presented in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*, in all material respects.

*[Practitioner's signature]*

*[Practitioner's city and state]*

*[Date of practitioner's report]*

Issue 8. Restricted-Use Report

Should all direct engagement reports include an alert restricting the use of the report to the engaging party?