



Agenda Item 3

Discussion Memorandum Providing for Direct Examination Engagements and Other Matters Related to the Attestation Standards

Objective of Agenda Item 3

To discuss proposed modifications to the attestation standards that would enable practitioners to perform examination engagements when only the practitioner measures or evaluates the underlying subject matter against criteria (direct examination engagements). The proposed standards would do the following:

- Introduce the concept of *direct examination engagements* in AT-C section 105, *Concepts Common to All Attestation Engagements*
- Provide engagement acceptance, performance, and reporting requirements and application guidance for direct examination engagements in a new section of the attestation standards tentatively designated as AT-C section 206, *Direct Examination Engagements*
- Retain the performance of traditional assertion-based examination and review engagements under AT-C sections 205, *Examination Engagements*, and 210, *Review Engagements*

The proposed changes to the attestation standards do not provide for direct review engagements.

The members of the Attestation Standards Task Force (task force) are

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Background

Under the extant attestation standards, a practitioner who is unable to obtain a written assertion from the responsible party in an examination or review engagement is required to withdraw from the engagement, unless the engaging party is not the responsible party. An assertion is a statement from the responsible party about whether the subject matter is in accordance with (or based on) the criteria. Generally, in a direct engagement, the responsible party has not measured or evaluated the subject matter against the criteria and therefore does not have a basis for providing an assertion. For that reason, the engaging party engages the practitioner to perform the measurement or evaluation of the subject matter as part of the practitioner's evidence gathering process in a direct examination or review engagement. Providing for direct engagements is in the public interest it enables practitioners to report on subject matter when the responsible party does not or is unable to measure or evaluate the subject matter against the criteria and therefore is unable to provide the practitioner with an assertion. Direct examination reports would be permitted a variety of subject matters available to the public.

In July 2018 the ASB issued an exposure draft *Revisions to Statement on Standards for Attestation Engagements No. 18, Attestation Standards: Clarification and Recodification* (ED) that, in part, would have revised AT-C sections 105, 205, and 210 to provide for direct examination and review engagements.¹ In the current agenda materials, the proposed changes to the attestation standards provide for direct examination engagements but not for direct review engagements because some members of the ASB were uncertain about whether a practitioner could measure or evaluate underlying subject matter against criteria and obtain limited assurance on the subject matter information using the procedures in extant AT-C section 210, which primarily consist of inquiry and analytical procedures.²

Since exposure of the ED, the task force has presented various proposals and drafts of AT-C sections 105 and 205 to the ASB in an attempt to provide for direct engagements. Most ASB members support enabling the performance of direct engagements, and members also support retaining the traditional examination and review engagements presented in the extant attestation standards. At its October 28-31, 2019 meeting, the ASB agreed that AT-C sections 205 and 210 should be retained to provide for traditional examination and review attestation engagements and that a new AT-C section should be developed to provide for direct examination engagements.

At the January 13–16, 2020 ASB meeting, the task force presented a revised draft of AT-C section 105 that would enable practitioners to perform direct examination and review engagements by introducing that option in AT-C section 105, while retaining the option to perform traditional assertion-based examination and review engagements under AT-C sections 205 and 210, respectively. The January draft of AT-C section 105 requires the practitioner to adapt and apply AT-C sections 205 and 210 to direct examination and review engagements.

¹ The exposure draft *Revisions to Statement on Standards for Attestation Engagements No. 18, Attestation Standards: Clarification and Recodification* also included proposed revisions to AT-C section 215, *Agreed Upon Procedures Engagements*. In December 2019 the ASB issued SSAE No. 19, *Agreed Upon Procedures Engagements*, finalizing that portion of the project.

² Although extant AT-C section 210 is essentially premised on the performance of inquiry and analytical procedures, it permits the practitioner to perform procedures other than inquiry and analytical procedures if those procedures are not expected to provide sufficient review evidence or if the subject matter does not lend itself to those procedures.

