



International Federation of Accountants

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Agenda Item

M

Committee: IAASB Consultative Advisory Group

Meeting Location: Barcelona

Meeting Date: March 1–2, 2010

Review and Compilation Engagements—ISRE 2400¹ and ISRS 4410²— Report Back and Key Issues

Objectives of Agenda Item

1. The Objectives of this Agenda Item are:
 - (a) To provide a report back on proposals of Representatives on the project proposal for the project to revise the standards for reviews and compilations, discussed at the September 9–11, 2009 CAG meeting; and
 - (b) To obtain the Representatives' views on a number of key issues relating to this project.
2. The discussion on this topic will follow the structure this CAG Paper. For reference only, the full set of meeting papers for the March 2010 IAASB meeting are included as CAG Reference Papers.

Current Status of the Project

3. The IAASB project Task Force is revising the standards for review and compilation engagements, and development of the draft revised standards is proceeding in tandem.
4. Issues Papers addressing the significant issues identified by the Task Force regarding each of the two standards were presented to the IAASB in September 2009 (reviews) and December 2009 (compilations). At the September 2009 CAG meeting, the project Task Force requested Representatives' views on key issues concerning review engagements, and Representatives gave feedback and comments on those issues.
5. At the meeting of the IAASB in March 2010, the Task Force will present draft proposed requirements for each of the two revised standards for the IAASB's consideration, and the Task Force's views on issues surrounding those requirements. In this CAG Paper, the project Task Force seeks the Representatives' views on a number of main issues relating to compilations and reviews.

¹ International Standard on Review Engagements (ISRE) 2400, "Engagements to Review Financial Statements."

² International Standard on Related Services (ISRS) 4410, "Engagements to Compile Financial Statements."

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Background

6. The project Task Force has identified the following guiding principles for this project, based on the IAASB's consideration of the project in June, September and December 2009, and the views offered by Representatives at the March and September 2009 CAG meetings.
- The revised standards being developed have a focus on addressing the needs of various types of audit-exempt entities, such as small and medium-sized entities (SMEs) and non-public interest entities, for services other than audits.³
 - Development of these standards is the first step in the IAASB's project to establish a platform of services for services related to entities' financial reporting other than the audit. These services will include assurance and other services that professional accountants will be able to draw upon to meet various service needs of SMEs and of other types of entities that are exempt from mandatory audit requirements. A key element of establishing service solutions for these entities is the availability of services that can meet their needs in both a meaningful and a cost-effective manner.
 - The project Task Force will assess whether there is a residual need for development of other services once the revised review and compilations standards are available.
 - The project has a high prioritization for the IAASB in view of the urgent need to develop other services that are suited to this particular market segment. Some countries already have well-established markets for the provision of other services (e.g., reviews, compilations and agreed-upon procedures). Other countries and jurisdictions are considering development of new service models to be able to respond to that need. The urgency of this project arises from the IAASB's desire to promote the use of International Standards to support provision of recognized types of other types of services that are performed on a consistent basis internationally.
 - The IAASB recognizes that reviews and compilations are well-established services already used in a number of countries. They are the optimal starting point for development of a platform of other services as International Standards already exist for these services and development of revised standards can be progressed relatively quickly (as opposed to developing altogether new services). Further, a number of stakeholders who provided input to the IAASB's earlier consultations for this project reported little need for development of new services in view of the existing availability of these services. This includes the ability to use combinations of services to provide services solutions that cater to different entity needs on a flexible basis.

³ The IFAC Small and Medium Practices (SMP) Committee has contributed views and feedback to the IAASB project Task Force throughout the project to date.

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- Review and compilation services are particularly suited for use by SMEs. They are relatively straight-forward (depending on individual entity circumstances) and cost-effective. There is extensive experience of their use in many countries and they are well-understood by practitioners who have experience of using them. The revised standards for these services aim to establish the essential requirements for consistent performance of reviews and compilations on an international basis.
- Reviews performed under ISRE 2410⁴ are not being addressed as part of this project. The project Task Force recognizes that there is a question about how a review performed by the auditor of an entity can be distinguished from the review performed by a practitioner that is not the auditor of an entity. The IAASB may need to consider this issue when the revised ISRE 2400 is completed. There may, as a consequence, be a need for consequential amendments to ISRE 2410 at a later stage.

September 2009 IAASB Meeting

7. At the September 2009 IAASB meeting, the IAASB considered significant issues identified by the project Task Force concerning review engagements. The IAASB agreed the following matters regarding the revised standards for engagements to review historical financial statements:
 - A “building block” approach should be used to design the review engagement, where the review engagement builds on the compilation service (i.e., providing limited assurance on financial statements on the basis of greater work effort than is applied in a compilation).
 - The approach to performing a review should be a hybrid approach, where the practitioner performs specified types of procedures with the aim of achieving a targeted level of assurance, i.e., limited assurance. The term limited assurance should not be defined, because it represents a range and the level of limited assurance actually achieved varies between review engagements depending on the work effort applied by the practitioner. However the practitioner must apply a minimum level of work effort (through performance of the procedures required for a review) that is aimed at delivering a minimum level of limited assurance. The Task Force should design the revised standard following this approach.
 - Regarding engagement acceptance considerations, the revised standard should include the premises on which a review of financial statements is performed as preconditions for acceptance of a review engagement. The integrity of management, and ability of an entity’s accounting systems to produce reliable information as the basis for being able to perform a review, should be identified as further considerations in the revised standard.
 - The practitioner’s understanding of the entity and its environment to perform a review of

⁴ ISRE 2410, “Review of Interim Financial Information Performed by the Independent Auditor of the Entity.”

