



## AUDITING STANDARDS BOARD (ASB)

### Meeting Highlights

October 19-22, 2020

Videoconference

### MEETING ATTENDANCE

#### ASB Members

Tracy Harding, *Chair*

Brad Ames

Monique Booker

Patricia Bottomly

Sherry Chesser

Harry Cohen

Jeanne Dee

Horace Emery

Audrey Gramling

Diane Hardesty

Robert Harris

Kathy Healy

Jon Heath

Clay Huffman

Kristen Kociolek

Sara Lord

Maria Manasses

Chris Rogers

Tania Sergott

#### AICPA Staff

Linda Delahanty, *Senior Technical Manager—A&A Standards*

Mike Glynn, *Senior Technical Manager—A&A Standards*

Ahava Goldman, *Associate Director—A&A Standards*

Hiram Hasty, *Associate Director—A&A Standards*

Judith Sherinsky, *Senior Technical Manager—A&A Standards*

Teighlor March, *Asst. General Counsel—General Counsel & Trial Board*

Andy Mrakovic, *Technical Manager—A&A Standards*

Note: The meeting was open to observers, whose names are not listed.

### Chair and Chief Auditor Report

Mr. Harding provided an update on recent activities and welcomed Diane Hardesty to the ASB.

The highlights of the July and August 2020 ASB meetings were approved unanimously.

#### 1. Attestation Standards

Ms. Dee, chair of the Attestation Standards Task Force, led the ASB in discussion of a proposed standard that would revise AT-C section 210, *Review Engagements*, to the ASB. The proposed

Statement on Standards for Attestation Engagements (SSAE) includes revisions primarily for consistency with revisions to AT-C section 205, *Examination Engagements*, included in SSAE No. 21, *Direct Examination Engagements*, and to permit the expression of an adverse conclusion in a review attestation engagement.

The following are the substantive revisions that were made to the draft standard as a result of the ASB's discussions:

- Paragraphs .18 and .19 were combined in order to clarify that the practitioner is required to design and perform procedures to obtain limited assurance to support the practitioner's conclusion, identifying and placing increased focus on those areas in which the practitioner believes there are increased risks that the subject matter may be materially misstated.
- Paragraph .60 (renumbered as paragraph .58) was revised to include a statement that any paragraphs in the practitioner's report emphasizing matters related to the subject matter or any other reporting responsibilities should be phrased in a manner that makes it clear that these paragraphs do not imply that the practitioner has obtained reasonable assurance.
- Paragraph .A27 (renumbered as paragraph .A26) was revised to clarify that procedures other than analytical procedures may be more effective or efficient to obtain limited assurance.

After discussion of the draft revisions, and in response to a question from Mr. Harding, Ms. Dee stated that the Attestation Standards Task Force has considered all comments received on the July 2018 exposure draft *Revisions to Statement on Standards for Attestation Engagements No. 18*, Attestation Standards: Clarification and Recodification (ED) related to AT-C section 210 and that all matters have been appropriately deliberated. Ms. Dee stated that the Task Force does not believe that any further deliberation is necessary. Ms. Goldman confirmed that the Board has met its due process obligations with respect to the project.

All 18 members of the ASB present voted affirmatively to issue the revisions to AT-C section 210 as SSAE No. 22, *Review Engagements*. Mr. Rogers was absent at the time of the vote.

## 2. Specialists/Investments

Ms. Bottomly, chair of the Specialist/Investments Task Force (Task Force), led the ASB in discussion of proposed revisions to various AU-C sections to address management specialists and consideration of convergence with recently issued PCAOB standards.

The following are the substantive revisions made to the draft proposed standard or to the draft explanatory (wrap) material to be included in the exposure draft as a result of the ASB's discussions:

- In the wrap, added a request for comment about whether the requirements in appendix A, "Special Topics," of AS 2501, should be incorporated in AU-C section 540 as guidance (in an appendix) or as requirements.
- Revised par. A19-A20 of AU-C section 501 to no longer refer to using the work of an external inventory-taking firm as using the work of a management's specialist. These amendments are not intended nor expected to change existing practice.
- Moved par. A85 of AU-C section 501 to follow par. A86.

