



Agenda Item 2

Auditor Reporting — Discussion Memorandum

Discussion of Comment Letter Responses to “Issues for Consideration” and “Requests for Comment” from the Auditor Reporting Exposure Draft

Objective

To provide the ASB with preliminary feedback from the comment letters received on the exposure draft *Proposed Statements on Auditing Standards—Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements*, and to obtain direction from the ASB on certain matters.

Task Force

The Auditor Reporting Task Force (task force) members are:

- Dan Montgomery (Chair)
- Audra Harrington
- Jan Herringer
- Susan Jones
- Richard Miller
- Jeffrey Rapaglia
- Rick Reisig
- Mike Westervelt (TIC)

Background

On November 28, 2017 the ASB issued three exposure drafts, with comments due by May 15, 2018:

1. *Proposed Statements on Auditing Standards—Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements.*
 - *Forming an Opinion and Reporting on Financial Statements*
 - *Communicating Key Audit Matters in the Independent Auditor’s Report*
 - *Modifications to the Opinion in the Independent Auditor’s Report*
 - *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report*

- *Proposed amendments to various AU-C sections*
- 2. Proposed SAS, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports* [To be discussed as part of Agenda Item 4]
- 3. Proposed SAS, *Omnibus Statement on Auditing Standards—2018* [To be discussed as part of Agenda Item 5]

This discussion memorandum will focus on the first exposure draft relating to auditor reporting.

Effect on Extant AU-C Sections 800, 805, and 810

As noted in the exposure draft, the ASB concluded that changes to the 800 series (AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, AU-C section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, and AU-C section 810, *Engagements to Report on Summary Financial Statement*) should be addressed after feedback is received on the proposed SASs in the auditor reporting exposure draft. The auditor reporting task force intends to propose any necessary changes to the 800 series through a separate exposure draft, with the intent of aligning the effective dates of all the reporting standards to the extent practicable. Agenda Item 6 addresses certain 800 series topics.

Employee Benefit Plans

In April 2017, the ASB released an exposure draft for a new auditing standard, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* (proposed EBP reporting standard), that addresses the auditor's responsibilities to form an opinion and report on ERISA plan financial statements. The EBP reporting standard is being voted as a final standard at this meeting, as part of Agenda Item 1, recognizing that conforming amendments will need to be considered to align with the auditor reporting standards once they are finalized.

Agenda Items Presented

Item 2 – Discussion Memorandum

Item 2A – Detailed Comment Letter Responses to *Issues for Consideration* (Questions 10-11)

Mr. Montgomery will lead the discussion through Agenda Item 2.

Summary of Comment Letter Feedback

High Level Summary

Overall, the responses to the exposure draft, *Proposed Statements on Auditing Standards—Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements* (ED) were supportive of moving forward with changes to the auditor reporting model, subject to further revisions to the proposals in the ED to address comments received.

The task force received 38 comment letters. Nine respondents supported the exposure draft with no significant comments. Twenty-eight respondents supported the exposure draft with comments. A response was considered “supportive of the proposed SAS with comments” if it supported the direction of the standard but recommended changes to further enhance the proposed SAS. The task force considered this to be 37 respondents (97%) supporting moving forward with changes to the auditor reporting model for non-issuers, subject to further revisions.

One respondent (PWC) had significant concerns with the exposure draft and questioned whether changes to the auditor’s report are needed at this time. This respondent suggested the ASB undertake outreach with users of private company audit reports and others to determine the level of interest in changing the auditor’s report for private companies in the US and what the focus of those changes should be. Further, they believe the ASB should take advantage of the opportunity to more fully converge with the PCAOB’s form and content of the auditor’s report. A number of respondents that supported the direction of the proposed revisions also had various comments or suggestions about exploring the possibility of further alignment with the PCAOB auditor reporting model.

Requests for Comment

The ED contained twelve “Requests for Comment” (questions 1-9, and 12-14) seeking specific feedback from respondents. The task force noted two areas in particular that received varied responses.