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financial statements should be scalable, to cater to the situations of performing reviews for both large and small entities. The practitioner need not have an understanding of internal control, but should be required to have an understanding of the accounting system as a minimum. The quality of management and the systems implemented by management for financial reporting are important elements of the practitioner's understanding.

- The practitioner's treatment of engagement risk in the review should be an integral part of planning the engagement and identifying and performing the review procedures to achieve the engagement objective. Use of professional judgment and application of professional skepticism are important to the practitioner's consideration of the risks of material misstatement in the financial statements.
- Regarding any inconsistencies the practitioner observes in the financial information being reviewed, and the extent of work effort to be applied to resolve those, the revised standard should require such inconsistencies to be resolved, in the first instance, through obtaining additional or amended information from management or those charged with governance of the entity where possible, and through performance of additional procedures. When such inconsistencies cannot be resolved either through additional information or additional procedures, the practitioner would modify the conclusion expressed in the report where appropriate. If the practitioner cannot obtain sufficient evidence to be able to form a conclusion on the financial statements that would mean the review is not complete, and the practitioner should not report with a disclaimer of the conclusion but should rather withdraw from the engagement without issuing a report.
- The positive expression of conclusion should not be used, because it leaves significant scope for misinterpretation by users. The negative form of conclusion is the more appropriate form of expression given the limited work effort applied in the engagement.
- Reporting requirements in the revised review standard should mirror those in ISA 700,⁵ and ISA 800⁶ for special purpose reports. The disclaimer of conclusion should be used in context of an inability to complete the review in the case where, under laws and regulations that apply in a national setting, the practitioner is not able to withdraw from the engagement (see above).
- Questions regarding the practitioner's independence in a review of financial statements are appropriately addressed in the IFAC *Code of Ethics for Professional Accountants* (the IFAC Code).
- ISRE 2410, which addresses reviews of financial statements or interim financial statements performed by the auditor of an entity, should not be renamed or re-classified to

⁵ ISA 700, "Forming an Opinion and Reporting on Financial Statements."

⁶ ISA 800, "Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks."

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better distinguish such reviews from reviews performed by a practitioner who is not the auditor of an entity. This question may be considered at a later stage when revised ISRE 2400 is completed.

December 2009 IAASB Meeting

8. At the December 2009 IAASB meeting, the IAASB considered significant issues identified by the project Task Force concerning compilation engagements. The IAASB agreed that the revised standards for compilations should focus on compilation of historical financial information, and should:

- Reflect the practitioner's objective as being to deliver a distinct service in the compilation engagement, clearly differentiated from assurance services. The compilation should also be distinguished from other types of activities professional accountants may undertake in the context of providing assistance to entities regarding prepare accounting records and financial information including financial statements.
- The standard should define what "association with financial information" means, to address the question of when a practitioner would need to apply the standard as a consequence of becoming associated with financial information by third parties, through the practitioner's actions or involvements with regard to the financial information or aspects of its preparation.
- Define the terms "compile" and "compilation engagement," to establish clarity as to when practitioners perform services within the scope of the standard and when they do not.
- Be able to be applied proportionately in regard to requirements concerning the practitioner's understanding of the entity, its operations and its environment, needed to be able to compile financial information. This recognizes that the understanding needed for a compilation will differ between entities of different size and complexity.
- Clarify how the practitioner discharges the ethical obligation of not knowingly being associated with materially false or misleading information. The IAASB considers that the revised standard should not require practitioners to apply work effort additional to that required for the compilation itself to be able to meet that obligation, absent any indications evident from performing the compilation that the compiled financial information is, or likely to be, materially false or misleading.
- Require the practitioner to withdraw from an engagement if the entity's management or those charged with governance refuse amendments to the compiled financial information that the practitioner considers necessary for the information not to be materially false or misleading to users.
- Not permit modification of reports issued for compilation engagements (as that would amount to expression of an opinion or conclusion on the compiled financial information).
- Contain reporting requirements that communicate the nature of the engagement performed

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to users of the compiled information, including:

- i) The work performed by the practitioner to compile the financial information; and
- ii) The fact that independence, as described in the IFAC Code for assurance engagements, is not required to perform a compilation engagement.

