

Split of Section 290

Background

The existing Code contains one Section (290) that addresses independence requirements for all assurance engagements. The Section deals with both “Financial Statement Audit engagements” and all “Other Assurance engagements”, whether assertion-based or direct reporting. The Section contains differing independence requirements depending on the nature of the engagement. Section 290 currently defines “Financial Statements” as:

“The balance sheets, income statements or profit and loss accounts, statements of changes in financial position (...) notes and other statements and explanatory materials which are identified as part of the financial statements”.

This effectively means a complete set of financial statements.

The IESBA concluded that existing section 290 should be split into two. A primary reason for this was to provide greater focus and clarity on the requirements relating to the audit of financial statements. Further, because most assurance engagements are either audit or review engagements, the IESBA revised Section 290 to address all audit and certain review engagements.

As noted in the Explanatory Memorandum to ED:

“Audit engagements are assurance engagements in which a professional accountant expresses an opinion on whether historical financial information is prepared in all material respects with an identified financial reporting framework. Such engagements include audit engagements to report on:

- A complete set of general purpose financial statements;
- A complete set of financial statements prepared in accordance with a framework designed for a special purpose;
- A single financial statement; and
- One or more specific elements, accounts or items of a financial statement.”

In the ED the definition of “Financial Statements” is consistent with that of the IAASB (see Appendix 2).

The ED proposed that the independence requirements of Section 290 apply to more than the audit (or review) of “financial statements” (see final bullet above), and in doing so extended the requirements beyond that of the current Code. For example, under the existing Section 290 the “audit” independence requirements apply to audit of financial statements – an audit of one or more specific elements, accounts or items of a financial statement would be treated as an “other assurance engagement.” Similarly, under the existing Section 290 review engagements are treated as “other assurance engagements.”

As noted in the Explanatory Memorandum the IESBA is “of the view that all such engagements should be addressed in proposed revised Section 290. In all such engagements the professional accountant obtains reasonable assurance that the information is prepared in all material respects with the identified financial reporting framework. The IESBA is of the view that a reasonable and informed third party would expect that the same independence requirements had been met in an audit of a complete set of financial statements as in an audit of a single financial statement or one or more specific accounts or elements of a financial statement.”

The IESBA was further of a view that certain review engagements should also be dealt with in Section 290. As further noted in the Explanatory Memorandum:

“A review engagement is a limited assurance engagement performed in accordance with International Standards on Review Engagements issued by the IAASB, or equivalent standards. The IESBA has concluded that such engagements should be addressed in proposed revised Section 290 together with audit engagements, rather than in proposed new Section 291 with “other assurance engagements”. In both audit and review engagements the accountant is expressing a conclusion on historical financial information and in many review engagements the accountant is expressing a conclusion on a complete set of financial statements. The subject matter and subject matter information of the engagement is the same as in an audit engagement; the difference is the level of assurance obtained.

The IESBA, therefore, is of the view that it is appropriate to address independence requirements for audit and review engagements in one section and to address independence requirements for other assurance engagements in a separate section”.

Discussion

Comments received

The majority of respondents that commented on this matter were in favour of a split of existing 290. Three respondents (FRS, CAGNZ and ICANZ) were explicitly against a split. CAGNZ noted for example that “The principles do not vary with the nature of the engagement and, for this reason, it is preferable that the guidance on independence is contained within one section of the Code of Ethics”.

A few respondents expressed concern about the level of repetition and length caused by the split.

15 respondents were expressly supportive of the proposed split. Many others provided no comment thereon, although it should be recognised that the Explanatory Memorandum did not specifically ask for comment on the split issue.

Comments were however received from many respondents as to “how” the split should be made. The comments vary in nature, but an overview of the key comments is provided in Appendix 1, by respondent.

Some expressed concern about the inclusion of reviews of historic financial information (either in totality or in part), as well as engagements relating to components of financial statements, in Section 290. These issues are dealt with separately below.

Reviews

A number of concerns were raised, including:

- The split does not recognise the differing level of assurance provided, users do not derive the same level of assurance from review engagements and user expectations of independence are not the same – 290 should deal only with positive assurance reports
- The level of public interest in review engagements is generally less
- The requirements may hinder the ability of small entities to obtain timely service or result in increased cost of reviews.
- The reference to ISRE2400 does not provide sufficient clarity as to which “review” engagements would be covered by 290
- Review engagements vary in nature around the world, and including some in 290 and some in 291 will lead to inconsistent application of the requirements
- The majority of review engagements are not similar in nature to an audit of financial statements
- No research is presented on the number of review engagements to support specific focus on such engagements
- Only reviews with a public interest element should be included in Section 290.

