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Proposed Statement on Auditing Standards – Amendments to AU-C sections 800, 805, and 810 to incorporate auditor reporting changes from SAS no. 134

Dear Ms. Macey,

Ernst & Young LLP is pleased to submit this comment letter to the Auditing Standards Board (ASB or the Board) in response to the ASB's request for comment on its proposed Statement on Auditing Standards (SAS) on amendments to AU-C sections 800, 805, and 810 to incorporate auditor reporting changes from SAS 134.

Overall, we support the proposed conforming amendments to better align the form and content of the auditor's report on the subject matters covered by AU-C sections 800, 805 and 810 with the recently issued guidance in SAS 134.

However, we encourage the ASB to continue its efforts to incorporate the concept of a compliance framework for certain types of special purpose frameworks, which would further align auditing standards generally accepted in the United States with the international auditing standards. Incorporating the concept of a compliance framework would also eliminate unnecessary audit procedures for evaluating an entity's compliance with a reporting framework that is not intended to achieve "fair presentation" and simplify the auditor's reporting requirements.

For example, the existing requirement to include a separate adverse opinion in the auditor's report stating that the financial statements are not prepared in conformity with generally accepted accounting principles (GAAP), even though the financial statements were prepared in accordance with an other comprehensive basis of accounting other than GAAP, seems unnecessary. Also, requiring the auditor to evaluate an entity's ability to continue as a going concern in accordance with AU-C 570 whenever the auditor is engaged to audit a complete set of financial statements, regardless of the special-purpose framework used by management to prepare the entity's financial statements, seems impractical and unnecessary, especially when the financial statements are not intended to be for general use.

The Attachment provides recommendations for your consideration and other editorial comments. We would be pleased to discuss our comments with members of the ASB or its staff.

Sincerely yours,

Attachment – Recommendations and editorial comments

- 1) AU-C 800, paragraph 7 – definitions:

We support moving the example special purpose frameworks to application guidance. However, we suggest the following change to the revised definition of a “special purpose framework.”

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).

If the words “designed to meet the financial information needs of specific users” are added to the definition, the standard may imply that all special purpose frameworks are not suitable for general use, which is not the case. We suggest ending the definition after the word “GAAP.”

- 2) AU-C 800, paragraph 17.a includes the following proposed addition:

“,when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.”

We suggest deleting this phrase since it repeats the second sentence in paragraph 17.

- 3) AU-C 800, paragraph 18.a.ii, as amended, states the following:

“an other basis of accounting, and the auditor is required to restrict use of the auditor's report pursuant to paragraph .06a-b of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. (Ref: par. .A29)”

We suggest the following revisions to clarify the requirement:

“an other basis of accounting, ~~and the auditor is required to restrict use of the auditor's report~~ ***that requires an alert that restricts the*** use of the auditor's report pursuant to paragraph .06a-b of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. (Ref: par. .A29)”

Separately, we observe that the references in AU-C 905, Appendix A – List of AU-C Sections Relating to the Restricted Use of the Auditor's Written Communication, needs to be updated to correctly reflect the paragraphs in the specified standards.

- 4) AU-C 800, paragraph 19 includes the following proposed addition:

“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.”

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.

- 5) AU-C 800, paragraph 22.c.ii, as proposed, states the following:

“contains an expression of opinion on the special purpose financial statements and a reference to the special purpose framework used to prepare the financial statements”

We observe that this content was moved from extant AU-C 800.22.h. However, the extant guidance also states “and, if applicable, an opinion on whether the special purpose financial statements are presented fairly, in all material respects, in accordance with GAAP when required by paragraph .21.” We believe this additional requirement should be retained and presented as new AU-C 800.22.c.iii.

- 6) AU-C 800, paragraph 22.g. includes the following proposed revision:

“A description of management’s responsibilities for the preparation and fair presentation of the special purpose financial statements that addresses, and is not inconsistent with, the requirements in paragraphs .31-.33 of section 700”

We believe the ASB’s decision to say “...and is not inconsistent with,” rather than “...and is consistent with” may cause confusion. If the ASB’s intent is to convey something less than the positive construction, that point should be clarified in the application guidance. Otherwise, we suggest replacing the highlighted phrase with the words “and is consistent with.” If the ASB agrees that further clarification is needed, similar changes would need to be made elsewhere in the proposed standard.

- 7) AU-C 800, paragraph .A1.c. defines a regulatory basis of accounting as follows:

“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).”

We understand that, in the United States, the state body prescribing the basis of accounting is generally referred to as the state insurance “department,” not “commission.” We recommend changing the reference, which would also further align with the references used in the AICPA’s insurance industry audit and accounting guides.