Project Timetable

9. The project Task Force anticipates the following revised project timetable for the project:

Project Stage	Timing
First read of exposure draft(s)	June 2010
Approve exposure draft(s)	2 nd Quarter, 2010
Full review of exposure draft comments and first read post-exposure	September 2011
Approve final standard(s)	December 2011

Task Force Activities since the December 2009 IAASB meeting

10. Since the December IAASB meeting, the Task Force has held physical meetings in December and January, and three conference calls in February. From these discussions it has developed the draft scope, definitions and requirements sections of the proposed revised standards. Issues surrounding these areas of the revised standards are being presented to the IAASB for consideration in Issues Papers that will be presented at the March 2010 IAASB meeting (Agenda Item 3 in the March 2010 IAASB meeting material).

September 9-11, 2009 CAG Discussion

11. Below are extracts from the draft minutes of the September 2009 CAG meeting,⁷ and an indication of how the project Task Force or IAASB has responded to the Representatives' comments.

Representatives' Comments	Task Force/IAASB Response
GENERAL COMMENTS	
Mr. Damant noted the likely difficulty there will be in developing thinking about reviews as a distinct service from audits, given the strong prevailing preference for	Point taken.

⁷ The minutes will be approved at the March 2010 IAASB CAG meeting.

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Representatives' Comments	Task Force/IAASB Response
<p>audits, even when audits clearly should not be done or are not needed.</p> <p>Mr. Johnson noted that changes in EU thresholds for audit exemptions will mean that approximately 95% of entities will not be subject to mandatory audit. For that reason FEE is particularly interested in the development of alternatives to the audit. Many individual countries in Europe are looking at development of new standards for other non-audit services to fill expected demand. He was of the view the IAASB needs to take the lead in this debate and that there is a need to go further than the review service.</p> <p>Mr. Pickeur expressed confusion about how the review service, which in Europe is only really used for providing assurance on the interim financial statements of listed entities, can also be used as an alternative for the audit of SMEs. Ms. Koski-Grafer agreed that clarification between ISRE 2400 and ISRE 2410 is important. Mr. Damant noted that it would be difficult to rename the ISRE 2410 service given that there is wide acceptance and uptake of that review service in the listed entity sector and by regulators.</p> <p>Mr. Diomeda expressed the view that the review service needs to be presented as a stand-alone assurance service. That can perhaps best be done by emphasizing the assurance delivered by the service rather than by reference to terms such as "limited assurance," or to the fact that limited procedures performed. He did not believe that the needs of regulators should be the main driver for development of the service.</p> <p>Mr. Koktvedgaard was of the view that changing the review conclusion from a negatively-expressed conclusion to a positive one will be a great step forward; the present negatively-expressed opinion is unintelligible to ordinary users. Mr. Johnson stated that there is already confusion in the market about what an audit is, or is not, and it is critical not to further add to the confusion by</p>	<p>The IAASB acknowledges the strategic priority of this project.</p> <p>The IAASB recognizes that reviews performed under ISRE 2410 by the auditor of an entity, need to be appropriately distinguished from a review performed by a practitioner, under the revised ISRE 2400. This question will be considered by the IAASB at a later stage, once the revised ISRE 2400 is developed.</p> <p>The IAASB agrees, and the project Task Force is following that approach in developing the revised review standard.</p> <p>The point has been noted.</p> <p>The IAASB gave full consideration to the question of whether the review engagement conclusion can be expressed in positive terms in the practitioner's report at its meeting in September 2009. The IAASB considers that the positive form of expression of the practitioner's conclusion leaves significant scope for</p>

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<p>introducing a positive form of reporting for reviews.</p>	<p>misinterpretation by users, and that the negative form is more appropriate given the limited work effort applied. The IAASB asked the Task Force to draft the revised standard requiring practitioners to express the review conclusion in the negative form, i.e., <i>based on the work performed in the engagement ... nothing has come to the practitioner's attention that causes the practitioner to believe the financial information is not fairly presented, in all material respects, in accordance with ...</i> (or using other suitable language to reflect the engagement terms).</p>
<p>OBJECTIVE OF A REVIEW ENGAGEMENT AND “LIMITED ASSURANCE”</p>	
<p>Mr. Pickeur expressed the view that practitioners may be reluctant to carry out engagements characterized as “limited assurance” engagements where they are characterized by limited procedures.</p> <p>Ms. Koski-Grafer expressed doubt about the approach to defining the term “limited assurance” in a way that would be understandable to non-auditors, for example, users. She said defining the term may not be needed if the auditor’s review procedures are clearly described in the report, and the report makes it plain by what it says, that a review delivers something less than a high level of assurance. She also noted that it may be easier to understand that an “audit is an audit” and a “review is a review” if one does not try to link the review report to the assurance terminology of limited assurance.</p> <p>Mr. White expressed the view that the proposed terminology is confusing. In an audit, the practitioner</p>	<p>Among the IAASB’s aims in this project is to build understanding among both practitioner and users about the benefits of having a review of financial statements, as a form of limited assurance engagement. As is the case at present, reviews can be used in combinations of services designed to meet individual user’s needs (for example, in combination with agreed-upon procedures).</p> <p>The IAASB has directed the Task Force not to define the term “limited assurance” in the revised standard. The revised standard will convey the approach that the level of assurance obtained is the outcome of the work performed, and there will be minimum procedures that are to be performed in every review engagement. Implicitly, performance of a review in accordance with the requirements of the revised standard will achieve the result of obtaining limited assurance. The revised standard as developed by the Task Force follows the approach of requiring the practitioner to carry out review procedures (defined) to obtain</p>