The comment made by the ICAEW is illustrative of views on this:

“We do not believe that the scope of section 290 should automatically include review engagements as well as audit engagements. ‘Review engagements’ covers a much wider range of possible activities than the latter, however, meaning different things around the world and indeed within the same country. In some jurisdictions and some circumstances they can indeed refer to engagements with a clear public interest perspective such as auditor reviews of interim reports which are issued to the market. However, in other jurisdictions and circumstances a review opinion (often applied to a small entity that does not require an audit and frequently intended for restricted use) would not demonstrate a public interest perspective and the guidance in section 291 (which requires the same standard of independence but is more principles based in achieving that) would be more appropriate. We note that the proposed definition of ‘review engagement’ is one “...conducted in accordance with International Standards on Review Engagements or equivalent.”

This indicates that IFAC does not intend section 290 to apply to all forms of engagement that might be called ‘review’ but as the International Standards on Review Engagements have not been adopted everywhere in the world we think there will be confusion. We also note that the terms ‘audit’ and ‘review’ are commonly used in place of ‘reasonable assurance engagement’ and ‘limited assurance engagement’ by practitioners and their clients alike. Considering the complexities and general lack of understanding as to what types of ‘review’ engagements exist, the definition of types of engagements to be covered by section 290 should be considered carefully. We believe that IFAC should seek to apply section 290 only to engagements with a clear public interest perspective such as where there is reporting to capital markets: indeed it may be appropriate for national standard setters to decide on this, in line with the approach in respect of ESPIs”

A few respondents noted concerns about the definition of a review engagement; “A review engagement is a limited assurance engagement performed in accordance with International Standards on Review Engagements issued by the IAASB, or equivalent standards”

ISRE 2400 states that “This ISRE is directed towards the review of financial statements. However it is to be applied to the extent practicable to engagements to review financial or other information”.

A concern is that it will not always be clear whether Section 290 requirements should apply to certain review engagements that are not related to “financial statements”, leading to inconsistent application of independence requirements.

Recognising the level of direct and indirect support for the inclusion of reviews “*performed in accordance with International Standards on Review Engagements issued by the IAASB, or equivalent standards*” in Section 290, the IESBA was not persuaded by the arguments presented is of the view that such reviews are dealt with in Section 290. In particular the IESBA was not persuaded by a primary argument that because the level of assurance was less than in an audit that the independence requirements should also be less rigorous.

In coming to this view, the IESBA had particular concerns that if reviews of financial statements were moved to Section 291 the important provisions in Section 290 relating to accounting and bookkeeping services might not be followed when the firm is conducting a review of financial statements. The IESBA is of the view that this is particularly important given the nature of the more limited procedures undertaken to form a review conclusion, but the same self review threat.

The IESBA considers that the provisions relating to accounting and bookkeeping services should be complied with in the case of a review of financial statements. The IESBA is not persuaded that the threats and safeguards approach in Section 291 would be sufficiently robust for reviews of financial statements.

The IESBA also noted that in the North American market, where many reviews are performed, the independence requirements for audit and review are effectively the same.

The IESBA does believe that some change is necessary to address the concerns raised about the reference to ISRE 2400. The IESBA is of the view that Section 290 should specifically include only reviews of “financial statements”. This would have the advantage of clarity and consistent application, removing any confusion as to whether “other” reviews should be addressed under Section 290, and further by consistent with the proposal below re audits. T

Action requested

CAG members are asked to consider the direction of the IESBA.

One or more specific elements, accounts or items of a financial statement.

A few respondents expressed concern about the inclusion of the audit and review of “*One or more specific elements, accounts or items of a financial statement*” in Section 290.

Extracts from the response from the CICA are illustrative of the concern:

“Our second main concern relates to the IESBA proposals that would require the same Independence standards for each of audits and reviews of general purpose financial statements plus single financial statements or discrete financial numbers. The existing approach would treat these latter items as other assurance services, which would be covered by the new Section 291. This change would result in broader independence requirements for those services, in terms of application to the firm and network, partners of the firm, and members of firm management.

We believe that this would create significant practical issues and is not necessary from a public interest perspective. There are several types of service that would be affected, including:

- reports on operating cost statements for rental buildings, where the statements are used for the charge of common area and related costs to tenants. In such cases, the property manager and the property owner are often not the same party, and obtaining the consent of all of the tenants is not something that could reasonably be done. The auditor of these statements is often the auditor for the property manager;
- reports on store sales for purposes of percentage rent calculations. Generally, the auditor is the auditor of the store's financial statements, but may or may not be the auditor of the entire chain that consolidates the results;

- reports on working capital or other financial statement items in connection with purchase and sale agreements for assets, divisions, or entire entities;
- reports on costs incurred for determination of various Crown royalties or other royalties that are payable under statute or an agreement;
- reports on costs which qualify for various assistance programs; and
- reports on expenditures incurred, or distributions made, as required by trust deeds or similar agreements.

