



Agenda Item 2

Discussion Memo Certain Issues Related to AU-C Section 800 in the Proposed SAS, Amendments to AU-C Sections 800, 805, and 810 to Incorporate Auditor Reporting Changes from SAS No. 134

Objective of Agenda Item 2

To obtain the ASB's views on three issues raised in comment letters on the August 28, 2019 exposure draft of the proposed SAS *Amendments to AU-C Sections 800, 805, and 810 to Incorporate Auditor Reporting Changes from SAS No. 134*. (The relevant comments are presented starting on page 6.)

Issue 1. Removing the Five Special Purpose Frameworks (SPFs) From the Definition of SPF and Recasting Them as Examples of SPFs

In extant AU-C 800, the definition of special purpose framework (SPF) identifies the cash, tax, regulatory, contractual, and other bases of accounting as SPFs. The proposed SAS would recast these SPFs as examples of SPFs rather than as part of the definition of SPF. The following are the proposed changes to paragraph .7 of the ED that would achieve that objective.

7. ...

Special purpose framework. A financial reporting framework other than GAAP designed to meet the financial information needs of specific users. ~~that is one of the following bases of accounting:~~ (Ref: par. ~~A2-A5~~.A6)

.A1 The following are examples of special purpose frameworks (Ref: par. .01):

- a. **Cash basis.** A basis of accounting ~~that~~ the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis.** A basis of accounting ~~that~~ the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance

- companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
- d. Contractual basis.* A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor.
- e. Other basis.* A basis of accounting that comprises a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as *other comprehensive bases of accounting*.

The proposed changes to the definition of SPF would more closely align the definition in AU-C 800 with the definition in ISA 800 (Revised), *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*.

In its comment letter, Grant Thornton indicates that the requirements in extant AU-C 800 are premised on the SPFs that are defined at the beginning of the standard, and that defining each SPF enables the ASB to ascribe certain requirements to specified SPFs. This enables the auditor to determine which requirements apply in the circumstances. Deleting the definition of each type of SPF from the definition of SPF makes it difficult for the auditor to determine which requirements apply because it eliminates the “framework” for these defined terms. Grant Thornton believes the requirements lack clarity without the extant definition of SPF. If the ASB prefers to retain the proposed definition of SPF in the ED (i.e., in which the specified SPFs are cast as examples of SPFs), Grant Thornton believes the requirements associated with specified SPFs in general would need to be revised to be more agnostic rather than anchored to terms that are no longer defined. Grant Thornton recommends that the ASB reinstate the extant definition of SPF.

Question for the ASB

Should the five SPFs currently included in the extant definition of SPF be retained in the definition or should they be moved to application guidance as examples of SPFs, as proposed in the ED?

Issue 2. Adding “Financial Reporting Framework for Small-and Medium-Sized Entities” to the List of Examples of SPFs in Paragraph .A1

The Financial Reporting Framework for Small-and Medium-Sized Entities (FRF for SMEs) is an accounting framework that

- was developed by a working group of the AICPA in 2013.
- is an option for preparing streamlined financial statements for privately held owner-managed businesses that are not required to use GAAP.
- consists of a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements.
- has not been approved, disapproved, or otherwise acted upon by any senior technical

committee of the AICPA or the Financial Accounting Standards Board (FASB) and has no official or authoritative status.

The bodies recognized to establish authoritative accounting standards and frameworks by AICPA Council Resolution include FASB, FASAB, and IASB. The cash and tax bases of accounting have been recognized in AU-C 800 as SPFs for years and thus have been “grandfathered” into proposed AU-C 800. Currently, the FRF for SMEs framework is considered an “other basis” SPF. Because the FRF for SMEs was not established by a body recognized by AICPA Council Resolution to establish accounting standards, it is questionable whether the ASB can or should elevate the prominence of the FRF for SMEs framework in U.S. GAAS given that it has only been in existence for just over five years.

As indicated in their comment letters, the AICPA Technical Issues Committee (TIC) and the Texas Society of CPAs believe that FRF for SMEs should be included in paragraph .A1 of AU-C section 800 as an example of an SPF. TIC believes that the following attributes of FRF for SME’s (as compared to certain other SPFs currently included as examples) make FRF for SMEs a framework that warrants inclusion in paragraph A1:

- Currently, AICPA non-authoritative guidance indicates that the auditor’s report on financial statements prepared in accordance with FRF for SMEs would meet the requirements set forth in AU-C 905, *Alert That Restricts the Use of the Auditor’s Written Communication*, for issuing a general use report.
- FRF for SMEs is a more robust framework than the cash and tax bases because it includes both presentation and disclosure guidance and is more akin to U.S. GAAP than both the cash and tax bases, including management considerations related to going concern.
- Since its issuance, TIC believes the FRF for SMEs framework has become more widely accepted. As U.S. GAAP becomes more complex, costly, and onerous for smaller private entities, TIC believes the use of FRF for SMEs will increase.