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<p>sets out to achieve a particular level of assurance and the procedures are driven by that; in contrast, the approach in a review is to perform a certain level of procedures where the level of assurance obtained is simply an outcome of having done that work. This is better described without assurance taxonomy/terminology. Mr. Peyret agreed that the terminology strongly identifies with the audit service. Mr. Koktvedgaard supported Mr. White's view.</p> <p>Ms. Sucher expressed the view that the key issue will be to define the review in terms of both the procedures that constitute the review and also the objective of the review, as is done in ISA 200⁸ for ISA audits. She noted that as both reviews and audits are assurance services she would expect the format used to describe and define the review service to follow a similar approach to that used for the ISA audit (even though they differ as assurance services).</p> <p>Ms. de Beer was of the view that unless the term "limited assurance" is clearly defined it can be expected that many practitioners will find it hard to use or implement the review service. She noted that while the procedures used in different review engagements will not be the same, laying down some minimum procedures, and something more than just analytical procedures and inquiries, will be important. Dr. Manabat suggested taking an approach of distinguishing the review from the audit through use of a "terms of reference" approach for each type of service.</p> <p>Mr. Koster was of the view that the purpose of the review is confusing and needs to be properly clarified. Saying that the financial statements being reviewed are "consistent with the practitioner's understanding" leaves users in the position of not knowing what that means.</p>	<p>review evidence (defined), which the practitioner evaluates to decide whether it is sufficient and appropriate to support the expression of the practitioner's conclusion on an entity's financial statements (expressed in negative terms).</p> <p>The project Task Force has developed the objectives to be achieved by the practitioner performing a review of financial statements, and the requirements that must be complied with to achieve those objectives, as a minimum, in the revised review standard.</p> <p>See above. The IAASB has agreed the Task Force's recommendation that the approach be to specify procedures that represent a minimum level of work effort but to also require the practitioner to apply professional judgment in obtaining the evidential base the practitioner believes necessary to support expression of the conclusion in the particular engagement circumstances.</p> <p>See above.</p> <p>The project Task Force is designing the revised standard in the context of the practitioner's objective of issuing a report for the review that will contain the practitioner's conclusion</p>

⁸ ISA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing."

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Mr. Bollman said linking provision of assurance to the practitioner's understanding of the entity and its business is counter-intuitive and dangerous; especially if the practitioner has only a low level of understanding of the entity. He encouraged the Task Force to exclude use of the term altogether, and simply report the work done and the outcome obtained.	expressed in negative terms. The conclusion is supported by review evidence the practitioner obtains by performing minimum, required review procedures and any additional procedures the practitioner considers necessary in order to be able to report a conclusion. The practitioner evaluates the sufficiency and appropriateness of the review evidence applying knowledge and understanding of the entity and its environment.
UNDERSTANDING OF THE ENTITY AND ITS ENVIRONMENT	
<p>Mr. Damant was of the view that the question of how much understanding is needed correlates with the question of how much assurance can be given in a review.</p> <p>Mr. Johnson believed that an understanding of the business was critical to a review, in part because it is necessary for the practitioner to set expectations when carrying out analytical reviews. He suggested that explanatory material in ISA 315⁹ could be incorporated in the review standard.</p>	<p>The Task Force agrees, and believes the extent of understanding needed should also be proportional to an entity's relative size and complexity.</p> <p>The Task Force has established the principle in the revised standard is that the practitioner's knowledge and understanding must be sufficient to perform the review engagement in accordance with the standard. There will be appropriate application guidance to explain how this principle should be interpreted by practitioners, including with reference to performing the review procedures and evaluating the review evidence.</p>
INDEPENDENCE	
Ms. Blomme noted this was an area on which FEE had commented in response to the IESBA's exposure draft of Section 290. In FEE's view, a distinction could be made between reviews that are for restricted use versus other reviews. She explained that the demand for lesser independence requirements is a significant issue in	The IAASB considered the question of whether the independence requirements for reviews of historical financial information contained in the current IFAC Code are appropriate, and whether the exceptions provided in the IFAC Code are sufficient to enable practitioners to

⁹ ISA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment."

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Scandinavian countries due to the types of other services that are often provided. Mr. Bluhm encouraged both the IAASB and IESBA to consider the matter further and consult with other national standard-setters, since many of the SMP Committee's comments on the IFAC Code were made in the context of the audit engagement, and commentators may not have fully considered Independence in the context of reviews.	appropriately assist clients in various aspects of accounting services and preparation of financial information or financial statements so that their Independence will be preserved in relation to the review. The IAASB expressed the view that independence for reviews of financial statements is appropriately addressed in the IFAC Code.

Matters for CAG Consideration

12. The Task Force welcomes Representatives' comments on any of the issues the Task Force has identified in Agenda Item 3 of the March 2010 IAASB meeting material.

