



## Agenda Item 7

### Auditor Reporting—AU-C 800 Series Discussion Memorandum

#### Objectives for the May 2019 ASB Meeting

- To discuss revised drafts of the following AU-C sections:
  - 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*
  - AU-C section 810, *Engagements to Report on Summary Financial Statements*
- To discuss proposed conforming amendments to Illustration 5, “A Report on Compliance With Aspects of Contractual Agreements Given in a Combined Report, and No Instances of Noncompliance Were Identified,” in AU-C Section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*
- To discuss issues related to
  - dual opinions in an auditor’s reports on regulatory basis financial statements intended for general use. in AU-C section 800
  - management’s and the auditor’s responsibilities related to going concern in AU-C section 805.

#### Members of the Auditor Reporting (AU-C 800 Series) Task Force

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

#### Observers

Mary Foelster

Kim Kushmerick

## Background

In 2015, the International Auditing and Assurance Standards Board (IAASB) issued new and revised International Standards on Auditing (ISAs) related to reporting on audited financial statements. In 2016, the IAASB made limited amendments to the ISA 800 series, which includes ISA 800 (Revised), ISA 805 (Revised), and ISA 810 (Revised). Rather than converging with the IAASB's changes to the ISA 800 series at that time, the ASB decided that it would reconsider revisions to the AU-C 800 series after the ASB had made further progress on its auditor reporting standards (AU-C 700 series).

In May 2019, the ASB finalized its auditor reporting standards and issued SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*. At its July 2019 meeting, the ASB plans to approve a separate exposure draft of proposed changes to the AU-C 800 series and to align the effective dates with those in SAS No. 134.

## Proposed Revisions to AU-C 800, 805, and 810

Mr. Montgomery plans to use Agenda Items 7A, 7B and 7C (drafts marked from the respective extant standards) for the ASB discussion. In addition to the marked changes, these documents include a number of comments and questions for the ASB's consideration.

All illustrative reports have now been updated to reflect changes to conform to the new structure of the auditor's report in SAS No. 134. A complete package of illustrative reports also will be provided to the ASB for final review and discussion in connection with the expected July 2019 vote to ballot an exposure draft of proposed revisions to AU-C 800, 805, and 810.

### Compliance Frameworks

In considering the introduction of the concept of a compliance framework in AU-C 800, a number of questions and concerns were raised during the various ASB discussions, including those related to the following:

- The applicability and acceptability of certain compliance frameworks
- How the auditor would determine whether a framework is a fair presentation or a compliance framework (i.e., what criteria would be used in making this judgment)
- Whether additional disclosures would be needed when the special purpose financial statements are prepared in accordance with a compliance framework
- Other implications for the auditor's report, including when a dual opinion would be required and when a restriction on use of the report would be warranted.

In view of these concerns and the discussion at the January 2019 ASB meeting, the Task Force concluded that the best course of action would be to start with extant AU-C section 800 (in which all special purpose frameworks are considered fair presentation frameworks), and identify the auditor reporting changes that would be needed to conform with the revisions to the AU-C 700 series in SAS No. 134. In doing so, a limited number of revisions, which were made to converge with ISA 800 (Revised) and discussed with the ASB, have been retained, e.g., identifying the various types of

special purpose frameworks in the application material rather than including them as part of the definition of the term *special purpose frameworks*.

Accordingly, all references to compliance frameworks, including wording intended to differentiate fair presentation and compliance frameworks, have been removed from the drafts of AU-C 800 in Agenda Items 7A and 7D.

The Task Force has continued to discuss a possible approach for permitting a single fair presentation opinion and eliminating the need for a dual opinion in certain circumstances when regulatory basis financial statements are intended for general use. See Issue 1 below.

#### ***Matters for the ASB:***

The ASB is asked to provide input on the proposed revisions to AU-C 800, 805, and 810. ASB members also are asked to consider the comments and questions included in Agenda Items 7A, 7B and 7C and to provide their views in connection with the walkthrough of the proposed SASs.

