

IAASB CAG PAPER

IAASB CAG Agenda (March 2010)

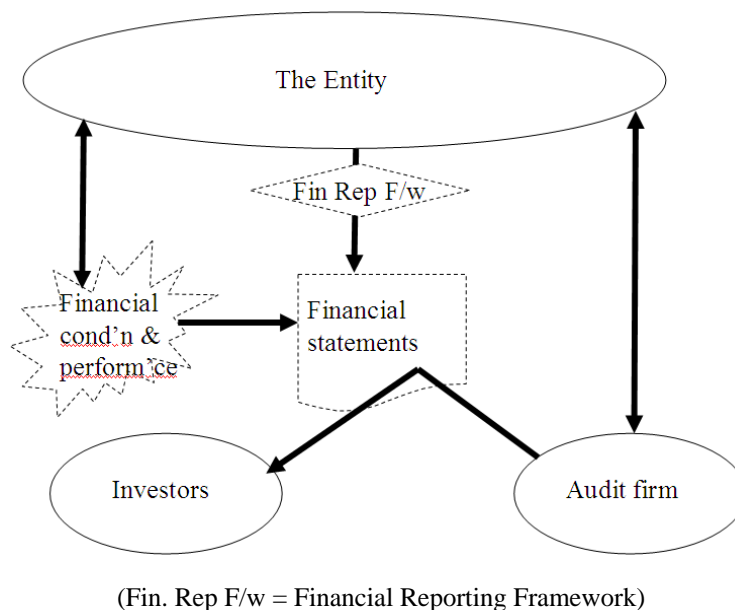
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Assurance Engagements Other than Audits or Reviews of Historical Financial Information—ISAE 3000—Key Issues

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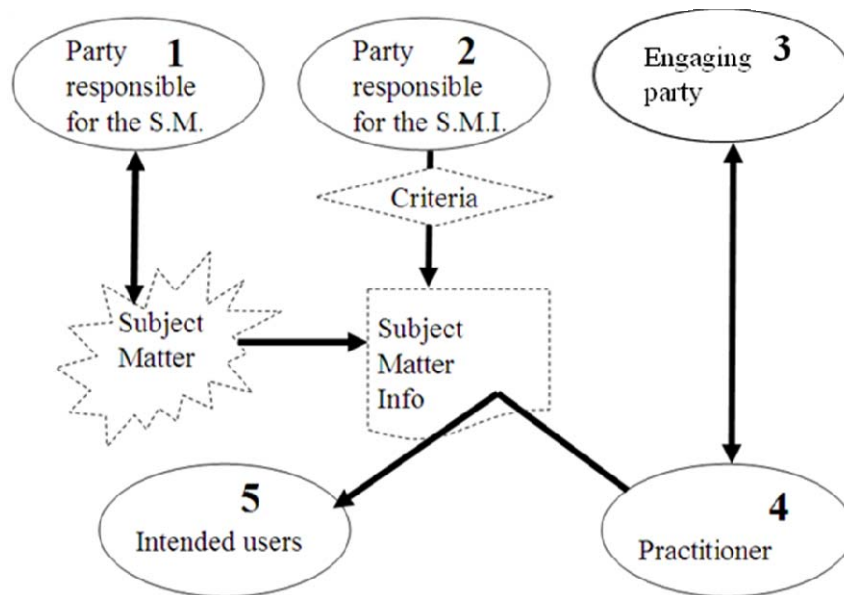
Background

1. It is helpful background to identify the key elements of an assurance engagement and the relationships that exist between the various parties in an assurance engagement by comparing a financial statement audit/review with a generic model of an assurance engagement.
2. In a financial statement audit/review, the entity (management or those charged with governance) is responsible for its financial condition and financial performance. It accounts to users by preparing financial statements that depict the financial condition and financial performance in accordance with a financial reporting framework and distributing them to users. The auditor is engaged by the entity to perform the audit/review and prepare a report that accompanies the financial statements. This can be depicted as follows:



3. A generic model that applies to all assurance engagements is depicted in the following diagram.

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4. In this generic model, there is an underlying “subject matter” (e.g., an entity’s environmental, social and economic impacts) which is reported on in the form of subject matter information (e.g., a sustainability report) prepared in accordance with criteria (e.g., the Global Reporting Initiative guidelines). A party can engage a practitioner to perform a reasonable/limited assurance engagement and prepare a report that accompanies the subject matter information.
5. A difference between the financial statement audit/review model and the generic model is that in the financial statement model, the entity actually performs 3 functions which can be separated out in some other assurance engagements, that is, in the financial statement model, the entity is the party responsible for: (a) the underlying subject matter; (b) preparing the subject matter information; and (c) engaging the practitioner, which is not always the case for other assurance engagements.

