

## Agreed-upon Procedures – Discussion

### Background

1. In December 2014, the IAASB released its Strategy for 2015-2019 and related Work Plan for 2015-2016 (“the Work Plan”). In response to input from numerous member bodies, national standards setters (NSS) and other professional organizations, the IAASB has included in its Work Plan the revision of International Standard on Related Services (ISRS) 4400<sup>1</sup> and the consideration of more holistic issues involving Agreed-upon Procedures (AUP) as one of its new initiatives. The AUP initiative as described in the Work Plan is set out in the appendix.
2. In response to the stakeholders’ comments, the IAASB established a Working Group (WG) to explore issues involving AUP engagements. Since its formation in early 2015, the WG has conducted preliminary research and consulted with various stakeholders on common practices and issues regarding AUP engagements.
3. The WG has developed this paper to provide the CAG Representatives and Observers with information about:
  - Section A — Existing practices regarding AUP engagements.
  - Section B — Preliminary Issues identified to ISRS 4400.
  - Section C — Key views expressed at the IAASB June 2015 Meeting.
  - Section D — Way forward.

### A. Existing Practices Regarding AUP Engagements

#### *Types of Agreed-upon Procedures*

4. Input from NSSs, members of the Small-Medium Practice Committee’s (SMPC) Rapid Response Task Force and others suggest that AUP engagements are performed on both financial and non-financial information. For example:

Primarily financial information	Primarily non-financial information
Eligibility of expenditures claimed from a funding program	Internal controls over financial reporting
Comfort letter to a securities regulator on investment firm’s fulfillment of its obligations to clients upon deregistration	Due diligence in a business acquisition
Report on revenues (e.g., for determining royalties, rent, franchise fees based on a % of revenues)	Compliance with “green packaging” requirements
Reconciliation between different financial reporting frameworks	Report on number of passengers to Civil Aviation Authority

<sup>1</sup> ISRS 4400, *Engagements to Perform Agreed-upon Procedures Regarding Financial Information*

Report on compliance with bank covenants	Report on greenhouse gas emissions
Report on capital adequacy ratio for regulatory authorities	Observation of destruction of fake or defective goods
Calculations of financial ratios of projected cash flows for reporting to tax authorities	Data generating process for national lottery draws

5. As indicated in the table above, there is a wide variety of AUP engagements. Some of these AUP engagements are highly regulated and may require specialized skills to perform.

*Lack of Clarity Regarding the Boundaries of an AUP Engagement and Hybrid Engagements*

6. Paragraph 9 provides a discussion of the premise of an AUP engagement. As discussed in paragraphs 11-17, there are areas within that premise where further clarification is needed. Further, in addition to AUP engagements, there are engagements that go beyond the premise of an AUP engagement, and may contain aspects of AUP engagements and assurance engagements. Paragraphs 24-26 provide further details on such engagements.

*National AUP Standards and Guidance*

7. Our survey of NSSs suggested that many jurisdictions have national standards or guidance that is based on, or similar to, ISRS 4400.

<b>AUP Standard</b>	<b>Jurisdictions</b>
National standard that is adopted from, based on, or is similar to, ISRS 4400	Canada, China, France, Hong Kong, Netherlands, South Africa
No national standard. However, guidance issued by professional body is based on, or similar to, ISRS 4400	Germany, Japan, Mexico, New Zealand, United Kingdom
National standard that is different from ISRS 4400	Australia, United States

8. With respect to jurisdictions that have responded to the NSS survey indicating that they do not have a national AUP standard, the results from the NSS survey suggests that the primary reason for not having a national AUP standard is that the NSS does not have the mandate to promulgate such a standard. However, the professional accounting bodies in many of these jurisdictions may issue guidance that is based on ISRS 4400. In the WG’s view, a revised AUP standard will benefit many jurisdictions around the world.

**B. Preliminary Issues Identified Relating to ISRS 4400**

*Distinction Between an AUP Engagement and an Assurance Engagement*

9. An AUP engagement is premised upon:
- The practitioner performing AUP and reporting on factual findings; and

- The intended users assessing for themselves the procedures and findings reported, and drawing their own conclusions on the practitioner's work.

This is in contrast to an assurance engagement when the practitioner performs procedures that the practitioner determines to be necessary to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users about the subject matter information.

10. Given the premise of an AUP engagement, areas that require further clarification include:
  - The role of professional judgment, professional skepticism, professional competence and due care in an AUP engagement;
  - The practitioner's objectivity in conducting an AUP engagement;
  - Performance of procedures normally associated with assurance engagements in an AUP engagement; and
  - Use of assurance terminology in an AUP report.