Engagements to Compile Financial Information

13. The Task Force would like to obtain Representatives' feedback on the issues set out below.
- The practitioner's objectives in a compilation engagement;
 - The approach followed by the practitioner to perform the compilation engagement;
 - Reporting requirements relating to independence and objectivity.

The Practitioner's Objectives

14. The Task Force believes the following statement of the practitioner's objectives for a compilation engagement should be stated in the revised standard:

In conducting an engagement to compile financial information, the practitioner's objectives are to:

(a) Compile the financial information, and

(b) Issue a report to accompany the compiled financial information.

15. The following definitions are proposed for the words "compile" and "compilation engagement":

"Compile" means, in relation to the practitioner, as applicable in the circumstances of the engagement, to collect, classify, summarize or present financial information in accordance with the agreed terms of the engagement

"Compilation Engagement" means an engagement in which a practitioner compiles financial information in respect of an entity in accordance with the agreed terms of engagement, and issues a report to accompany the compiled financial information.

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Approach Followed by a Practitioner Performing a Compilation Engagement

16. The Task Force proposes the approach reflected in the following requirements for the performance of a compilation engagement with due care and competence:

The practitioner shall determine that the compiled financial information agrees with or is reconciled to the information provided to the practitioner by management.

The practitioner shall read the compiled financial information, and based on the practitioner's knowledge and understanding described in paragraph [insert paragraph reference], consider whether:

- *The applicable financial reporting framework applied to compile the financial information is adequately referred to or described in the compiled financial information, and*
- *The compiled financial information contains no obvious material misstatements, or if a compliance framework is used to compile the financial information, the compiled financial information is not misleading to the intended users.*

If the practitioner concludes that the applicable financial reporting framework is not adequately referred to or described in the compiled financial information, or that the compiled financial information contains material misstatements or that it is misleading to the intended users, the practitioner shall make appropriate amendments to the financial information.

17. When a practitioner has cause to believe that the compiled financial information contains material misstatements, or is likely to be misleading, the Task Force proposes the following requirements:

Unless prohibited by law or regulation, the practitioner shall withdraw from the engagement, and inform management or those charged with governance of the reasons for withdrawing, in the following situations:

- (a) *The practitioner believes the compiled financial information is, or may be misleading to the intended users, and management or those charged with governance refuse amendments to the compiled financial information that the practitioner considers are necessary so that it will not be misleading, including amendments needed for the applicable financial reporting framework to be adequately referred to or described in the compiled financial information, or*
- (b) *The practitioner becomes aware that accounting records, documents, or other information provided by management for the compilation engagement are incorrect, incomplete or otherwise unsatisfactory, so that the practitioner is unable to make a proper consideration of whether the compiled financial information is, or is likely to be misleading to the intended users, and management does not respond to a request made by the practitioner to provide correct, complete or*

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sufficient additional information or explanations to enable the practitioner to comply with the requirements [insert reference to relevant requirements in the revised standard].

18. The Task Force has considered the question of how far the practitioner needs to go, to avoid being knowingly associated with information that is, or may be materially false or misleading. The Task Force believes the engagement procedures set out in paragraphs 16 and 17 in this CAG Paper are adequate and appropriate in view of the practitioner's objectives in a compilation engagement. This approach is also appropriate and proportional given that the compilation is not an assurance engagement, and viewed in the context of the wider objectives of this project as discussed in paragraph 6 of this CAG Paper.

Questions:

- 1) Do Representatives consider that the objectives of the practitioner in a compilation engagement as set out in paragraph 14 (read with the definitions in paragraph 15), are appropriate for such engagements?
- 2) Do Representatives believe the approach described in paragraphs 16 to 18 is reasonable to require practitioners to follow to achieve the engagement objectives, bearing in mind that the engagement is not an assurance engagement? Is the proposed approach sufficient to discharge the practitioner's ethical obligations in a compilation engagement? If not, do Representatives consider there is another approach that is more appropriate and that would meet the overall objectives of such engagements?
- 3) Do Representatives agree with the approach explained in paragraphs 17 and 18, about how the practitioner should respond when there are indications that the compiled financial information contains material misstatements or is likely to be misleading?

Reporting Requirements Concerning Independence and Objectivity

19. The Task Force has considered the question of whether there should be disclosure requirements concerning the practitioner's objectivity and independence in the context of compilation engagements. Extant ISRS 4410 contains the requirement that, when relevant (i.e., when the practitioner is not independent), the report on a compilation engagement should contain a statement that the accountant is not independent of the entity (and the standard clarifies elsewhere that independence is not a requirement for a compilation engagement). The problem the Task Force identifies with this is that independence is only described in the IFAC Code in the context of assurance engagements, and so the question arises how practitioners are able to assess whether or not they are independent, and on a consistent basis. Also, users reading a statement that the practitioner is not independent in a compilation report are likely to have difficulty understanding precisely what that means, and the implications for the engagement.