- 8) AU-C 800, paragraph .A20 includes the following proposed application guidance:

“For audits of special purpose financial statements, section 701, Communicating Key Audit Matters in the Independent Auditor’s Report, applies only when the auditor is engaged to communicate key audit matters”

We observe that AU-C 701 paragraph 4 states that this section applies to an audit of a “complete set of general purpose financial statements [**emphasis added**] when the auditor is engaged to communicate key audit matters.” We believe the Board should either amend the application guidance in proposed AU-C 800.A20 to better align with the scope requirements in AU-C 701.04 or clarify that these communication requirements would also apply if the special-purpose financial statements are not intended for general use, provided the auditor is engaged to communicate KAMs.

9) AU-C 800.A39 Appendix B – Fair Presentation and Adequate Disclosures:

In footnote 1, we suggest deleting “(GAAP)” since the acronym is defined earlier in the standard.

10) AU-C 800.A40 Exhibit – Illustrations of Auditor’s Reports on Special Purpose Financial Statements – Illustrations 3, 4 and 5:

In the “Responsibilities of Management for the Financial Statements” section, in addition to the footnote reference already included, we believe it would be helpful to auditors if the ASB also provided an example of a description of management’s responsibilities relating to going concern when applicable. For example, leveraging the illustrative reports included in the recently revised AU-C 700, the ASB could include the following example:

“In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company’s ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].”

11) AU-C 800.A40 Exhibit – Illustrations of Auditor’s Reports on Special Purpose Financial Statements – Illustration 4:

We recommend the following revision to the “Adverse Opinion on U.S. Generally Accepted Accounting Principles” section of the illustrative report:

“In our opinion, because of the significance of the matter discussed in the “Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles” section of our report, the financial statements do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of ABC Government Authority as of December 31, 20X1, or the changes in net position ~~and position~~ and cash flows thereof for the year then ended.”

12) AU-C 805.A34 Exhibit – Illustrations of Auditor’s Reports on a Single Financial Statement and a Specific Element of a Financial Statement – Illustration 4:

The penultimate sentence of the Emphasis of Matter – Basis of Accounting paragraph states “As a result, the financial statements may not be suitable for another purpose.” Based on the subject matter of the example, the words “financial statements” in the highlighted sentence should be replaced with “schedule.”

Similarly, the words “financial statement” in the last sentence of first paragraph in the Auditor’s Responsibilities for the Audit of the Schedule section of the auditor’s report should be replaced with “schedule.”

- 13) AU-C 805.A8 of the exposure document includes the following proposed revision:

“If the auditor concludes that an audit of a single financial statement or a specific element of a financial statement in accordance with GAAS may not be practicable, the auditor may discuss with management whether another type of engagement might be more practicable, ***such as an engagement performed in accordance with the Statements on Standards for Attestation Engagements*** as described in paragraph ~~.A4~~ *A3*”

Paragraph AU-C 805.A4 describes agreed-upon procedures and review engagements performed under the attestation standards as more practicable alternatives to audit engagements performed under this auditing standard. We believe the application guidance should clarify that it would not be appropriate to accept an engagement to review or examine the same subject matter (e.g., a single financial statement prepared in accordance with US GAAP) under the attestation standards, since those engagements are subject to auditing standards. Paragraph 3 of AT-C section 105, *Concepts Common to All Attestation Engagements*, states that “this section is not applicable to professional services for which the AICPA has established other professional standards, for example, services performed in accordance with (Ref: par. .A2 – .A3)

- a. Statements on Auditing Standards
- b. Statements on Standards for Accounting and Review Services, or
- c. Statements on Standards for Tax Services”

We are concerned that, without this clarification, the guidance could be interpreted to permit the practitioner to issue an opinion or conclusion under the attestation standards that a single financial statement or a specific element thereof is in accordance with an applicable financial reporting framework.

- 14) AU-C 805.A34 Exhibit – Illustrations of Auditor's Reports on a Single Financial Statement and a Specific Element of a Financial Statement – Illustrations 1 and 2:

Because these examples illustrate an auditor’s report on a single financial statement, the word “statements” appearing in the penultimate point under the “Auditor’s Responsibilities for the Audit of the Financial Statement” section of the report should be singular (i.e., it should read “statement”).

- 15) AU-C 805.A34 Exhibit – Illustrations of Auditor's Reports on a Single Financial Statement and a Specific Element of a Financial Statement – Illustration 3:

Footnote 4 to the *Responsibilities of Management for the Schedule* section of the report states that “the description of management’s responsibilities to going concern required by paragraph .32b of AU-C section 700 may not be relevant or may need to be included in this section of the report, adapted as necessary. See paragraph .A21 of this section.”