In these cases, the user community is not generally of wide public interest. The subject matter is generally related to specific matters over which small (and generally identifiable) groups have any relevant interest. Defining the "audit client" broadly to include the entire entity is unnecessarily restrictive (and this assumes that it can be agreed in each case which in the group is the audit client). It is also difficult to see the benefit in restricting a broad range of individuals.

We do not believe that the "restricted use" provisions solve the problem in every instance. Those provisions require some agreement or understanding with the users as to the independence standards that have been applied. As noted in the example above, this is not always possible or practical in many of these cases.

The practical effect of the proposal is that frequently the corporation's financial statement auditor will be the only logical choice to conduct these audits, given that the ability for all firms to become "independent" may be next to impossible. That will result in a significant change in allocation of audit work within the firm which itself is probably not in the public interest. Moreover, in some cases, other auditors from the same firm or network firm may be better equipped, due to office locations or resources, to do these audits which are often in varied or remote locations away from the normal corporate offices.

We would therefore recommend that the two levels of Independence standards should be as currently exists – one level in Section 290 for audits (and reviews) of complete sets of general purpose financial statements, and a second level in Section 291 for all other "assurance services".

Whilst not all the examples above would seem to fall within the scope of "One or more specific elements, accounts or items of a financial statement", a number clearly would and the IESBA is of the view that the provisions of Section 291 are appropriate for such engagements. The IESBA is therefore of the view that Section 290 does not deal with such engagements, and that Section 290 should address only the audit and review of "financial statements". This would have the following advantages:

- Having the clarity and simplicity of focussing on the audit and review of "financial statements", as consistently defined with that of the IAASB
- It recognises that in some situations (e.g. an audit of royalties due) the application of the threats and safeguards approach in 291, based on the nature of subject matter information, will be appropriate

- It minimises the relevance of the difficult concepts in 291 regarding the definition of an assurance engagement (e.g where there are, for example, multiple parties or direct reporting engagements)

Action requested

CAG members are asked to consider the direction of the IESBA.

Other issues

Three respondents (IOSCO, CEBS and APB) commented that the split should take into account whether the reporting was public or not. In some respects the ED already takes this into account with more stringent requirements for entities that are of significant public interest and the ability to apply modified independence requirements if the report is expressly restricted for use by only the intended users (provided the users are knowledgeable as to the purposes, subject matter information and limitations of the report and they explicitly agree to the modified independence requirements).

In addition if a firm provides an “other assurance service” for an audit client the requirements of Section 290 also apply to the firm, networks firms and to members of the audit team. Accordingly, the IESBA is of the view that the split is appropriate amended as above for single elements of a financial statement.

Action requested

CAG members are asked to consider the direction of the IESBA.

Appendix 1

Summary of comments received

| Comment | Member Bodies | Firms | Regulators | Others |
|--|---|-----------------|-------------|----------------------------|
| Not supportive of any split | FSR, ICNAZ | | | CAGNZ |
| Support the split (without further comment) or explicitly support the proposed split with 290 dealing with audits and reviews | CIMA, DnR, CNCC, SAICA, ICAS, IDW, IBR-IRE, CICA, FAP | E&Y, Mazars, DT | | APESB, AC, APB |
| Section 290 should deal only with “audits” and review engagements should be dealt with in Section 291 | ACCA, NIVRA, ICAEW | GT, BDO, KPMG | | SMP, IRBA, CARB, FEE, POAC |
| Expressed other concerns about the split such as <ul style="list-style-type: none"> - standards for assurance engagements should distinguish between public reporting and private reporting - all assurance engagements involving listed entities should adhere to the same independence requirements | | | CEBS, IOSCO | APB |
| Exclude audit and review of components, single line items and special purpose FS from 290 | ICAEW, CICA | PwC | | |
| The term “general purpose financial statements” as defined | | PwC, KPMG | | APB |

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|---|--|--------------|--|--|
| by the IAASB appears to differ from the context used in the ED. Use of the report, not the framework, is key. | | | | |
| Proposed split does not wholly remove the complexities of the definition of an assurance engagement, as dealt with in 291, from 290 | | PwC, KPMG | | |

Appendix 2

Definitions in the ED

Audit

A reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether historical financial information is prepared in all material respects in accordance with an identified financial reporting framework, such as an engagement conducted in accordance with International Standards on Auditing. This includes a Statutory Audit, which is an audit required by legislation or other regulation.

Review Engagement

An assurance engagement in which a professional accountant in public practice expresses a conclusion on whether, on the basis of the procedures which do not provide all the evidence that would be required in an audit, anything has come to the accountant's attention that causes the accountant to believe that the historical financial information is not prepared in all material respects, in accordance with an applicable financial reporting framework, which is an engagement conducted in accordance with International Standards on Review Engagements or equivalent.

Financial Statements

A structured representation of historical financial information, which ordinarily includes explanatory notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term can relate to a complete set of financial statements, but it can also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes.