

Agenda Item 1



Proposed Revisions to SSARs – Compliance Frameworks

Discussion Memo

Objective of Agenda Item

To consider revisions to the proposed revised AR-C sections 60, 70, 80, and 90 as directed by the ARSC at its meeting in November 2018 and for consistency with proposed revisions to AU-C section 800 proposed by the Auditor Reporting Task Force and being considered by the Auditing Standards Board at its meeting in January 2019.

Background

At its meeting in August 2018, the ARSC considered revisions that the ASB's Auditor Reporting Task Force has proposed to AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, to introduce the concept of a compliance framework, which is included in ISA 800 (Revised) *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* and ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*. The ARSC directed revisions be developed to SSARs that would be consistent with the proposed revisions to AU-C section 800 and, if determined to be appropriate by the ARSC, that such proposed revisions be included in the exposure draft of the proposed revisions to further converge the requirements for reviews performed in accordance with SSARs with ISRE 2400 (Revised). That exposure draft was approved for issuance by the ARSC at its meeting in August 2018.

The ASB's Auditor Reporting Task Force is presenting a draft revised AU-C section 800 to the ASB at its meeting in January 2019. It is expected that the ASB will be asked to vote to expose the proposed revisions for public comment at its meeting in May 2019. The ARSC has determined that it is appropriate to expose the proposed SSARS for public comment simultaneously with the ASB's exposure draft.

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Agenda item 1A represents the exposure draft approved by the ARSC at its meeting in August 2018 with additional revisions necessary to incorporate the concept of *compliance frameworks* and certain other revisions.

Issues for ARSC Consideration

Issue #1 – Definition of “financial statements”

At its meeting in November 2018, the ARSC considered the following proposed revised definition of *financial statements* (paragraph .07 of proposed revised AR-C section 60):

Financial statements. A structured representation of historical financial information, including ~~related notes~~ *disclosures*, intended to communicate an entity’s economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework but can also refer to a single financial statement. *Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement or in the notes, or incorporated therein by reference.*

It is proposed the following paragraph be added to the definition:

In the context of general purpose financial statements, references to financial statements means a complete set of general purpose financial statements, including the related notes. In the context of special purpose financial statements, references to financial statements means a complete set of special purpose financial statements. The requirements of the applicable financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements.

The definition of financial statements in the auditing literature includes the following as a second paragraph (the first paragraph of the definition is consistent with the proposed revised SSARs definition):

In the context of section 700, reference to *financial statements* means a complete set of general purpose financial statements, including the related notes. In the context of section 800, references to *financial statements* means a complete set of special purpose financial statements, including the related notes.

The ASB is considering the following revision to paragraph .08 of AU-C section 800:

.08 Reference to *financial statements* in this ~~proposed SAS section~~ means “a complete set of special purpose financial statements; ~~including the related notes.~~” ~~The related notes ordinarily comprise a summary of significant accounting policies and other~~

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~~explanatory information~~. The requirements of the applicable financial reporting framework determine the ~~presentation, structure, form~~ and content of the financial statements and what constitutes a complete set of financial statements. Reference to “special purpose financial statements” includes the related disclosures.

Action Requested of ARSC

The ARSC is asked to consider the proposed revised definition of *financial statements*.

Issue #2 – Forming the Accountant’s Review Conclusion on the Financial Statements

Previously, the ARSC had approved the inclusion of requirements consistent with ISRE 2400 (Revised) regarding forming the accountant’s review conclusion on the financial statements. Those requirements (from proposed revised AR-C section 90) are as follows:

.62 In forming the conclusion on the financial statements, the accountant should:

- (a) Evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework;**
- (b) Consider whether, in the context of the requirements of the applicable financial reporting framework and the results of procedures performed:**
 - (i) The terminology used in the financial statements, including the title of each financial statement, is appropriate;**
 - (ii) The financial statements adequately disclose the significant accounting policies selected and applied;**
 - (iii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;**
 - (iv) Accounting estimates made by management appear reasonable;**
 - (v) The information presented in the financial statements appears relevant, reliable, comparable, and understandable; and**
 - (vi) The financial statements provide adequate disclosures to enable the intended users to understand the effects of material transactions and events on the information conveyed in the financial statements.**

.63 The accountant should consider the impact of:

- (a) Uncorrected misstatements identified during the review, and in the previous year’s review of the entity’s financial statements, on the financial statements as a whole; and**

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(b) Qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

However, the ARSC had determined to not include the following paragraph from ISRE 2400 (Revised):

71. If the financial statements are prepared using a fair presentation framework, the practitioner's consideration shall also include:

- (a) The overall presentation, structure and content of the financial statements in accordance with the applicable framework; and
- (b) Whether the financial statements, including the related notes, appear to represent the underlying transactions and events in a manner that achieves fair presentation or gives a true and fair view, as appropriate, in the context of the financial statements as a whole.