Direct Reporting Assurance Engagement

6. An important implication of separating out these roles is that the party responsible for the underlying subject matter is not always the party that performs the evaluation or measurement of the underlying subject matter against the criteria, and in fact in some assurance engagements, the party that performs the evaluation or measurement of the underlying subject matter against the criteria is the practitioner. When the practitioner performs that evaluation or measurement and reports both the findings (i.e., the subject matter information) as well as the practitioner's assurance conclusion in the practitioner's report, the engagement is known as a direct reporting assurance engagement.
7. The Task Force has identified a number of issues with respect to direct reporting assurance

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engagements, for example, whether the concept of “risks of material misstatement” is appropriate when the practitioner in fact performs the evaluation and measurement and reports the findings directly, the nature of the practitioner’s assurance conclusion as stated in the assurance report, and how to articulate the differences between a direct reporting assurance engagement and a compilation engagement. The Task Force is still exploring these issues, however, and expects to seek feedback on them from Representatives at the September 2010 CAG meeting, as appropriate.

Nature and Extent of Amendments to ISAE 3000

8. In accordance with the IAASB’s discussion when approving the proposal for this project, and its subsequent discussions in relation to both this project and other ISAEs under development, in particular the working draft on GHG assurance,¹ the Task Force is proposing the following approach to revising ISAE 3000, a first working draft of which will be presented at the March 2010 IAASB meeting.
9. Revised ISAE 3000 will:
 - (a) Be based on the existing ISAE 3000 and the Assurance Framework. Conceptual matters underlying ISAE 3000 will not be reopened for consideration except to clarify them where a particular need to do so has been identified through experience with ISAE 3000. To the extent that any such clarification is required, this may require consequential amendments to the Assurance Framework. Conceptual matters that may require clarification include, for example, a number of issues in relation to direct reporting assurance engagements as identified in paragraph 7 above, and certain misconceptions that have developed about the levels of assurance, as discussed in the following section.
 - (b) Be written using the clarity drafting conventions. This will likely require some consequential amendments to the Preface.²
 - (c) Be applicable to all assurance engagements, whether or not there is also a relevant subject matter-specific ISAE:
 - When there is no relevant subject matter-specific ISAE, ISAE 3000 would be the only standard that needs be followed.
 - When there is a relevant subject matter-specific ISAE, the subject matter-specific ISAE would need to be followed in addition to ISAE 3000. Therefore, it will be important that subject matter-specific ISAEs do not duplicate requirements in ISAE 3000 where those requirements adequately cover a topic (see next point).

¹ Included in the October 2009 Consultation Paper “Assurance on a Greenhouse Gas Statement.”

² Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services.

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- (d) Include requirements that are generally applicable in virtually all assurance engagements.³ This will include both:
- High-level requirements on principles like engagement risk and materiality, where the specifics of how those principles should be applied will vary considerably depending on the subject matter. When a subject matter-specific ISAE is being developed, it is likely to include specific requirements/guidance on how these high-level requirements should be applied in the context of that subject matter; and
 - More detailed requirements on a small number of topics that apply in a reasonably uniform way across all subject matters, and are therefore likely to need little or no supplementation in subject matter-specific ISAEs. These topics will mostly relate to “engagement management” matters, like documentation, quality control and engagement acceptance.
- (e) Be a stand-alone document in that:
- Requirements and guidance regarding any topic, like documentation, quality control and engagement acceptance, are not expected to be so extensive that they will need to be pared off into a separate topic-specific ISAE.
 - Extensive references to paragraphs in the Assurance Framework will be avoided, for example, where the explanation of a concept contained in the Assurance Framework is needed for an understanding of a requirement, that concept will be explained, or at least summarized, in ISAE 3000.