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20. At its December 2009 meeting the IAASB suggested that it would be sufficient to flag the issue of independence for users, by inclusion of a statement in the report along the lines that “independence in the sense required for an assurance engagement is not required to perform a compilation engagement.”
21. The Task Force considered, on further reflection about the matter of objectivity and independence in a compilation engagement, that users have a valid interest in knowing about factors that could impact the practitioner’s ability to be objective for the purpose of the compilation. This can be addressed by a requirement for the practitioner to disclose in the report the fact of the existence of any significant interests or relationships that the practitioner believes are of interest to the intended users of the compiled financial information. The Task Force has requested the IAASB’s view on whether this is a more constructive approach, from a user perspective.
22. The Task Force proposes that the practitioner should be required to include in the compilation report:
 - Include a statement that independence, as described in the IFAC Code for assurance engagements, is not required to perform a compilation engagement (unless not relevant where national laws or regulations require independence for a compilation engagement).
 - Disclosure of the fact of the existence of any significant interests or relationships the practitioner has with the entity the compiled financial information relates to that the practitioner believes are of interest to the intended users of the compiled financial information.
23. The Task Force has consulted with the International Ethics Standards Board (IESBA) member that represents the IESBA on the Task Force. The matter was referred to the IESBA for discussion at its meeting in February 2010. The views expressed by the IESBA in that discussion will be covered in the presentation of this Agenda Item at the CAG meeting.

Questions:

- 4) Do Representatives consider that the proposed reporting requirements set out in paragraph 22 concerning independence and objectivity are important disclosures for users of compilation reports?
- 5) Do the proposed reporting requirements provide sufficient information to users regarding independence and objectivity in compilation engagements?

Engagements to Review Financial Statements

24. The Task Force requests Representatives’ feedback on the following particular issues:
 - The practitioner’s objectives in a review of financial statements;

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- The approach followed by the practitioner to perform the review; and
- The practitioner's response when there is an indication of likely material misstatements in the financial statements.

The Practitioner's Objectives

25. Reflecting that the review engagement is intended to be a procedures-oriented assurance engagement, the Task Force proposes the following statement of the practitioner's objectives in the revised standard:

In conducting a review of financial statements, the practitioner's objectives are to:

*(a) Obtain limited assurance about the financial statements of an entity by obtaining sufficient, appropriate **review evidence** through performance of **review procedures** to enable the practitioner to express a conclusion on whether anything has come to the practitioner's attention that causes the practitioner to believe the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework; and*

(b) Report on the financial statements in accordance with the practitioner's findings.

26. This objective is framed on the basis that the practitioner's conclusion on the financial statements is expressed in the negative form, i.e., based on the review work performed (which is intentionally limited) nothing has come to the practitioner's attention that causes the practitioner to believe the financial statements are not prepared in accordance with the applicable financial reporting framework. The IAASB has requested the Task Force to apply this form of conclusion in the revised standard, and not the positive form of expression that is used in reasonable assurance engagements such as financial statement audits. The positive form of opinion is not considered appropriate for limited assurance engagements such as financial statement reviews because, in the IAASB's view, it leaves significant scope for misinterpretation by users who may not appreciate the limited nature of the work undertaken if that form of expression is used.

27. The terms "review evidence" and "review procedures" are proposed to be defined as follows:

*Review evidence – The information used by the practitioner to obtain limited assurance that the financial statements as a whole are worthy of belief. Such information is obtained through the practitioner's understanding of the entity and its environment, combined with performance of **review procedures** that the practitioner judges appropriate in the circumstances of an individual engagement.*

Review procedures – Primarily inquiry of management and analytical procedures performed by the practitioner.

28. The term "review procedures" is defined since review evidence is intended to be generated primarily through performance of certain types of procedures that are a minimum. The

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¹⁰ Traditionally, in countries where financial statement reviews are performed those procedures mainly comprise inquiry and analytical review procedures.

Approach Followed by a Practitioner Performing a Review

29. The interaction between the proposed objectives and the definition of “review evidence” is a pivotal feature of the revised standard. The Task Force has followed the direction provided by the IAASB at the September 2009 IAASB meeting, that following a “procedures-based” approach to describing what limited assurance means in a review engagement is the optimal approach, and preferable to attempting to define limited assurance as a concept. Accordingly, limited assurance is achieved through performance of review procedures (as defined) in the context of the practitioner’s understanding of the entity and its environment, which taken together provide the evidential basis for expression of a conclusion on the financial statements.
30. The question of how the practitioner comes to the view that the review evidence provides limited assurance on the financial statement is proposed to be described as the financial statements being “worthy of belief” in the practitioner’s view, based on the information and evidence obtained for the review. This phrase figuratively represents the “floor” of the concept of limited assurance in a review, i.e., the level of evidential support the practitioner must achieve as a minimum to be able to express a conclusion on the financial statements as a whole. That level is achieved through review procedures performed against the background of the practitioner’s knowledge and understanding of the entity.
31. The Task Force does not consider the phrase “worthy of belief” needs to be defined, but will develop explanatory material to assist practitioners’ understanding and interpretation of it. The Task Force has considered other language that might possibly be used to communicate this idea, for example “plausible,” and also how well alternative wording might translate in other languages. The phrase “worthy of belief” appeared to the Task Force to be the best option for use in the revised standard because it is non-technical, and can be used in the context of its ordinary plain-language meaning without requiring a great deal of interpretation or explanation.