This example assumes that the reporting entity also prepared a full set of the financial statements in accordance with accounting principles generally accepted in the United States (GAAP), which requires reporting entities to assess their ability to continue as a going concern. It's not clear why management wouldn't be required to describe its responsibility to assess the entity's ability to continue as a going concern under the circumstances described in the example.

We understand that judgment is required, but we think it would be helpful if the ASB provided an assumption in the example. For example, the example could include an assumption that management determined that the going concern assessment in GAAP does not apply to the preparation of a specific element, account or item of a financial statement. The example could further explain that although a going concern assessment was made in the preparation of the full set financial statements from which the financial information being reported has been derived, the going concern assessment period is significantly different because the schedule is anticipated to be issued several months after the full set financial statements were issued. Including any previous conclusions about the entity's ability continue as a going concern without further analysis would not be appropriate.

- 16) AU-C 805.A34 Exhibit – Illustrations of Auditor's Reports on a Single Financial Statement and a Specific Element of a Financial Statement – Illustration 4:

Because this example assumes an audit of a schedule of royalties, we believe the words "financial statements" in the *Emphasis of Matter – Basis of Accounting* paragraph and the words "financial statement" at the end of the first paragraph in the *Auditor's Responsibilities for the Audit of the Schedule* section of the report should be replaced with "schedule."

- 17) AU-C 805.A34 Exhibit – Illustrations of Auditor's Reports on a Single Financial Statement and a Specific Element of a Financial Statement – Illustration 5:

Because this example assumes an audit of historical summaries of gross income and direct operating expenses, we believe the section titled *Auditor's Responsibilities for the Audit of the Financial Statement* should read *Auditor's Responsibilities for the Audit of the Historical Summaries*. Making this change would also better align the description of the auditor's responsibilities with how the subject matter (i.e., the historical summaries) is described elsewhere in the illustrative report.

- 18) AU-C 810.15.j of the proposed standard represents a significant change from extant guidance that would make the auditor's report less informative if it were finalized as exposed. We believe this result would be contrary to some of the Board's recent standard-setting activities (e.g., SAS 134).

For example, replacing as a required element of the auditor's report a statement that "the [auditor's] procedures consisted principally of comparing the summary financial statements with the related information in the audited financial statements from which the summary financial statements have been derived and evaluating whether the summary financial statements are prepared in accordance with the applied criteria" with a simple statement that "the auditor is responsible for expressing an opinion based on the auditor's procedures conducted in accordance with GAAS" does not represent an improvement. Although the proposed change would more closely align the AICPA standard with the requirements in ISA 810 (Revised), we recommend retaining the existing reporting requirements.

19) AU-C 810.18 of the proposed standard states the following:

“If the auditor’s report on the audited financial statements contains a qualified opinion, an emphasis-of-matter paragraph, ~~or~~ an other-matter paragraph, **a going concern section, or communication of key audit matters [emphasis added]**, and the auditor expresses an unmodified opinion (see paragraph .14) on the summary financial statements, in addition to the elements in paragraph .15 ~~.17~~, the auditor’s report on the summary financial statements should

- a. state that the auditor’s report on the audited financial statements contains a qualified opinion, an emphasis-of-matter paragraph, ~~or~~ an other-matter paragraph, **a going concern section, or communication of key audit matters [emphasis added]** and
- b. describe
 - i. the basis for the qualified opinion on the audited financial statements and that qualified opinion or the emphasis-of-matter paragraph or other matter paragraph in the auditor’s report on the audited financial statements and ii the effect **thereof, if any**, on the summary financial statements,; if any. **or**
 - ii. **the matter referred to in the emphasis-of-matter paragraph, other-matter paragraph, or going concern section in the auditor’s report” on the audited financial statements and the effects thereof, if any, on the summary financial statements.**

Based on the overall construct of AU-C 810.18, we believe paragraph 18.b.ii should also refer to the communication of key audit matters in the auditor’s report, using language like what is mentioned in both the introductory paragraph and 18.a.

20) AU-C 810.A24 Exhibit – Illustrations of Reports on Summary Financial Statements – Illustration 4:

The second paragraph in the “Adverse Opinion” section of the illustrative report states the following:

“In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph **[emphasis added]**, the summary financial statements of ABC Company as of and for the year ended December 31, 20X1 referred to above are not consistent with the audited financial statements from which they have been derived, on the basis described in Note X.”

We recommend replacing the word “paragraph” in the second line of the excerpt above with the words “section of our report.” We observe that in Illustration 3 in the same section of AU-C 810, the second paragraph of the Disclaimer of Opinion section of the illustrative report refers to “The Audited Financial Statements and Report Thereon section of our report,” not “The Audited Financial Statements and Report Thereon paragraph of our report.” While these are not significant discrepancies, we believe it would be helpful to auditors if the ASB used consistent terms to refer to the different sections of the auditor’s report.