The following are some of the changes to that model that the ASB requested at its October 2019 and January 2020 meetings, and how the task force responded to those requests:

- In response to the agreement reached by the ASB during its October 2019 meeting, the task force has drafted proposed AT-C section 206 (Agenda Item 3C) which contains the requirements and application guidance for direct examination engagements that differ from those in AT-C section 205, such as requirements related to preconditions, acceptance and continuance of the engagement, terms of the engagement, written representations, and wording of the practitioner’s report. For all other requirements, the practitioner is directed to apply and, if necessary, adapt AT-C section 205 to the direct examination.
- Provide guidance on factors the practitioner should consider in determining whether to perform a direct examination engagement. The task force included such requirements and guidance under the headings “Preconditions” and “Engagement Acceptance and Continuance” in the draft of proposed AT-C section 206.
- Provide guidance to assist practitioners in determining how to adapt AT-C sections 205 to direct examination engagements. The task force added some examples under the heading “Adapting AT-C Section 205 to a Direct Examination Engagement” in the draft of proposed AT-C section 206.
- Although the practitioner’s report in a direct examination engagement and in an assertion-based examination engagement may ultimately contain some differences in language, the practitioner’s opinion or conclusion should be the same in both reports because the practitioner would obtain the same level of assurance in both engagements. In the reporting requirements and illustrative reports in proposed AT-C section 206, the task force retained the opinion that is included in an assertion-based examination report.
- Given that the term *direct examination* is a new concept, AT-C sections 105 and 205 use the following drafting conventions to clearly identify the type of engagement being referred to:
 - *assertion-based examination*, when the requirement or application guidance applies to assertion-based examinations
 - *direct examination*, when the requirement or application guidance applies to direct examinations

The task force used this terminology in the drafts.

- In the extant attestation standards, the term *subject matter* refers to the phenomenon that is measured or evaluated by applying criteria. The IAASB International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, provides for direct engagements and uses the term *underlying subject matter* (USM) to refer to the phenomenon that is measured or evaluated by applying criteria, and the term *subject matter information* (SMI) to refer to the outcome of the measurement or evaluation of the USM against the criteria. At its October 2019 and January 2020 meetings, the ASB asked the task force to

use the terms USM and SMI in the attestation standards because using those terms clarifies that in any examination or review engagement a party other than the practitioner is responsible for the USM, while in a direct examination engagement the practitioner needs to be independent of the USM but not necessarily independent of the SMI. The task force has defined these terms in AT-C section 105 and used them in AT-C sections 105 and 206, but not in AT-C sections 205 and 210 in order to retain the extant language in those sections. To acknowledge the new terminology, the following sentence was inserted in the first paragraph of AT-C sections 205 and 210 and will be inserted in AT-C section 215 in the final SSAE: “For purposes of applying this section, the term *subject matter* encompasses the terms *underlying subject matter* and *subject matter information*, as defined in AT-C section 105.”

- The ASB asked the task force to provide examples of USM and SMI in the application guidance to help practitioners understand the difference between these two concepts. Based on previous ASB discussions, the task force noted that the meaning of these terms can sometimes be elusive because the meaning of these terms depends on the context in which they are used, the particular facts and circumstances of the engagement, and what the practitioner has been engaged to report on. For example, SMI may be in the form of the responsible party’s assertion, a schedule of royalties, or the practitioner’s measurement or evaluation of the USM. Each of these represents the outcome of the measurement or evaluation of USM against criteria. Although these concepts are important in establishing a basis for the practitioner’s independence in a direct examination engagement, the task force does not believe it would be beneficial to provide examples of USM and SMI because they are subject to varying interpretations. The importance of using these terms in the attestation standards is to emphasize that the responsible party, and not the practitioner, is responsible for the USM.

It should be noted that in the Objectives section of proposed AT-C section 105, extant paragraph .09b, shown below, has been deleted because it is included in proposed AT-C sections 205, 206, and 210 and is subsumed by extant paragraph .09a, also shown below

11.09 In conducting an attestation engagement, the overall objectives of the practitioner are as follows:

- a. Apply the requirements relevant to the attestation engagement.
- ~~b. In an examination or review engagement, report on the subject matter or assertion, and in an agreed-upon procedures engagement, report on the procedures performed and related findings without providing an opinion or conclusion on the subject matter~~
- be. Communicate as required by the applicable AT-C section, in accordance with the results of the practitioner's procedures.
- ~~cd.~~ Implement quality control procedures at the engagement level that provide the practitioner with reasonable assurance that the attestation engagement complies with professional standards and applicable legal and regulatory requirements.