#### **Issue 1: Dual Opinions in Reports on Regulatory Basis Financial Statements Intended for General Use**

Paragraph .21 of extant AU-C section 800 addresses reporting on special purpose financial statements prepared on a regulatory basis of accounting when the special purpose financial statements together with the auditor's report are intended for general use. In these circumstances, the auditor is required to express an opinion on whether the financial statements are presented fairly in accordance with GAAP and an opinion on whether the financial statements are prepared in accordance with the regulatory basis of accounting (a dual opinion). Paragraph 21 states the following:

If the special purpose financial statements are prepared in accordance with a regulatory basis of accounting, and the special purpose financial statements together with the auditor's report are intended for general use, the auditor should not include the *emphasis-of-matter* or *other-matter* paragraphs required by paragraphs .19–.20. Instead, the auditor should express an opinion about whether the special purpose financial statements are presented fairly, in all material respects, in accordance with GAAP. The auditor should also, in a separate paragraph, express an opinion about whether the financial statements are prepared in accordance with the special purpose framework.

The emphasis-of-matter paragraph required by extant paragraph .19 alerts report users that the financial statements are prepared in accordance with a special purpose framework that is a basis of accounting other than GAAP and describes the framework. The other-matter paragraph required by extant paragraph .20 restricts the use of the report.

#### Task Force discussions

The Task Force notes that extant AU-C 210 and AU-C 800 have an implicit presumption that a financial reporting framework prescribed by law or regulation is acceptable for purposes of the engagement. Paragraph .A7 of extant AU-C 800 (paragraph .A8 of Agenda Item 7A) states the following (emphasis added):

The applicable financial reporting framework may encompass the financial reporting standards established by an organization that is authorized or recognized to promulgate standards for special purpose financial statements. In that case, those standards will be presumed acceptable for that purpose if the organization follows an established and transparent process involving deliberation and consideration of the views of relevant stakeholders. In some circumstances, law or regulation may prescribe the financial reporting framework to be used by management in the preparation of special purpose financial statements for a certain type of entity. For example, a regulator may establish financial reporting provisions to meet the requirements of that regulator. In the absence of indications to the contrary, such a financial reporting framework is presumed acceptable for special purpose financial statements prepared by such an entity.

The Task Force considered an approach that would eliminate the need for a dual opinion when the regulatory framework has been developed pursuant to an “established and transparent process” as described above. For purposes of discussion, the Task Force considered the comprehensive process followed by the National Association of Insurance Commissioners (NAIC) in developing the insurance statutory basis of accounting. The Insurance Audit Guides further describe the process followed in developing the NAIC *Accounting Practices and Procedures Manual* (Manual), which is the codification of statutory accounting principles (SAP) applicable to U.S insurance entities. The Manual is subject to an ongoing maintenance process. All states have adopted the Manual as the primary basis of prescribed SAP in those states. If, however, the requirements of state laws, regulations, and administrative rules differ from the guidance provided in the Manual or subsequent revisions, those state laws, regulations, and administrative rules will take precedence.

Attributes of the NAIC process that were considered by the Task Force as being part of an “established and transparent process” include, among others, the following:

- GAAP accounting and disclosure guidance is evaluated to determine if such guidance is applicable and should be included in SAP.
- The Statutory Accounting Principles Working Group (SAPWG) is responsible for developing and proposing new Statements of Statutory Accounting Principles (SSAPs) and amendments to adopted SSAPs.
- SAPWG has a documented SAP Maintenance Process and is responsible for developing and adopting substantive, nonsubstantive, and interpretative revisions to the Manual. This includes the review of all new or revised accounting and disclosure guidance in the GAAP hierarchy to determine whether the guidance is applicable to the insurance statutory basis of accounting.
- The Manual provides the basis for insurers to prepare financial statements for financial regulation purposes. If the guidance is deemed applicable to insurance entities, SAPWG develops proposed guidance that is exposed for public comment via its national and interim meetings and on the NAIC website, similar to the exposure process for new GAAP guidance. After exposure, the NAIC publicly discusses comments received to finalize changes to existing SSAPs or new SSAPs. The process is deliberative and many issues go through more than one comment period. The NAIC also maintains a list of the conclusions of SAPWG and the status of GAAP guidance currently being considered.
- A document is attached to all exposed documents that serves as the notice of public hearing and request for written comments.

The Task Force recognized that any approach that would provide an “exception” to extant paragraph .21 would involve the use of auditor judgment in determining whether the approach used in developing the framework is “established and transparent,” as well as in determining whether the regulatory basis of accounting used results in fair presentation of the financial statements.