Going Concern (question 2)

Many respondents supported including the descriptions of the responsibilities of management and the auditor relating to going concern in the report because they believe it will provide additional clarity to the users of the auditor’s report, and provided recommendations on how to better communicate such matters. Some respondents raised concerns about including a going concern section in every auditor’s report when there is no substantial doubt about an entity’s ability to continue as a going concern and, in some cases, no indication of events or conditions that could give rise to substantial doubt. Other respondents expressed concerns with requiring a statement about the appropriateness of the going concern basis of accounting when the going concern basis of accounting may not be relevant for all financial reporting frameworks. The task force will consider the comments received relating to this issue for discussion with the ASB at the October 2018 meeting.

Key Audit Matters (question 5)

Many of the respondents supported a separate standard to address communicating KAMs in the auditor's report and provided recommendations on how better to communicate such matters. However, several respondents indicated that it was not totally clear that the communication of KAM is not required for non-issuers and recommended that this be clarified in both proposed SAS *Forming an Opinion and Reporting on Financial Statements* (AU-C section 700) and proposed SAS *Communicating Key Audit Matters in the Independent Auditor's Report* (AU-C section 701). Other respondents suggested a closer alignment with the PCAOB's requirements for communicating critical audit matters, while others questioned whether nonissuers would want this information and believe there could unintended consequences to including a KAM model in GAAS. Concerns were also expressed about the auditor's report becoming complex and lengthy. The task force will consider the comments received relating to this issue for discussion with the ASB in October.

A high-level overview of the responses to the requests for comment can be found later in this discussion memorandum.

Issues for Consideration

The ED contained two "Issues for Consideration" (questions 10 and 11) seeking specific feedback from respondents. The responses to these questions are discussed in more detail below.

**ISSUES FOR CONSIDERATION
(Questions 10 & 11 from the Exposure Draft)**

The following contains a summary of the responses to the "Issue for Consideration" (questions 10 & 11) contained in the exposure draft.

Issue 1—Timing of Communications With Those Charged With Governance

Question 10 — Should the requirement in AU-C section 260 be more specific regarding the timing of communication about certain matters with those charged with governance, including whether there should be a requirement for certain communications to be made prior to issuance of the auditor's report?

Results — 31 of the 38 comment letters specifically responded to question 10. Of the 31 who responded 81% believe the requirement in AU-C section 260 should not be changed. There was strong sentiment that auditor judgment should be allowed and the proposed SAS should retain the flexibility in the timing of communications due to the variety of circumstances that may be encountered during an audit. Respondents noted that such flexibility is essential to ensure the proposed SASs are scalable and appropriate for audits of companies of all sizes and degrees of complexity.

Of the six respondents who supported including a requirement in the proposed SAS for communications to be made prior to the issuance of the auditor's report, the following are some of

the matters mentioned and the reasons why they believe the requirement should be included in the proposed SAS:

- communication of significant deficiencies and material weaknesses to those charged with governance should be made prior to the issuance of the auditor's report. (TN State)
- auditor's communications with those charged with governance required by AU-C section 260 should be made prior to issuance of the auditor's report (RSM) (KPMG)
- the requirement in AU-C 260 should be more specific regarding the timing of the communication about certain matters to those charged with governance (FICPA)
- be consistent with the PCAOB reporting model, which requires the auditor to provide a draft of the auditor's report to those charged with governance prior to issuance (NASBA)
- EY recommended the following:
 - AU-C section 260 should require the following matters to be communicated to those charged with governance prior to the issuance of the auditor's report:
 - Significant deficiencies and material weaknesses identified during the audit
 - Uncorrected 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
 - Significant judgments about threats to independence and related safeguards
 - the auditor should communicate the following events when they occur:
 - Identified potential illegal acts, noncompliance with laws, suspected fraud or whistle-blower allegations that might have a more than clearly inconsequential effect on the client's financial statements or cause us to question the integrity of management
 - requiring these matters to be communicated prior to the issuance of the auditor's report or when they occur would allow those charged with governance enough time to take the appropriate actions and enhance the auditor's ability to meet the objective of providing "those charged with governance timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process."
- Revising the requirement to communicate before report release date would eliminate other inconsistencies with certain of the required report elements. (KPMG) Some respondents also raised a question about whether key audit matters could be communicated if not also required to be communicated to those charged with governance prior to report issuance.