Common Misconceptions about Levels of Assurance

10. ISAE 3000 covers both reasonable assurance engagements and limited assurance engagements. The Task Force is aware of the following misconceptions about these two levels of assurance that it appears are commonly enough held to warrant clarification in revised ISAE 3000. The IAASB has tentatively agreed that this is the case.
11. The views of Representatives are sought on whether their experience indicates that the following misconceptions are commonly held and should be clarified. The Task Force is also interested in whether CAG members believe that clarifying any of these misconceptions could lead to any negative unintended public interest consequences.

Unacceptable Limited Assurance Engagements

12. Misconception 1: If a reasonable assurance engagement cannot be undertaken because, for

³ Like the ISAs, ISAE 3000 is intended to apply to both large and small engagements. Also like the ISAs, ISAE 3000 may include requirements that only apply when certain conditions that limit their relevance and applicability are present.

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example, the subject matter is primarily qualitative, future oriented or overly subjective; the criteria are too “soft;” or there are other limitations on the evidence available such as relevant information systems being poorly controlled, then a limited assurance engagement may be able to be undertaken instead.

13. This view reflects what was known, when ISAE 3000 was originally being drafted, as the “interaction of variables” approach. The IAASB at that time, after much deliberation including commissioning Research Study 1 and several years of discussion, decided against the interaction of variables approach and in favor of the work effort approach (this approach had also been supported by the 2003 Fédération des Experts Comptables Européens (FEE) Study, “Principles of Assurance”). Under the work effort approach, the only difference between a reasonable assurance engagement and a limited assurance is the nature, timing and extent of procedures the practitioner performs; therefore, if a reasonable assurance engagement cannot be undertaken because of the reasons in the preceding paragraph, then a limited assurance engagement cannot be either. The only time a limited assurance engagement could be undertaken even though a reasonable assurance engagement cannot be is when time or cost constraints would prevent the practitioner from undertaking the work effort required for a reasonable assurance engagement.
14. The intended interpretation (i.e., the work effort approach) is implicit in the Assurance Framework and ISAE 3000,⁴ but neither document explicitly states that if a limitation (other than time or cost constraints) prevents a reasonable assurance engagement being performed, it should also prevent a limited assurance engagement. The Task Force is proposing to state this explicitly. When this is better understood, it may result in some engagements being rejected by practitioners that would otherwise be accepted. That doesn’t mean that practitioners will not be able to provide any services in relation to such subject matters. Rather, it may also result in such engagements being accepted as compilation engagements, agreed-upon procedures engagements, or consulting engagements (for example, to improve information systems), and could also lead to improvements to how criteria are articulated to enable assurance engagements to be performed.

Materiality Varies with the Level of Assurance

15. *Misconception 2:* For a particular set of circumstances, materiality varies (or can vary) with the level of assurance, such that in a limited assurance engagement, larger errors can be considered immaterial than in a reasonable assurance engagement.
16. The model adopted when ISAE 3000 was approved is that materiality is identical whether a reasonable assurance or a limited assurance engagement is undertaken because it is a user-driven concept that plays a part in determining the practitioner’s work effort, rather than being determined by the practitioner’s work effort. This is consistent with how materiality is applied in

⁴ For example, paragraph 48 of the Assurance Framework says “The level of assurance engagement risk is higher in a limited assurance engagement than in a reasonable assurance engagement *because of* the different nature, timing or extent of evidence-gathering procedures” (emphasis added).

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the ISAs and International Standards on Review Engagements (ISREs) for reasonable and limited assurance engagements for historical financial information (i.e., audit and review engagements)

17. While both the Assurance Framework and ISAE 3000 discuss materiality as a user-driven concept, neither explicitly addresses this misconception. The Task Force is proposing to make an explicit statement that materiality is not affected by the level of assurance.