The Task Force also is aware of concerns about the elimination of the dual opinion. As noted in the agenda materials for the October 2018 and January 2019 ASB meetings, GASB representatives have expressed concerns that eliminating the dual opinion could result in unintended consequences, e.g., it might “incentivize” state or local governments to create regulatory frameworks to achieve a specific financial statement outcome. An example is a state government that establishes a special purpose framework that is the same as GAAP but omits the requirement to record a liability for other postemployment benefits, thereby enabling the governmental entity to avoid a deficiency in revenue over expenditures. GASB believes that the requirement to express an adverse opinion to GAAP serves as an effective impediment to the adoption of such a framework by a state regulator.

Possible options

The Task Force believes that the considerations above lead to one of the following options:

- Option 1 -- Retain the status quo, i.e., auditor’s reports on regulatory basis financial statements intended for general use would include a dual opinion (adverse to GAAP, prepared in accordance with the framework) and use of the report would not be restricted.
- Option 2 -- Create an exception to paragraph .21 for a regulatory basis framework that is developed pursuant to an “established and transparent process” that would allow a single, fair presentation opinion and also not be restricted as to use. The Task Force discussed whether criteria based on the NAIC attributes noted above could provide a basis for an auditor judgment about an “established and transparent process.”

The following is a straw case illustration of how such a requirement might be included in AU-C 800 (paragraph references to Agenda Item 7A):

| <b>Requirements</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | <b>Application and Explanatory Material</b> |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------|
| <p><i>.21 Except for the circumstances described in paragraph .21A, if the special purpose financial statements are prepared in accordance with a regulatory basis of accounting, and the special purpose financial statements together with the auditor's report are intended for general use, the auditor should not include the <i>emphasis-of-matter</i> or <i>other-matter</i> paragraphs required by paragraphs .19 and .20. Instead, the auditor should express an opinion about whether the special purpose financial statements are presented fairly, in all material respects, in accordance with GAAP. The auditor should also, in a separate paragraph, express an opinion about whether the financial statements are prepared in accordance with the special purpose framework.</i></p> |                                             |

| Requirements                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | Application and Explanatory Material                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p><u>.21A When the organization responsible for developing the regulatory basis framework follows an established and transparent process that involves considering the views of relevant stakeholders, the auditor should express an opinion about whether the special purpose financial statements are presented fairly, in all material respects, in accordance with [the special purpose framework]. The auditor should not include the <i>emphasis-of-matter</i> or <i>other-matter</i> paragraphs required by paragraphs .19 and .20.</u></p> | <p>Application material could be provided to address the following points:</p> <ul style="list-style-type: none"> <li>• Reference paragraph .A8 of AU-C 800, which indicates that a special purpose framework would be presumed to be acceptable if the organization follows <u><i>an established and transparent process involving deliberation and consideration of the views of relevant stakeholders.</i></u></li> <li>• Include guidance for making the determination about whether the process followed is “established and transparent,” which might include: <ul style="list-style-type: none"> <li>— a deliberative and comprehensive process for considering new or revised GAAP requirements in determining requirements that are deemed appropriate for establishing and maintaining the regulatory framework</li> <li>— exposure of proposed guidance for public comment</li> <li>— discussion by the regulator of comments received on exposure prior to finalizing new or revised statutory accounting or disclosure requirements</li> <li>— A link back to paragraph .17 and related application material, including paragraph .A12b regarding the evaluation of “fair presentation” (i.e., whether the financial statements <u>represent the underlying transactions and events in a manner that achieves fair presentation</u>).</li> <li>— Consider whether guidance could be provided regarding “indications to the contrary,” as noted in paragraph .A8, which may indicate that a regulatory framework, even if purported to be developed pursuant to an “established and transparent process,” is not acceptable for the intended purpose.</li> </ul> </li> </ul> |

**Question for the ASB**

The ASB is asked for its views on the options described above. If the ASB agrees that option 2 merits further discussion, does the ASB have other thoughts about how this “exception” might be addressed in AU-C 800, and what additional guidance would be needed to help auditors make a judgment about whether the regulatory framework has been developed pursuant to an “established and transparent process?”