See Agenda Item 2A for detailed comment letter responses to Question 10.

The following is a summary of the results.

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<i>Question 10</i>	<i># Responses out of 31</i>	<i>Percentage of those who responded</i>
Supportive	5	16%
Supportive with comments	1	3%
Total supporting	6	19%
Not Supportive	25	81%

Task Force Recommendation

Based upon the responses received, the task force believes that AU-C section 260 should continue to retain the flexibility in the timing of communications and not require the auditor to make certain communications prior to the issuance of the auditor’s report, given the variety of circumstances that may be encountered by auditors of nonissuers. Accordingly, the task force will not propose any amendments to AU-C section 260 in this regard.

Action Requested of the ASB

1. Does the ASB agree that, based on the comment letter responses, AU-C section 260 should continue to retain the flexibility in the timing of communications and therefore no amendments should be made to AU-C section 260 for such matters?

Issue 2—Addressee in the Auditor’s Report

Question 11 — Please provide your views on the following:

- a. Would including the city and state of the addressee in the auditor’s report be beneficial to users of the financial statements?*
- b. What would the practical implications be if such a requirement were adopted?*

Results — 32 of the 38 comment letters specifically responded to question 11. Of the 32 who responded, 78% believe including the addressee’s city and state would not be beneficial to users of the financial statements and believe the difficulties in determining that information would outweigh the benefits.

The seven respondents that supported including the addressee’s city and state noted the following:

- appears appropriate but not sure what benefit the users will obtain from this information (TN state)
- beneficial to State regulators (NASBA)
- helpful to various users of the financial statements, including funding agencies, grantors, and others (NASBA)
- believe provision of such information would facilitate States’ adoption of firm mobility provisions (NASBA)

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- makes the addressee more complete and possibly more clear (office of Washington State auditor)
- some users may find that including the city and state of the addressee beneficial, but it is doubtful that many users will gain any significant benefit from this information (NYSSCPA)
- may be beneficial to users; however, would not provide any additional information to users and there could be practical difficulties (Cherry Bekaert)
- may be beneficial to some users of the financial statements; however, may not always be practical to implement in all instances and the difficulties in doing so may outweigh the benefits (ALGA)
- believe could be useful information and that there would be no practical implications if this requirement were adopted (NCACPA)

See Agenda item 2A for detailed comment letter responses to Question 11.

The following is a summary of the results.

<i>Question 11</i>	<i># Responses out of 32</i>	<i>Percentage of those who responded</i>
Supportive	2	6%
Supportive with comments	5	16%
Total supporting	7	22%
Not Supportive	25	78%

Task Force Recommendations

Based upon the responses received, the task force believes that the proposed SAS should not require the city and state of the addressee to be included in the auditor’s report. Accordingly, the task force will not propose any amendments to the proposed SAS relating to this matter.

Action Requested of the ASB

2. Does the ASB agree that, based on the comment letter responses, the city and state of the addressee should not be required to be included in the auditor’s report?

REQUESTS FOR COMMENT (Questions 1-9, and 11-14 from the Exposure Draft)

The following is a summary of the responses to the “Requests for Comment” (questions 1-9, and 12-14) contained in the exposure draft. This summary is being provided for reference purposes

only, and there is no plan to discuss the comments received on these issues during the July 2018 ASB meeting.

Proposed SAS *Forming an Opinion and Reporting on Financial Statements (AU-C 700)*
[Questions 1-4]

Question 1 — Are the proposed revisions to existing requirements clear and understandable, and is the application material helpful in supporting the application of those requirements?

Results — 31 of the 38 comment letters specifically responded to question 1. Of the 31 who responded, 15 supported the proposed SAS, and 15 supported the proposed SAS with comments. The task force viewed this as 97% of respondents believing that the revisions in the proposed SAS are clear and understandable, and the application material is helpful in supporting the application of the requirements, subject to further revisions to address the comments received.