- Revised the proposed Appendix to AU-C section 540 so that the wording of paragraphs 1, 2 and 8 is closer to the comparable paragraphs in appendix A of AS 2501.

All 18 members of the ASB present voted affirmatively to issue the proposed Statement on Auditing Standards (SAS) for exposure for a period of 90 days. Ms. Dee was absent at the time of the vote.

### 3. NOCLAR

Mr. Cohen presented the proposed revisions to AU-C section 210, *Terms of Engagement* to the ASB. The proposed SAS would require a successor auditor, once management authorizes the predecessor auditor to respond to inquiries from the successor auditor, to inquire of the predecessor auditor regarding identified or suspected fraud or noncompliance with laws or regulations (NOCLAR).

The following are the substantive revisions made to the draft standard or to the draft explanatory (wrap) material to be included in the exposure draft as a result of the ASB's discussions:

- In the draft wrap material, include a statement that the ASB believes the proposed approach is similar to the approach included in the PCAOB's AS 2610, *Initial Audits – Communications Between Predecessor and Successor Auditors*, that direct the successor auditor to make more specific inquiries of the predecessor auditor.
- The proposed effective date is for audit engagements beginning on or after December 15, 2022.
- Paragraph 13 – concern was raised that the phrase “in the absence of unusual circumstances” might be misinterpreted as the ability for a predecessor auditor to not respond to the successor auditor's inquiries. The ASB directed that additional clarity be provided as to what would constitute an “unusual circumstance.” The following sentence was added:

However, when the predecessor auditor decides, due to impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, not to fully respond to the (successor) auditor's inquiries, the predecessor auditor should clearly state that the response is limited.

The ASB deferred the scheduled vote to issue the proposed revisions to AT-C section 210 for exposure to allow for further research and discussion with stakeholders. The Task Force plans to bring a revised draft of the proposed exposure draft to the ASB's meeting in January 2021 with a request that the ASB vote to expose the proposed revisions for public comment.

### 4. Quality Standards

Sara Lord, chair of the QM1 Task Force, and Jon Heath, chair of the QM2/220 Task Force, led a discussion of proposed quality management standards: Proposed Statement on Quality Management Standard (SQMS) No. 1, *A Firm's System of Quality Management*, proposed SQMS No. 2, *Engagement Quality Reviews*, and proposed Statement on Auditing Standards

(SAS), *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (AU-C section 220).

SQMS No. 1

The ASB requested the Task Force to consider adding application material or develop implementation guidance addressing the following:

- The relationship between component auditors and the firm’s system of quality management.
- The QM system applies to the firm; the component auditor is a member of the engagement team but not a member of the firm (see par. A24 and A118). Is the component auditor subject to all the policies and procedures of the firm’s QM system if they are a member of the engagement team?
- What is the firm obligation when the component auditor, which is a service provider (see par. A27), is a non-network firm; for example, see par. A111 – is my firm responsible for making sure that component auditor has an appropriate methodology.
- Par. 42, how peer review evaluates the severity and pervasiveness of identified deficiencies and how that interacts with how the firm evaluates the deficiency, if the firm’s approach is different from the peer reviewer’s.
- A161, consider examples that would lead firms to review in-process engagements more often, as well as examples about firms using data analytics for in-process engagements; intent is to say that firms don’t have to use the same cycle for every partner. Add guidance on how to set up cycles.
- A205, clarify the intent of “the effect of them corrected at the point in time of the evaluation”: It is unclear whether this means the engagement deficiency was corrected or that the firm has implemented new policies and procedures that apply to the whole firm.