In these agenda materials, most of the proposed revisions to the attestation standards were made to provide for direct examination engagements. AT-C sections 205 and 210 are relatively unchanged. However, certain additional changes were made to those sections in response to support of commenters on the following proposals in the ED:

- *In all attestation reports, add a statement to the practitioner's report regarding independence.* The ED requires the practitioner to include a statement in the practitioner's report indicating that the practitioner is independent and has fulfilled the practitioner's other ethical responsibilities in accordance with relevant ethical requirements related to the engagement. This new requirement aligns with the requirement in ISAE 3000 (Revised).
- *In AT-C sections 205 and 210,*
 - *add a requirement for the practitioner to determine whether management has a reasonable basis for its assertion when management provides an assertion.* The ED requires the practitioner to use professional judgment in determining whether the responsible party has a reasonable basis for making its assertion.
 - *acknowledge the practitioner's ability to add information to the practitioner's report that goes beyond the minimum report elements required by AT-C sections 205 and 210.* Consistent with ISAE 3000, the ED adds application guidance to AT-C sections 205 and 210 to indicate that a practitioner may issue a report that contains only the minimum required report elements or issue a report that expands on or supplements those elements, for example, a report that contains details about the terms of the engagement, the applicable criteria being used, findings relating to particular aspects of the engagement, details of the qualifications and experience of the practitioner and others involved with the engagement, a description of the procedures the practitioner performed, and, in some cases, recommendations.
 - *eliminate the required report modification resulting from the practitioner's inability to obtain one or more requested written representations.* The ED
 - revises paragraph .A64 of AT-C section 205, which indicates that failure by the responsible party to provide one or more written representations results in a scope limitation sufficient to preclude an unmodified opinion,
 - permits the practitioner to use professional judgement in determining whether sufficient appropriate evidence about the matter addressed by that representation has been obtained by performing other procedures, and
 - revises paragraphs .55 of extant AT-C section 205 and .38 of extant AT-C section 210 to say that if the appropriate party does not provide the requested representations, and the matter is not resolved to the practitioner's satisfaction, the practitioner should determine the possible effect on the opinion (or conclusion) in the practitioner's report.

This approach would be consistent with AU-C section 580, *Written Representations*, when the engaging party and the responsible party are the same, and would also converge with ISAE 3000 (Revised) when the engaging party and responsible party are different

- *In AT-C section 210,*
 - *clarify the types of procedures a practitioner may perform in a limited assurance engagement.* Although extant AT-C section 210 permits the practitioner to perform procedures other than inquiry and analytical procedures in a review engagement, it is essentially premised on the performance of those procedures. The ED more closely harmonizes AT-C section 210 with the limited assurance provisions of ISAE 3000 (Revised) by more explicitly describing the types of procedures a practitioner may perform to obtain limited assurance. With respect to some subject matters, the performance of analytical procedures may not be sufficient or practical; therefore, the nature of the procedures that a practitioner may perform in a review could be similar to those performed in an examination engagement.
 - *require that the practitioner's review report include a description of the work performed as a basis for the practitioner's conclusion.* In order to assist intended users in understanding the basis for the practitioner's conclusion, the ED requires the practitioner to provide an informative summary of the procedures the practitioner performed in the review engagement. This is consistent with the reporting requirements of ISAE 3000 (Revised).
 - *allow the practitioner to express an adverse conclusion when the practitioner, having obtained sufficient appropriate evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the subject matter.* The ED revises the extant requirements when misstatements of the subject matter are both material and pervasive to allow the practitioner to express an adverse conclusion when the practitioner, having obtained sufficient appropriate evidence, concludes that the subject matter is materially and pervasively misstated. The proposed requirement is consistent with ISAE 3000 (Revised), and without such a requirement in extant AT-C section 210, a practitioner engaged to perform an engagement in accordance with both AT-C section 210 and ISAE 3000 would not be able to report on subject matter that is both materially and pervasively misstated. In addition, the proposed requirement is consistent with Statement on Standards for Accounting and Review Services No. 25, *Materiality in a Review of Financial Statements and Adverse Conclusions* which revised AR-C section 90, *Review of Financial Statements* to permit the expression of an adverse review conclusion in a review report on historical financial statements when misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Issue For ASB Consideration – Proposed Effective Date

The ED included an effective date of reports dated on or after May 1, 2020 with early implementation not permitted. SSAE No. 19, *Agreed-Upon Procedures*, is effective for agreed-upon procedures reports dated on or after July 15, 2021 with early implementation permitted.

The ASB is asked to consider an appropriate effective date for the proposed SSAE.

Agenda Materials for Agenda Item 3

Agenda Item 3A: AT-C section 105 marked from the extant
Agenda Item 3B: AT-C section 205 marked from the extant
Agenda Item 3C: Proposed AT-C section 206
Agenda Item 3D: AT-C section 210 marked from the extant