Questions for the ASB

If the proposed definition of SPF in the ED is retained, should FRF for SMEs be included in paragraph .A1 of AU-C 800 as an example of an SPF?

If the ASB reverts to the extant definition of SPF, should the FRF for SMEs be a defined SPF on par with the cash and tax bases of accounting?

Do the ASB’s views differ depending on the resolution of Issue 1 above?

Issue 3. Requirement to Add an Alert to the Auditor’s Report on Financial Statements Prepared on a Contractual or Other Basis of Accounting Regarding the Suitability of These Financial Statements for Another Purpose

The ED includes a proposed change that would expand the requirement to add an alert to the auditor's report regarding the suitability of the financial statements for another purpose to the auditor's report on financial statements prepared in accordance with an other basis of accounting. Currently, that alert is required in the auditor's report on financial statements prepared in accordance with a contractual basis of accounting. Except for reports on regulatory basis financial statements intended for general use, paragraph .19 of extant AU-C 800 requires the auditor's report on special purpose (SP) financial statements to include an emphasis-of-matter paragraph

- a. stating that the SP financial statements are prepared in accordance with a SPF,
- b. referring to the note to the financial statements that describes that framework, and
- c. stating that the SPF is a basis of accounting other than GAAP.

When financial statements are prepared in accordance with a contractual or other basis of accounting, paragraph .19 of the proposed SAS requires that a statement be added to the emphasis-of-matter paragraph indicating that the financial statements may not be suitable for another purpose. FRF for SMEs would be considered an other basis of accounting; accordingly, the auditor's report on financial statements prepared in accordance with that basis of accounting would be required to include a statement about the suitability of the financial statements for another purpose.

ISA 800

Paragraph 13a of ISA 800 requires that the auditor's report on all SP financial statements describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information. In addition, paragraph .14 of ISA 800 requires that the auditor's report on all SP financial statements include an emphasis-of-matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a SPF as well as a statement that as a result, the financial statements may not be suitable for another purpose.

The following are some of the comments on this proposed addition to the auditor's report:

- TIC points out that the compilation and review literature does not require use of this additional language in the accountant's report.
- TIC believes that FRF for SMEs should be treated in the same way as the tax and cash bases, for which the additional language is not required. It also notes that for clients who have converted from U.S. GAAP to FRF for SMEs, the additional language could result in some lenders being more cautious about accepting this framework.
- Grant Thornton notes that the additional language is relevant and appropriate only in circumstances in which the auditor is required to describe the purpose for which the financial statements are prepared, as in paragraph .18a of AU-C section 800. Describing the original purpose provides the necessary context for the alert that the financial statements may not be suitable for another purpose. Grant Thornton recommends that the alert stating that the financial statements may not be suitable for another purpose be

required only when use of the auditor's report is restricted. For a report on financial statements prepared on an other basis of accounting, adding the alert noted above would be applicable if the auditor determines that use of the report should be restricted.

- E&Y opposes this addition and believes that extant paragraphs .A27 and .A28 provide appropriate application guidance. If the ASB believes that financial statements prepared under the cash, tax, or regulatory basis of accounting do not require an alert to the reader that the financial statements may not be suitable for another purpose, it should say so and provide application guidance explaining when that may be the case.

Question for the ASB

Should the proposed addition to AU-C 800 that requires the auditor to add an alert to the auditor's report on financial statements prepared on a contractual or other basis of accounting indicating that the financial statements may not be suitable for another purpose be retained?

Summary of Comments on Certain Topics Addressed in AU-C 800 of the Proposed SAS, Amendments to AU-C Sections 800, 805, and 810 to Incorporate Auditor Reporting Changes from SAS No. 134

Comments Relevant to AU-C Section 800, <i>Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>			
Paragraph No./ Topic	Commenter	Comment	Response to Comment
Views on Recasting Five SPFs as Examples of SPFs			
<p>Disagrees with moving SPFs to application paragraph as examples of SPFs.</p> <p>Par. 7 and A1</p> <p>Retain the 5 SPFs as the only SPFs rather than as examples of SPFs.</p>	Grant	<p>Definition of a special purpose framework/convergence matters</p> <p>We see that the Board is proposing to revise the definition of “special purpose framework” in order to align it more closely with the definition that exists in ISA 800 (Revised), <i>Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks</i>. While we generally support convergence, we are concerned this proposed change could have negative unintended consequences on the application of certain requirements in the standard given the specificity of those requirements to certain types of frameworks.</p> <p>Currently, AU-C section 800, <i>Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks</i>, defines a special purpose framework as being, specifically, one of the following: cash basis, tax basis, regulatory basis, contractual basis, or other basis. Each basis is then defined individually. This construct enables that certain requirements in the remainder of the standard be limited to certain of these bases. For example, requirements specific to when the regulatory basis of accounting is used or other requirements specific to contractual basis of accounting. Moving these definitions to application guidance and calling them examples of special purpose frameworks could result in unintended changes in how such frameworks, particularly regulatory, are currently defined and used in practice. We believe this could cause unnecessary confusion to auditors since the definitions will no longer align with how the remaining requirements are constructed. Accordingly, we recommend that the Board reconsider adopting the international definition and retain the extant presentation. If the Board moves forward with the definition as proposed, we believe further clarification to the requirements prescribed for specific types of special purpose frameworks will be necessary.</p> <p>As described in the body of the letter, we recommend the Board reinstate the existing definition of special purpose framework.</p>	