Paragraph .71 from ISRE 2400 (Revised) is consistent with the following paragraph from AU-C section 700:

.17 The auditor's evaluation about whether the financial statements achieve fair presentation should also include consideration of the following:

- a. The overall presentation, structure, and content of the financial statements
- b. Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation

The one substantive difference being the omission in paragraph .17b of AU-C section 700 of the phrase "or gives a true and fair view, as appropriate, in the context of the financial statements as a whole."

It is proposed that the following additional paragraphs be included in the proposed revised AR-C section 90:

.64 If the financial statements are prepared using a fair presentation framework, the accountant's consideration should also include:

- (a) The overall presentation, structure and content of the financial statements in accordance with the applicable framework; and***
- (b) Whether the financial statements, including the related notes, appear to represent the underlying transactions and events in a manner that achieves fair presentation.***

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.65 When the financial statements are prepared in accordance with a compliance framework, the accountant is not required to evaluate whether the financial statements achieve fair presentation. However, if in extremely rare circumstances, the accountant concludes that such financial statements are misleading, the accountant should discuss the matter with management and, depending on how it is resolved, should determine whether, and how, to communicate it in the accountant's review report.

Action Requested of ARSC

The ARSC is asked to consider whether agrees with the proposed additional required consideration when the financial statements are prepared in accordance with a *fair presentation framework*.

The ARSC is further requested to consider whether similar requirements should be included in AR-C section 80 with respect to compliance engagements.

Issue #3 – Conclusion in the Accountant's Review Report

The proposed revised AU-C section 800 includes the following proposed auditor report language:

- .10** AU-C section 700 addresses the form and content of the auditor's report, including the specific ordering for certain elements. In the case of an auditor's report on special purpose financial statements,
- a. with respect to the auditor's opinion:
 - i. when expressing an unmodified opinion on special purpose financial statements prepared in accordance with a fair presentation framework, the auditor's opinion should state that, in the auditor's opinion, the accompanying special purpose financial statements present fairly, in all material respects, [...] in accordance with [the special purpose framework]; or
 - ii. when expressing an unmodified opinion on special purpose financial statements prepared in accordance with a compliance framework, the auditor's opinion should state that, in the auditor's opinion, the accompanying special purpose financial statements are prepared, in all material respects, in accordance with [the special purpose framework];

To compare, ISRE 2400 (Revised), includes the following:

74. When the practitioner expresses an unmodified conclusion, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:
- (a) "Based on our review, nothing has come to our attention that causes us to believe that the financial statements do not present fairly, in all material respects (or do

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not give a true and fair view), ... in accordance with the applicable financial reporting framework,” (for financial statements prepared using a fair presentation framework); or

- (b) “Based on our review, nothing has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework,” (for financial statements prepared using a compliance framework).

The extant SSARSs review conclusion does not easily lend itself to the convention proposed to be used by the auditing literature or by ISRE 2400 (Revised). The following is proposed:

.67 When the accountant expresses an unmodified conclusion, the accountant should, unless required by law or regulation, use one of the following phrases, as appropriate:

a. Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements for them to be presented fairly in accordance with (the applicable financial reporting framework) (for financial statements prepared using a fair presentation framework); or

b. Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements for them to be in accordance with (the applicable financial reporting framework) (for financial statements prepared using a compliance framework).

The bottom line is that it is proposed that the accountant’s review conclusion refer to financial statements being presented fairly when such financial statements are prepared using a fair presentation framework (such as U.S. GAAP, the cash-basis, or the tax-basis).

Action Requested of ARSC

The ARSC is asked to consider the proposed review reporting requirements with respect to financial statements prepared in accordance with a fair presentation framework vs. a compliance framework.

Issue #4 – Effective Date

The proposed effective date for the Omnibus standard is for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2020. This date is consistent with the proposed effective date for the auditor reporting suite of standards. The requirement to disclose the city and state of the addressee in the accountant’s review report and the inclusion of the concept of a *compliance framework* is also consistent with the auditor reporting suite. The ARSC has concluded that the changes should be exposed at

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the same time as the corresponding changes to the auditor reporting suite and should be effective at the same time.

The auditor reporting suite of standards precludes early implementation.

Action Requested of ARSC

The ARSC is asked to consider whether it continues to support an effective date consistent with the auditor reporting suite of standards. Further, the ARSC is requested to consider whether it is appropriate for the complete Omnibus standard to preclude early implementation or if early implementation should be permitted on those revisions that are not consistent with the auditor reporting suite.

Agenda Items Presented:

Agenda item 1A Proposed revised AR-C sections 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*; 70, *Preparation of Financial Statements*; 80, *Compilation Engagements*; and 90, *Review of Financial Statements* marked to show changes from exposure draft presented to the ARSC at its meeting in November 2018