Review Procedures

32. The procedures the practitioner undertakes for the review drive the result of obtaining limited assurance on the financial statements. The review procedures (as defined) are required to be

¹⁰ The cost-effectiveness of reviews as a form of assurance engagement is the result of being able to express a conclusion on the financial statements, conveyed in negative terms, on the basis of the evidence derived from performance of limited procedures.

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supplemented by additional procedures when a practitioner considers that to be necessary in the circumstances of individual engagements.

33. The practitioner needs to exercise considerable professional judgment about the design of the review procedures, and in evaluating the results obtained from those procedures.
34. The design of review procedures is informed by the practitioner's understanding of the entity and its environment, which must be sufficient to be able to identify areas where risk of material misstatement exists, or is likely to exist in the financial statements prepared by management. In line with the limited assurance nature of the engagement, however, they are always intended to be limited, but nevertheless sufficient for the practitioner to be able to conclude on the financial statements taken as a whole on the basis of having obtained limited assurance.
35. The Task Force proposes the following requirements in the revised standard regarding the design and performance of review procedures:

The nature timing and extent of the review procedures shall be determined by the practitioner having regard to the practitioner's knowledge and understanding [of the entity and its environment, and of how the applicable financial reporting framework is applied in the entity's industry], and the requirements of this ISRE.

The practitioner shall determine the review procedures needed to be able to form a conclusion on the financial statements as a whole, and shall focus the procedures on those areas where, based on the practitioner's understanding ..., the practitioner believes there is, or is likely to be risk of material misstatement occurring in the financial statements.

Questions:

- 6) Do Representatives consider that the objectives of the practitioner in a review of financial statements set out in paragraph 25 (read with the definitions in paragraph 27) are appropriate for a limited assurance engagement carried out for an entity's financial statements?
- 7) Do Representatives believe the approach described in paragraphs 29 to 31 is reasonable to achieve the stated objectives the practitioner in the review of financial statements, bearing in mind the engagement is a limited assurance engagement? If not, do Representatives consider there is another, more appropriate approach that meets the overall objectives of such reviews?
- 8) Do practitioners agree with the approach to use of review procedures explained in paragraphs 28, and 32-35?

Practitioner's Response to Likely Material Misstatements

36. The Task Force has considered the approach the practitioner should follow when, having performed review procedures and evaluated the results obtained from those, the practitioner

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considers there are indications that material misstatements exist, or are likely to exist in the financial statements, or (where a compliance framework is used) that the financial statements are likely to be misleading.

37. The Task Force proposes the following approach in such situations:

- (i) Perform such additional procedures (not necessarily limited to additional review procedures) as the practitioner deems necessary to obtain limited assurance that the financial statements, taken as a whole, are worthy of belief.
- (ii) The practitioner decides what additional procedures are needed to reach this overall conclusion. Following the limited assurance nature of the engagement, the practitioner does not have to obtain audit-level assurance (“reasonable assurance”) that material misstatements exist or do not exist in affected account balances or items reflected in the financial statements, following indications that misstatements are likely to exist.
- (iii) The practitioner makes a judgment about what additional procedures are needed only for the purpose of being able to conclude in accordance with the overall purpose of the engagement – to obtain limited assurance.

38. The Task Force’s rationale for proposing this approach is that if, in the alternative, the practitioner is required to “track down” material misstatements following indications that they may exist to the extent required in an audit, the nature of the engagement would shift away from the underlying limited assurance objective that characterizes the review.

39. The Task Force has debated this situation at great length, and the majority view of the Task Force is that the over-arching, limited assurance nature of the engagement prevails. If, on the basis of performing limited procedures, the practitioner is unable to form a view about whether or not a likely material misstatement actually exists, and so is not able to conclude on whether the financial statements are prepared in accordance with the applicable financial reporting framework in all material respects, this amounts to an inability to complete the review.

40. Under the Task Force’s suggested approach there are two possible outcomes:

- (a) Additional procedures performed resolve the question of whether a material misstatement exists so that the practitioner is able to form the conclusion that the financial statements as a whole are worthy of belief. The practitioner is able to report a review conclusion on the financial statements as a whole either:
 - (i) Without modification, or
 - (ii) With modification (i.e., either a qualified or an adverse conclusion), if management or those charged with governance do not amend the financial statements to remove a material misstatement that the practitioner believes exists in the financial statements.
- (b) Additional procedures performed do not resolve the question of whether or not a likely material misstatement actually exists in the financial statements. Unless management

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provides additional information, where possible, to assist the practitioner to establish whether or not the financial statements are materially misstated, to the practitioner's satisfaction, the outcome is that the practitioner is unable complete the review. Accordingly the practitioner will not provide a report for the engagement. The question of "how much" additional procedures are performed is a question of judgment for the practitioner, and should be decided in the light of the results of the practitioner's communications with management and those charged with governance about the likely material misstatement. If it is not possible for management to provide additional information to the practitioner in such situations, the final result is that the practitioner cannot reach a conclusion on the financial statements, and no report is provided.