Summary of Comments on Certain Topics Addressed in AU-C 800
ASB Meeting, December 6, 2019

Comments Relevant to AU-C Section 800, <i>Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>			
Paragraph No./ Topic	Commenter	Comment	Response to Comment
		We generally support the other proposed changes with respect to converging with the international standards.	
<u>Add FRF for SMEs to the List of Examples of SPFs</u>			
FRF for SMEs should be added to the list of examples of SPFs Par. A1	TIC	<p>TIC believes that paragraph .A1 of AU-C section 800 specifically should address the FRF for SMEs as one of the examples of special purpose frameworks, rather than combining it with “other frameworks.” TIC believes that, since the issuance of the FRF for SMEs in 2013, this framework has become more widely accepted and is more akin to the cash and tax bases of accounting rather than the contractual basis, which typically would be limited as to use and may only be suitable for certain purposes. TIC would even argue that the FRF for SMEs is a more robust framework than the cash and tax bases, as it includes both presentation and disclosure guidance and is more akin to U.S. GAAP than both the cash and tax bases, including management considerations related to going concern.</p> <p>In addition, with the upcoming effective dates of the FASB revenue standard under ASC 606 and upcoming new standard on leases under ASC 842 for private companies, some TIC clients have found the FRF for SMEs to be the most suitable financial reporting framework that results in less cost and complexity while still satisfying the needs of financial statement users (typically this would include lenders). As noted at a September TIC meeting in Norwalk with the FASB, one TIC member noted almost 40 percent of their client base converted from U.S. GAAP to the FRF for SMEs due to these additional U.S. GAAP complexities. In large part, this has been due to this firm performing outreach and educating the local banks on the similarities and differences between U.S. GAAP and the FRF for SMEs.</p> <p>TIC believes that, as U.S. GAAP becomes more complex, costly, and onerous for smaller private entities to apply, this trend may continue. While the cash and tax bases might be widely understood and accepted, the recognition, measurement, and disclosure requirements are not nearly as robust as those required by the FRF for SMEs.</p>	<p><u>Points to Consider</u> Appendix A of the AICPA Code of Conduct, “Council Resolution Designating Bodies to Promulgate Technical Standards” does not include the body that established FRF for SMEs</p> <p>Cash and tax bases have a long history of use.</p>
	Texas Society	After reviewing amendments to Section 800, the committee thinks that the substantive meanings of the new definitions remain unchanged. On page 10, special purpose frameworks are defined, but the five specific frameworks provided as examples are not inclusive of the AICPA’s Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs). The definition on page 19 of “other basis” is open ended to include those frameworks that are not specifically mentioned. However, the alternative accrual basis framework that was	

Summary of Comments on Certain Topics Addressed in AU-C 800
ASB Meeting, December 6, 2019

Comments Relevant to AU-C Section 800, <i>Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>			
Paragraph No./ Topic	Commenter	Comment	Response to Comment
		developed for FRF for SMEs business by AICPA should be prominently included in the list of example frameworks.	
Views on Adding an Alert to the Report Regarding Suitability of SP Financial Statements for Another Purpose			
Supports the addition with appropriate revisions to EOM paragraph stating that the financial statements may not be suitable for another purpose when f/s are prepared in accordance with contractual or other basis of accounting Par. 19	Grant	<p>Suitability of purpose We support the Board’s proposal to enhance the emphasis-of-matter paragraph required by AU-C section 800 that alerts readers that the financial statements are prepared in accordance with a special purpose framework. However, we do not support requiring that the proposed additional statement, “as a result, the financial statements may not be suitable for another purpose,” apply to all financial statements prepared in accordance with contractual basis or other basis of accounting. We believe that such statement would be relevant and appropriate only in circumstances where the auditor is required to describe the purpose for which the financial statements are prepared (refer to proposed paragraph .18a of AU-C section 800). Describing the original purpose provides the necessary context to readers for the alert that the financial statements may not be suitable for another purpose. As such, we recommend revising proposed paragraph .19 as follows (<i>bolded italics</i> for additions and strikethrough for deletions).</p> <p>Except for the circumstances described in paragraph .21, the auditor’s report on special purpose financial statements should include an emphasis-of-matter paragraph under an appropriate heading that <i>includes the following</i>.</p> <p><i>a. A statement indicates</i> that the financial statements are prepared in accordance with a special purpose framework</p> <p><i>b. A reference refers</i> to the note to the financial statements that describes that framework, and</p> <p><i>c. A statement states</i> that the special purpose framework is a basis of accounting other than GAAP, <i>and</i></p> <p><i>d. When a description of the purpose for which the financial statements are prepared or reference to a note in the special purpose financial statements that contains that information is required pursuant to paragraph .18a, a statement that, as a result, the financial statements may not be suitable for another purpose.</i></p>	Par. 14 of ISA 800 requires this language in the EOM paragraph of all reports on f/s prepared in accordance with an SPF.
	E&Y	4) AU-C 800, paragraph 19 includes the following proposed addition:	