The following is a summary of the results.

<i>Question 1</i>	<i># Responses out of 31</i>	<i>Percentage of those who responded</i>
Supportive	15	48.5%
Supportive with comments	15	48.5%
Total supporting	30	97%
Not Supportive	1	3%

The task force is not asking the ASB for any action at this time.

Question 2 — Are the descriptions of the responsibilities of management and the auditor relating to going concern (paragraphs 31b and 36biv) useful and understandable, in view of the calls for more information in the auditor’s report about their respective responsibilities in this area? Would any modifications to the descriptions of management’s responsibility be necessary for any specific financial reporting framework? Are there any concerns about possible confusion or misinterpretation about the auditor’s responsibilities, in particular the requirement to conclude on the entity’s ability to continue as a going concern, recognizing that the description is consistent with the requirement in paragraph .20 of AU-C section 570 (SAS No. 132)?

Results — 34 of the 38 comment letters specifically responded to question 2. Of the 34 who responded, 9 supported the proposed SAS, and 15 supported the proposed SAS with comments. Of those respondents who supported the proposed SAS with comments, many of those respondents believe additional guidance is needed to help the auditor when the going concern basis of accounting is not relevant in the context of the applicable financial reporting framework. The task

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force viewed this as 71% of respondents supporting the inclusion in the auditor’s report of the description of the responsibilities of management and the auditor relating to going concern, subject to further revisions to address the comments received.

10 of the 34 (29%) respondents did not support the enhanced discussion about going concern in the proposed SAS.

<i>Question 2</i>	<i># Responses out of 34</i>	<i>Percentage of those who responded</i>
Supportive	9	27%
Supportive with comments	15	44%
Total supporting	24	71%
Not Supportive	10	29%

The task force is not asking the ASB for any action at this time and will consider the comments received relating to this issue for discussion with the ASB at the October 2018 ASB meeting.

Question 3 — Will the requirement to identify those responsible for the oversight of the financial reporting process present any practical difficulties when those responsible for the oversight of the financial reporting process are also responsible for preparation of the financial statements (as may be the case, for example, in a small owner-managed entity)?

Results — 33 of the 38 comment letters specifically responded to question 3. Of the 33 who responded, 14 supported the proposed SAS, and 11 supported the proposed SAS with comments. The task force viewed this as 76% of respondents supporting the proposed SAS.

8 of the 33 (24%) respondents did not support identifying those responsible for the oversight of the financial reporting process in the auditor’s report.

The following is a summary of the results.

<i>Question 3</i>	<i># Responses out of 33</i>	<i>Percentage of those who responded</i>
Supportive	14	43%
Supportive with comments	11	33%
Total supporting	25	76%
Not Supportive	8	24%

The task force is not asking the ASB for any action at this time and will consider the comments received relating to this issue for discussion with the ASB at the October 2018 ASB meeting.

Question 4 — Does the expanded description of the auditor’s responsibilities, including the key features of the audit, provide useful information and greater transparency into what an audit is and what the auditor does? Are there any aspects of the auditor’s responsibilities that should be added?

Results — 31 of the 38 comment letters specifically responded to question 4. Of the 31 who responded, 16 supported the proposed SAS, and 11 supported the proposed SAS with comments. The task force viewed this as 87% of respondents supporting the proposed SAS, subject to further revisions to address the comments received.

4 of the 31 (13%) respondents do not believe the proposed SAS will provide useful information or greater transparency. One respondent is not in favor of increasing the amount of boilerplate language in the audit report (Washington State (8)).

The following is a summary of the results.

<i>Question 4</i>	<i># Responses out of 31</i>	<i>Percentage of those who responded</i>
Supportive	16	52%
Supportive with comments	11	35%
Total supporting	27	87%
Not Supportive	4	13%

The task force is not asking the ASB for any action at this time and will consider the comments received relating to this issue for discussion with the ASB at the October 2018 ASB meeting.