41. Members of the Task Force argue that, in practice, faced with an indication that a material misstatement is likely to exist in the financial statements, the practitioner's first action will be to discuss that situation with management, or those charged with governance as appropriate. The practitioner will inform management of the need for more information to resolve the question of whether a material misstatement exists, and that the practitioner will also perform additional procedures for that purpose. An inevitable consequence is that the cost of performing the review will increase due to the greater work effort required of the practitioner.
42. If the practitioner cannot satisfactorily resolve questions surrounding likely material misstatements through evidence obtained from additional information or through additional procedures, management is faced with:
 - (a) The practitioner's withdrawal from the engagement without providing a report, due to inability to obtain sufficient, appropriate review evidence to form a conclusion on the financial statements; or
 - (b) Significantly increased costs if the practitioner extends the work for the review to the extent needed to establish whether one or more material misstatements actually exist.

At this point in the engagement management and those charged with governance have a significant incentive to provide whatever assistance is possible to facilitate the practitioner's ability to form a conclusion on the financial statements, and to be able to report.

43. The Task Force believes the requirement to withdraw if the practitioner is unable to form a conclusion is a powerful incentive for management and those charged with governance to do everything possible to assist the practitioner to resolve questions surrounding likely material misstatements. This is preferable to having a requirement in the revised standard that would mean practitioners are always required to follow up likely material misstatements to establish that their existence in the way that would be done in an audit.
44. In line with the arguments set out above, the Task Force proposes the following requirements for the revised standard:

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Practitioner's Response When Review Procedures Indicate Likelihood of Material Misstatements in the Financial Statements

When the practitioner believes the financial statements are likely to be materially misstated, the practitioner shall perform additional procedures the practitioner deems necessary to obtain limited assurance that the financial statements taken as a whole, are worthy of belief.

If, following performance of additional procedures, the practitioner believes the financial statements are materially misstated, the practitioner shall consider the effect of the practitioner's report to be issued on those financial statements.

Circumstances When Modification of the Practitioner's Conclusion Is Required

The practitioner shall modify the conclusion in the report when, based on the work performed for the review, matters have come to the practitioner's attention causing the practitioner to believe that:

- (a) The financial statements do not comply, in all material respects, with the applicable financial reporting framework, where a compliance framework is used, or*
- (b) The financial statements are not fairly presented, or do not give a true and fair view, in all material respects, in accordance with the applicable financial reporting framework, when a fair presentation framework is used.*

Consequence of an Inability to Obtain Sufficient Appropriate Review Evidence after the Practitioner Has Accepted the Engagement

The practitioner shall withdraw from the engagement, where permitted under applicable laws or regulations, when the practitioner is unable to:

- (a) Obtain sufficient appropriate review evidence in accordance with this ISRE, to be able to conclude, on the basis of limited assurance, that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, [or*
- (b) Obtain written representations from management or those charged with governance, as appropriate]*

In such circumstances, the practitioner is unable to complete the review, and accordingly is unable to reach a conclusion and report. The practitioner shall withdraw from the engagement informing those charged governance of the reasons for withdrawal.

If withdrawal from the engagement is not permitted under applicable law or regulation, the practitioner shall provide a report on the engagement stating that the practitioner was unable to complete the review, and accordingly is unable to express a

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conclusion on the financial statements.

Questions:

- 9) Do Representatives consider that the approach to be followed by a practitioner when the results of review procedures point to likely material misstatements in the financial statements, as explained in paragraphs 36-43, is appropriate?
- 10) Do Representatives agree with the Task Force's view that "limited assurance" nature of the engagement should guide the approach followed so that if, on the basis of performing limited procedures, the practitioner is unable to form a view on whether or not a likely material misstatement actually exists, this would amount to an inability to complete the review, which would then prevent the practitioner from issuing a report (paragraphs 38 - 39)?
- 11) Do Representatives support the Task Force's view that if the practitioner is unable to complete the review it is not appropriate to provide a report that disclaims expression of a conclusion on the financial statements, and that the practitioner should instead withdraw from the engagement without providing a report (paragraphs 40 - 43)?

Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

Agenda Item 3 of the March 2010 IAASB Meeting – Review and Compilation Engagements – Cover Sheet [Link to follow](#)

Agenda Item 3-A of the March 2010 IAASB Meeting – Compilation Engagements – Issues and IAASB Task Force Proposals [Link to follow](#)

Agenda Item 3-B of the March 2010 IAASB Meeting – Review Engagements – Issues and IAASB Task Force Proposals [Link to follow](#)

Appendix to Agenda Items 3-A and 3-B (Material provided for illustrative purposes only, not for IAASB discussion) – Table showing "side-by-side" draft requirements of the proposed revised standards for compilation engagements and review engagements [Link to follow](#)