Summary of Comments on Certain Topics Addressed in AU-C 800
ASB Meeting, December 6, 2019

Comments Relevant to AU-C Section 800, <i>Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>			
Paragraph No./ Topic	Commenter	Comment	Response to Comment
<p>Opposes addition to EOM paragraph stating that the financial statements may not be suitable for another purpose when f/s are prepared in accordance with contractual or other basis of accounting Par. 19</p> <p>Opposes addition to EOM paragraph stating that the financial statements may not be suitable for another purpose when f/s are prepared in accordance with contractual other basis of accounting</p>		<p><i>“For special purpose financial statements prepared in accordance with a contractual basis or other basis of accounting, the emphasis-of-matter paragraph should also state that, as a result, the financial statements may not be suitable for another purpose.”</i></p> <p>We do not support this addition. We believe extant paragraphs .A27 and .A28 provide appropriate application guidance. If the ASB believes that financial statements prepared under the cash, tax or certain regulatory basis of accounting may not require an emphasis-of-matter paragraph alerting the reader that the financial statements may not be suitable for another purpose, it should say so and provide application guidance explaining when that may be the case.</p>	
	TIC	<p>TIC has concerns about the additional language to be added in paragraph .19 of the ED, which requires that, for special purpose financial statements prepared in accordance with a contractual basis or other basis of accounting, the emphasis-of-matter paragraph also should indicate that, as a result, the financial statements may not be suitable for another purpose. TIC believes that the FRF for SMEs should be treated the same way as the tax and cash bases, whereby this new additional language is not required. In addition, TIC believes the generic reference to “other basis” could cause diversity in practice so, perhaps, the ASB should consider being more prescriptive or consider adding examples in the implementation guidance paragraphs.</p> <p>TIC has concerns that, in cases where they have assisted clients in converting from U.S. GAAP to the FRF for SMEs and lenders and other users have accepted those audited financial statements, the addition of this language could add confusion and result in some lenders being more cautious of accepting this framework. TIC feels this language alludes to the fact that this alternative to U.S. GAAP may not be suitable when, in fact in most cases, it is a very suitable alternative to U.S. GAAP.</p> <p>In addition, TIC would like to note that the compilation and review literature does NOT require use of this additional language related to being suitable for another purpose. Below is the emphasis-of-matter paragraph that would be required when reviewing financial statements that have been prepared using the FRF for SMEs.</p> <p style="text-align: center;">Basis of Accounting</p>	

Summary of Comments on Certain Topics Addressed in AU-C 800
ASB Meeting, December 6, 2019

Comments Relevant to AU-C Section 800, <i>Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>			
Paragraph No./ Topic	Commenter	Comment	Response to Comment
Par. 19		<p>I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the AICPA’s Financial Reporting Framework for Small- and Medium-Sized Entities, which is a basis of accounting other than accounting principles generally accepted in the United States of America. My (Our) conclusion is not modified with respect to this matter.</p> <p>In addition, paragraph .A32 of AR-C section 80, <i>Compilation Engagements</i>, indicates the following: When the financial statements are prepared in accordance with a regulatory or contractual basis of accounting, the accountant is required by paragraph .20b to describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information. This is necessary to avoid misunderstandings when the financial statements are used for purposes other than those for which they were intended.</p> <p>Note that paragraph .A85 of AR-C section 90, <i>Review Engagements</i>, contains similar requirements. Therefore, the SSARS only require the practitioner to describe the purpose for which the financial statements are prepared when the financial statements are prepared in accordance with a regulatory or contractual basis of accounting, whereas the FRF for SMEs is treated the same as the tax and cash bases of accounting.</p> <p>TIC recommends consistency in the way financial statements prepared using the FRF for SMEs are treated under the SSARS and the way they are treated under the SASs since the SSARS do not require additional language related to the suitability of the report and TIC believes this is the appropriate treatment.</p>	