Proposed SAS Communicating Key Audit Matters in the Independent Auditor’s Report (*proposed new AU-C section 701*)
[Questions 5-6]

Question 5 — What are your views regarding whether the requirements and guidance in the proposed SAS will be helpful for auditors in determining and communicating KAMs?

Results — 35 of the 38 comment letters specifically responded to question 5. Of the 35 who responded, 9 supported the proposed SAS, and 14 supported the proposed SAS with comments. The task force viewed this as 66% of respondents supporting the proposed SAS and, in concept, communicating key audit matters (KAMs) in the auditor’s report, subject to further revisions to address the comments received.

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12 of the 35 (34%) respondents did not support creating a standard to permit the communication of KAM in the auditor's report.

The following is a summary of the results.

<i>Question 5</i>	<i># Responses out of 35</i>	<i>Percentage of those who responded</i>
Supportive	9	26%
Supportive with comments	14	40%
Total supporting	23	66%
Not Supportive	12	34%

The task force is not asking the ASB for any action at this time and will consider the comments received relating to this issue for discussion with the ASB at the October 2018 ASB meeting.

Question 6 — Is it sufficiently clear that the communication of KAMs is not required for audits of nonissuers?

Results — 33 of the 38 comment letters specifically responded to question 6. Of the 33 who responded, 11 supported the proposed SAS, and 8 supported the proposed SAS with comments. The task force viewed this as 58% of respondents believe the proposed SAS is sufficiently clear that the communication of KAM is not required for audits of nonissuers.

14 of the 33 (42%) respondents do not believe the proposed SAS is sufficiently clear that the communication of KAMs is not required.

The following is a summary of the results.

<i>Question 6</i>	<i># Responses out of 33</i>	<i>Percentage of those who responded</i>
Supportive	11	34%
Supportive with comments	8	24%
Total supporting	19	58%
Not Supportive	14	42%

The task force is not asking the ASB for any action at this time and will consider the comments received relating to this issue for discussion with the ASB at the October 2018 ASB meeting.

Proposed SAS Modifications to the Opinion in the Independent Auditor’s Report (AU-C section 705)

[Question 7]

Question 7 — Are the revisions to existing requirements clear and understandable, and is the application material helpful in supporting the application of those requirements?

Results — 32 of the 38 comment letters specifically responded to question 7. Of the 32 who responded, 25 supported the proposed SAS, and 7 supported the proposed SAS with comments. The task force viewed this as 100% of respondents believing that the revisions to AU-C section 705 are clear and understandable and the application material is helpful, subject to further revisions to address the comments received.

The following is a summary of the results.

<i>Question 7</i>	<i># Responses out of 32</i>	<i>Percentage of those who responded</i>
Supportive	25	78%
Supportive with comments	7	22%
Total supporting	32	100%
Not Supportive	0	0%

The task force is not asking the ASB for any action at this time and will consider the comments received relating to this issue for discussion with the ASB at the October 2018 ASB meeting.

Proposed SAS Emphasis-of-Matter and Other-Matter Paragraphs in the Independent Auditor’s Report (AU-C section 706)

[Questions 8-9]

Question 8 — Are the revisions to existing requirements clear and understandable, and is the application material helpful in supporting the application of those requirements?

Results — 29 of the 38 comment letters specifically responded to question 8. Of the 29 who responded, 23 supported the proposed SAS, and 5 supported the proposed SAS with comments. The task force viewed this as 96% of respondents supporting the proposed SAS and believe the revisions to AU-C section 706 are clear and understandable and the application material is helpful, subject to further revisions, if necessary, to address the comments received.

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One (4%) respondent (CLA (10)) does not believe the revisions to AU-C section 706 are clear and understandable.

The following is a summary of the results.

<i>Question 8</i>	<i># Responses out of 29</i>	<i>Percentage of those who responded</i>
Supportive	23	79%
Supportive with comments	5	17%
Total supporting	28	96%
Not Supportive	1	4%

The task force is not asking the ASB for any action at this time and will consider the comments received relating to this issue for discussion with the ASB at the October 2018 ASB meeting.