Moderate Assurance

18. Misconception 3: The level of assurance obtained on all limited assurance engagements is a specific point on a scale (sometimes called “moderate” assurance).
19. It seems to be well understood that in a reasonable assurance engagement the level of assurance obtained is, perhaps tautologically, that which is reasonable in the circumstances, regardless of the subject matter. It involves obtaining enough evidence for the practitioner to be in a position to offer an opinion expressed in the positive form about the subject matter information, i.e. “in my opinion the subject matter information has been prepared in all material respects in accordance with the criteria.” With respect to limited assurance engagements, however, the level of assurance obtained is less well understood.
20. The model adopted when ISAE 3000 was approved is that the level of assurance obtained in a limited assurance engagement varies with the engagement circumstances.
21. The level of assurance for any given limited assurance engagement is determined by the nature, timing and extent of procedures performed. That level may vary from, at the upper end, just below “reasonable”⁵ to, at the lower end, just above “meaningful.” Because the procedures performed do not result in enough evidence for the practitioner to offer an opinion expressed in the positive form, the conclusion in a limited assurance engagement is expressed in the negative form, i.e., “having done a, b and c (but not x, y or z), nothing has come to my attention that leads me to believe the subject matter information has not been prepared in all material respects in accordance with the criteria.”
22. The lower end of the level of assurance that must be obtained to express limited assurance in the negative form (i.e., above “meaningful”), is described in ISAE 3000, paragraph 23, as that which “is likely to enhance the intended users’ confidence about the subject matter information to a degree that is clearly more than inconsequential.” The Task Force will consider revising this explanation when redrafting ISAE 3000. For example, the lower threshold could be expressed in terms such as “the subject matter information appears to be worthy of belief.”

⁵ Having said that there is an upper end in theory, there is nothing in ISAE 3000 that prevents a practitioner who has obtained a reasonable level of assurance from expressing a limited assurance conclusion if permitted by the terms of the engagement. However, in such cases, that the practitioner cannot ignore any of the additional evidence obtained.

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23. The ISREs currently “peg” the level of assurance for financial statement reviews as “moderate,” but because there are no equivalent standards to peg the level of assurance for limited assurance engagements on other subject matters, using the term “moderate” to describe the level of assurance obtained is not appropriate for ISAE 3000. The Task Force is paying close attention to the revision of ISRE 2400⁶ as the IAASB’s thinking on that project regarding matters such as the role of risk will no doubt influence its thinking on limited assurance engagements under ISAE 3000. *It is recognized, however, that not all the decisions that are appropriate for limited assurance in a financial statement context will necessarily be appropriate for limited assurance with respect to different kinds of subject matters.*
24. The varying levels of assurance obtained in different limited assurance engagements is why ISAE 3000⁷ states, with respect to the requirement to include in the assurance report a summary of the work performed:

Because in a limited assurance engagement an appreciation of the nature, timing, and extent of evidence-gathering procedures performed is essential to understanding the assurance conveyed by a conclusion expressed in the negative form, the summary of the work performed:

- (i) Is ordinarily more detailed than for a reasonable assurance engagement and identifies the limitations on the nature, timing, and extent of evidence-gathering procedures. It may be appropriate to indicate procedures that were not performed that would ordinarily be performed in a reasonable assurance engagement; and
- (ii) States that the evidence-gathering procedures are more limited than for a reasonable assurance engagement, and that therefore less assurance is obtained than in a reasonable assurance engagement.

25. The Task Force is proposing to give this more emphasis in the revised ISAE.

Inquiries of Management and Analytical Procedures

26. Misconception 4: The nature of procedures for all limited assurance engagements is primarily inquiries of management and analytical procedures.
27. The model adopted when ISAE 3000 was approved is that the nature of procedures for a limited assurance engagement will vary with the engagement circumstances unless there is an applicable subject matter-specific standard that sets out particular requirements regarding the nature of procedures, as do the ISREs with respect to reviews of financial statements. The Task Force

⁶ ISRE 2400, “Engagements to Review Financial Statements.”

⁷ Paragraph 49(j).

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dealing with GHG emissions is currently contemplating which procedures would be appropriate for a limited assurance engagement with respect to GHG information.⁸

28. Where there is no applicable subject matter-specific standard, the nature of procedures will vary according to the engagement circumstances, including the needs of intended users. As both the Assurance Framework and ISAE 3000 state:⁹

Both reasonable assurance and limited assurance engagements require the application of assurance skills and techniques and the gathering of sufficient appropriate evidence as part of an iterative, systematic engagement process that includes obtaining an understanding of the subject matter and other engagement circumstances. The nature, timing and extent of procedures for gathering sufficient appropriate evidence in a limited assurance engagement are, however, deliberately limited relative to a reasonable assurance engagement. For some subject matters, there may be specific pronouncements to provide guidance on procedures for gathering sufficient appropriate evidence for a limited assurance engagement. For example, ISRE 2400, “Engagements to Review Financial Statements” establishes that sufficient appropriate evidence for reviews of financial statements is obtained primarily through analytical procedures and inquiries. In the absence of a relevant pronouncement, the procedures for gathering sufficient appropriate evidence will vary with the circumstances of the engagement, in particular, the subject matter, and the needs of the intended users and the engaging party, including relevant time and cost constraints.