## Issue 2: Applicability of Going Concern Basis to Single Financial Statements and Elements

At its May 2018 meeting, the ASB discussed the applicability of the going concern basis of accounting to single financial statements and specific elements, accounts, or items of a financial statement. Various points of view were expressed, similar to previous discussions on the topic, and no conclusions were reached at that time about the most appropriate way to address this issue in proposed AU-C section 805.

At its July 2018 meeting, the ASB conducted a straw vote and decided that AU-C section 805 should be silent regarding whether a going concern assessment is needed or required for a single financial statement, element, account, or item, and that it should be left to auditor judgment to determine whether AU-C section 570, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*, is relevant to the audit.

During its January 2019 discussion, the ASB recommended that the task force

- consider adding an application material paragraph to AU-C section 805 indicating that the auditor’s report on an element of or single financial statement may include a statement that management is responsible for evaluating whether there are conditions or events that raise substantial doubt about the entity’s ability to continue as a going concern,
- add to the list of circumstances that precedes the illustrative reports that the going concern basis of accounting is relevant.

### Task Force discussions

The Task Force considered the ASB’s input from the January 2019 meeting, but also noted the preference for retaining the status quo in AU-C 805 expressed in the straw vote at the July 2018 ASB meeting. The status quo means being silent about going concern in AU-C 805 except for the following:

- The requirement in paragraph .8 for the auditor to comply with all AU-C sections relevant to the audit, and the requirement in paragraph .13 for the auditor, in planning and performing the engagement, to adapt all AU-C sections relevant to the audit as necessary in the circumstances of the engagement.
- References to going concern in the examples in the application material that support the requirements in paragraphs .8 and .13 (for example, in paragraphs .A8 and .A15 in Agenda Item 7B).

However, the Task Force noted that a gap may appear to exist in proposed AU-C 805 if the standard does not address, in some way, the requirements in AU-C section 700 of SAS No. 134 relating to the statements in the auditor's report about management's and the auditor's responsibilities for going concern. Because paragraph .16 of proposed AU-C section 805 requires the auditor to comply with the requirements for forming an opinion and reporting in AU-C section 700 (or the proposed EBP reporting SAS), questions may arise about whether the requirements relating to going concern responsibilities are applicable for audits of single financial statements or elements, or need to be adapted in some way.

The Task Force recommends that the following application material paragraph, which is based on paragraph A19 of ISA 805 (Revised), be added to AU-C section 805:

.A22 The applicable financial reporting framework may not specifically address whether management is required to make a going concern assessment for a single financial statement or a specific element, account, or item of a financial statement. Therefore, the description in the auditor's report of management's responsibilities relating to going concern may not be relevant or may need to be adapted as necessary. The description in the auditor's report of the auditor's responsibilities relating to going concern may also need to be adapted as necessary depending on whether section 570 is determined to be relevant to the audit in accordance with paragraph .13.

The Task Force also recommends that footnotes be added to each of the illustrative reports in AU-C section 805 referring back to paragraph .A22. These footnotes have been included in the illustrative reports in Agenda Items 7B and 7E.

The Task Force believes that this is an appropriate way of addressing the potential gap noted above, and does not believe that further discussion is needed about the applicability of going concern to single financial statements or a specific element, account, or item of a financial statement given the decision reached at the July 2018 ASB meeting.

In its discussions, the Task Force also noted the important point in paragraph .A30 of proposed AU-C 805 that the auditor may deem it appropriate to refer in the auditor's report on the single financial statement or a specific element of the financial statement to a going concern section included in the auditor's report on the complete set of financial statements.

**Question for the ASB**

The ASB is asked for its views on the recommendation of the Task Force as described above.

## Agenda Items Presented

- 7A AU-C 800, *Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, dated May 2019; marked from extant AU-C 800
- 7B AU-C 805, *Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, dated May 2019; marked from extant AU-C 805
- 7C AU-C 810, *Engagements to Report on Summary Financial Statements*, dated May 2019; marked from extant AU-C 800
- 7D AU-C 800 dated May 2019; marked from the draft presented at the January 2019 ASB meeting
- 7E AU-C 805 dated May 2019; marked from the draft presented at the January 2019 ASB meeting
- 7F AU-C 810 dated May 2019; marked from the draft presented at the January 2019 ASB meeting
- 7G Amendments to AU-C Section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*