Question 9 — Is the interrelationship between emphasis-of-matter or other-matter paragraphs and KAMs clear and understandable, recognizing that the communication of KAMs is not required for audits of nonissuers? If not, what additional guidance would be helpful?

Results — 30 of the 38 comment letters specifically responded to question 9. Of the 30 who responded, 15 supported the proposed SAS, and 10 supported the proposed SAS with comments. The task force viewed this as 84% of respondents supporting the proposed SAS and believe that the interrelationship between emphasis-of-matter (EOM) paragraphs, other-matter (OM) paragraphs, and KAMs is clear and understandable, subject to further revisions to address the comments received.

5 of the 30 (16%) respondents do not believe the interrelationship is clear and understandable.

The following is a summary of the results.

<i>Question 9</i>	<i># Responses out of 30</i>	<i>Percentage of those who responded</i>
Supportive	15	50%
Supportive with comments	10	34%
Total supporting	25	84%
Not Supportive	5	16%

The task force is not asking the ASB for any action at this time and will consider the comments received relating to this issue for discussion with the ASB at the October 2018 ASB meeting.

**Proposed Amendments Addressing Disclosures in the Audit of Financial Statements
[Questions 12-14]**

Question 12 — Are the proposed changes appropriate and sufficient for purposes of enhancing the focus of the auditor on disclosures and, thereby, further enhancing audit quality?

Results — 32 of the 38 comment letters specifically responded to question 12. Of the 32 who responded, 26 supported the proposed SAS, and 6 supported the proposed SAS with comments. The task force viewed this as 100% of respondents supporting the proposed SAS and believe that the proposed changes are appropriate and sufficient for purposes of enhancing the focus of the auditor on disclosures and thereby further enhancing audit quality.

The following is a summary of the results.

<i>Question 12</i>	<i># Responses out of 32</i>	<i>Percentage of those who responded</i>
Supportive	26	81%
Supportive with comments	6	19%
Total supporting	32	100%
Not Supportive	0	0%

The task force is not asking the ASB for any action at this time and will consider the comments received relating to this issue for discussion with the ASB at the October 2018 ASB meeting.

Question 13 — Are there any specific areas where, in your view, additional enhancements to either the requirements or application material would be necessary for purposes of effective auditing of disclosures as part of a financial statement audit?

Results — 30 of the 38 comment letters specifically responded to question 13. Of the 30 who responded, 23 supported the proposed SAS, and 6 supported the proposed SAS with comments. The task force viewed this as 97% of respondents believe that there are no additional enhancements to either the requirements or application material necessary for purposes of effective auditing of disclosures as part of the financial statement audit.

The following is a summary of the results.

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<i>Question 13</i>	<i># Responses out of 30</i>	<i>Percentage of those who responded</i>
Supportive	23	77%
Supportive with comments	6	20%
Total supporting	29	97%
Not Supportive	1	3%

The task force is not asking the ASB for any action at this time and will consider the comments received relating to this issue for discussion with the ASB at the October 2018 ASB meeting.

Question 14 — Will the proposed changes to the assertions in AU-C section 315 help appropriately integrate the auditor’s audit approach to the risk of material misstatement in the disclosures with the audit work on the underlying amounts, thereby promoting a more effective audit of disclosures?

Results — 31 of the 38 comment letters specifically responded to question 14. Of the 31 who responded, 26 supported the proposed SAS, and 5 supported the proposed SAS with comments. The task force viewed this as 100% of respondents supporting the proposed SAS and believe that the proposed changes to the assertions in AU-C section 315 help appropriately integrate the auditor’s audit approach to the risk of material misstatement in the disclosures with the audit work on the underlying amounts, thereby promoting a more effective audit of disclosures.

The following is a summary of the results.

<i>Question 14</i>	<i># Responses out of 31</i>	<i>Percentage of those who responded</i>
Supportive	26	84%
Supportive with comments	5	16%
Total supporting	31	100%
Not Supportive	0	0%

The task force is not asking the ASB for any action at this time and will consider the comments received relating to this issue for discussion with the ASB at the October 2018 ASB meeting.