29. It is acknowledged that this leads to different limited assurance engagements having different procedures. While in some cases this is not seen as ideal, particularly where procedures vary from engagement to engagement for a given type of subject matter information, it is consistent with allowing new engagements to develop in a way that does not inhibit innovation. It is also consistent with the expression of a negative form of conclusion based on the description of procedures included in the assurance report.
30. The Task Force is proposing to make it clearer in the revised ISAE that the procedures for a limited assurance engagement are not necessarily comprised primarily of inquiries of management and analytical procedures.

Matters for CAG Consideration

The views of Representatives are sought on whether their experience indicates that the following misconceptions are commonly held and should be clarified:

- Unacceptable limited assurance engagements;
- Materiality varying with the level of assurance;

⁸ See Consultation Paper “Assurance on a Greenhouse Gas Statement,” paragraphs 58-60 and the related question 30.

⁹ Assurance Framework, paragraph 53 and ISAE 3000, paragraph 37.

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- Moderate assurance; and
- Inquiries of management and analytical procedures?

Do Representatives see any negative unintended public interest consequences resulting from clarifying these misconceptions?

Examples of Assurance Engagements

31. ISAE 3000 is intended to cover all assurance engagements other than audits or reviews of financial statements. It therefore has an exceptionally wide coverage. The extent of this coverage is indicated in the Appendix in the form of an analysis prepared by IAASB staff.
32. One difficulty in preparing such a broad standard is identifying those characteristics of different engagements that might cause the IAASB to consider whether certain requirements actually apply to all, or virtually all, assurance engagements.
33. It would be most helpful if Representatives were able to identify the kinds of assurance engagements other than audits or reviews of financial statements with which they are familiar, and in particular, if they were able to supply copies of assurance reports (whether prepared by accounting professionals or others) for Task Force analysis.

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Appendix

The table below shows a categorization of possible subject matters with examples of each. The categorization is helpful in testing whether planned requirements of revised ISAE 3000 will apply to different types of subject matter/subject matter information. It is not necessarily complete, and the categories are not necessarily mutually exclusive. Also, in some cases, the examples are the subject matter information, in other cases they are the subject matter or merely an indication of the type of question that information could assist with, whichever is more meaningful in the circumstances.

Information about:		Historical Information	Future Oriented Information
Financial	Performance	• <i>Income Statement</i>	• <i>Forecast/projected cash flow</i>
	Position	• <i>Balance Sheet</i>	• <i>Forecast/projected financial position</i>
Non-Financial	Performance/ Use of Resources/ Value for Money	<ul style="list-style-type: none"> • <i>A statement of an entity's GHG emissions</i> • <i>KPIs</i> • <i>Statement on effective use of resources</i> • <i>Statement on Value for Money</i> 	<ul style="list-style-type: none"> • <i>Expected emissions reductions attributable to a new in technology, or GHGs to be captured by planting trees</i> • <i>Statement on projected effective use of resources</i> • <i>Statement that a proposed action will provide value for money</i>
	Condition	<ul style="list-style-type: none"> • <i>The description of a system</i> • <i>Physical characteristics, the size of leased property</i> 	• <i>Prediction of next week's weather</i>
System/ Process	Design	• <i>Effectiveness of the design of controls at a service organization</i>	• <i>Effectiveness of the design of proposed controls for a new production process</i>
	Operation/ Performance	• <i>Actual effectiveness of procedures for hiring and training staff</i>	• <i>Whether a risk management system will manage risks as they arise</i>
Aspects of Behavior	Compliance	• <i>An entity's compliance with loan covenants (or specific legal or regulatory</i>	• <i>Whether an entity will continue to comply with loan covenants</i>

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		<i>requirements)</i>	
	Human Behavior	<ul style="list-style-type: none"> • <i>Evaluation of audit committee effectiveness</i> • <i>Ability to drive a car</i> 	<ul style="list-style-type: none"> • <i>Whether a jury will find a defendant guilty or not</i>
	Other	<ul style="list-style-type: none"> • <i>The fitness for purpose of a software package</i> 	<ul style="list-style-type: none"> • <i>An entity's creditworthiness</i>