The ASB also directed that the following changes be made:

- Par. 11, second sentence, add example of complex audit to replace ISQM example of listed entities
- Par. 35 f(ii) – consider whether application material makes it clear that policies and procedures should include criteria for determining when an EQR is to be performed.
- A145, consider working into par. A142
- A183, revise to reflect existence of AU-C 585, *Omitted Procedures*, which has no comparable ISA

SQMS No. 2

The ASB discussed the requirement for a cooling-off period. A straw poll indicated that 2 members were for no cooling-off period; 10 for a one-year cooling-off period; and 7 for a two-year cooling-off period. Points made during the discussion included the following:

- Requiring a cooling-off period, in conjunction with the need to hire an external inspector (who can't have served as an EQR for an engagement to be inspected), will have the unintended negative consequence of small firms setting criteria that result in no EQRs being performed
- The IAASB requires this for all size firms; nothing is different in the U.S. for nonissuers than for nonlisted entities around the world.
- No research seems to have been done of the effectiveness of the cooling-off period.
- There's a need for outreach, to PEEC, to regulators, to small firms, and to the IAASB to understand their reasoning for this prescriptive requirement.
- Finding an external person for two years instead of one doesn't seem any more difficult. However, the effect of needing an external person for inspections as well may compound that if the same external people aren't available in the second year.
- A one-year cooling off period provides sufficient distance for the engagement partner (one year cooling off means serving as EQR two years after serving as engagement partner; two-year cooling-off is serving as EQR in the third engagement after serving as engagement partner).
- Firms that work in highly specialized industries may not be able to find suitable external people.
- Few small firms currently perform EQRs, so this may not make a big change in practice.

The ASB discussed, but did not conclude, which option to require in the proposed standard:

- Require two years to better manage expectations (that is, the requirement either stays the same or gets less prescriptive, which is easier to accept)
- Require one year because that is the majority position

Other substantive revisions to SQMS No. 2 directed by the ASB were as follows:

- Par. A15, add an example of a GAAS audit subject to SEC independence rules
- Par. A17, revise to be clearer about the intent of the guidance
- Par. A47, consider deleting the added language taken from the AICPA comment letter on the IAASB exposure drafts
- Par. A50, revise to be clearer
- Par. A53, delete the last sentence that suggests firm policies specify that the documentation of the engagement quality review needs to be finalized on or before the date of the engagement report, because that is stricter than the documentation required for engagement partners.

The primary issue discussed by the ASB about proposed AU-C section 220 was about how the standard would be applied in a group audit involving component auditors.

## 5. Group Audits

Dora Burzenski, Chair of the Group Audits Task Force (task force), led a discussion of matters raised in the ASB's comment letter on the International Auditing and Assurance Standards Board's April 2020 exposure draft, Proposed International Standard on Auditing (ISA) 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (ISA 600 ED). The task force is monitoring the changes being made to ISA 600 in anticipation of converging extant AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, with ISA 600 (Revised).

Ms. Burzenski noted that comment letters on the ISA 600 ED were due at the beginning of October 2020 so at the date of the October 2020 ASB meeting, comments on the ISA 600 ED had not yet been analyzed. Based on an initial reading of some of the comment letters, she believes commenters will request (1) a framework for determining whether the group auditor has obtained sufficient evidence now that the concept of significant components has been eliminated from the ISA and (2) guidance on how to foster two-way conversation between the component auditor and the group engagement team.

As noted in agenda item 4 above, the ASB also discussed a draft of proposed AU-C section 220, which is applicable to all audits of financial statements, and therefore applicable to a group audit. In discussing the ISA 600 ED, it was observed that the definition of *engagement team* in ISA 220 includes component auditors, while the definition of *group engagement team* in the ISA 600 ED excludes component auditors.) Some members of the ASB noted that certain requirements in the AU-C section 220 draft addressing the engagement partner's responsibility related to the engagement team appear, because of this difference, to extend to component auditors in a group audit, making that responsibility overly onerous for the group engagement partner and group engagement team.

The following are other recommendations from the ASB regarding proposed AU-C section 600:

- The Group Audits Task Force should work with the Quality Standards Task Force in determining the best location in the auditing standards for quality management requirements and guidance tailored to a group audit. The possibilities include placing all of the requirements and guidance in AU-C section 600 or placing it in AU-C section 220 and indicating, wherever it appears, that the guidance is unique to group audits
- There may be a need for additional application material in AU-C 600 to clarify the applicability of AU-C section 220 to a group audit.

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- The ASB should consider aligning the effective dates of AU-C section 220 and AU-C section 600 to be sure that inconsistencies between the two standards have been rectified prior to the issuance of the standards.