#### Professional Judgment, Professional Skepticism, Professional Competence and Due Care

11. The concepts of professional judgment and professional skepticism are currently not addressed in ISRS 4400. These concepts would need to be further explored in terms of how they are applied in the context of an AUP engagement. For example, a practitioner may need to exercise professional judgment in agreeing with the engaging party the nature, timing and extent of procedures that should be included in certain types of AUP engagements to reflect the expectations of the parties involved and to enable a description that is sufficiently specific. However, since the intended user (and not the practitioner) is ultimately responsible for the sufficiency and appropriateness of the procedures, the exercise of professional judgment in the context of agreeing the nature, timing and extent of procedures in an AUP engagement is different from the designing of the nature, timing and extent of procedures in an assurance engagement. Reporting on the AUP engagement may require some professional judgement. However, since only factual findings are included in the AUP report and the descriptions of the procedures are specific, the exercise of professional judgment in the context of determining the facts to be reported is more limited in an AUP engagement as compared to the expression of a conclusion in an assurance engagement.
12. Similarly with professional skepticism, although the practitioner does not need to consider the sufficiency and appropriateness of evidence to support a conclusion as in assurance engagements, professional skepticism is relevant in performing the procedures and considering the evidence obtained to support the factual finding being reported. Professional competence and due care are briefly addressed in ISRS, but further insight may be needed to better explain these concepts in the context of AUP engagements. For example, when adding the sales figure from a stack of sales invoices, the practitioner would need to possess the necessary professional competence and exercise due care in determining whether the documents in question are in fact sales invoices and which figures ought to be included in the addition.

### Practitioner's Objectivity

13. Objectivity is a principle that imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others. Independence applies to assurance engagements and comprises of independence of mind (the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment) and independence of appearance (the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's, or a member of the engagement team's, integrity, objectivity or professional skepticism has been compromised). The Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants ("IESBA Code") requires a practitioner to be objective, but does not require the practitioner to be independent, when performing a non-assurance engagement.
14. Certain national AUP standards (e.g., Australia's ASRS 4400<sup>2</sup> and the American Institute of Certified Public Accountants' (AICPA) proposed attestation standard on AUP) require the practitioner to be independent when performing an AUP engagement. Certain users may also require the practitioner to comply with the independence requirements when performing the AUP engagement (e.g., the European Commission's Horizon 2020 program requires the practitioner to comply with the independence requirements in the "IESBA Code", even though the independence requirements apply only to assurance engagements).
15. The WG does not intend to open up the question as to whether a practitioner should be independent when performing a non-assurance engagement. However, the issue of the role of objectivity may need to be further explored in light of the approaches taken by various national AUP standards around the world and user needs.

### Procedures Normally Associated with Assurance Engagements

16. Certain procedures such as the determination of materiality and the assessment of risk are normally associated with an assurance engagement. For example, establishing materiality may not be necessary in an AUP engagement as it is the responsibility of users to determine whether the subject matter information is free from material misstatement or non-compliance. Likewise, risk assessments may not be necessary as the nature, timing and extent of procedures to be performed are agreed with the engaging party, and are not determined by the practitioner in response to assessed risks. Some national AUP standards such as Australia's ASRS 4400 explicitly prohibit such procedures. ISRS 4400 is silent on whether such procedures are prohibited. Further exploration of procedures normally associated with assurance engagements in the context of an AUP engagement and the confusion this may create will be undertaken to substantiate a position to be taken in this regard.

### Assurance Terminology

17. There is lack of clarity regarding the use of terminology that is normally associated with assurance in ISRS 4400. For example, the phrase "review" may be appropriate when read in the context of a layperson's understanding, but may be misinterpreted by others as limited assurance being provided on the subject matter information. In some cases, the use of such terminology is set out in law or

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<sup>2</sup> Australia Standard on Related Services (ASRS) 4400, *Agreed-upon Procedures Engagements to Report Factual Findings*

regulation. Some national AUP standards (e.g., Australia's ASRS 4400 and the AICPA's proposed standard on AUP) explicitly prohibit the use of such terminology. The issue to be further explored is whether the revised AUP standard should also prohibit the use of such terminology, and whether exceptions should be permitted when law or regulation mandates the use of such terminology.

#### *Non-Financial Information*

18. The scope of extant ISRS 4400 is limited to AUP on financial information. However, paragraph 2 of ISRS 4400 also states that ISRS 4400 "may provide useful guidance for engagements regarding non-financial information, provided the auditor has adequate knowledge of the subject matter in question and reasonable criteria exist on which to base findings."
19. Several national AUP standards include non-financial information within their scope (for example, the AICPA's proposed standard on AUP engagement and Australia's ASRS 4400). Given that AUP engagements are often performed on non-financial information, an issue to consider is whether the revised AUP standard should continue to focus on financial information only with reference that it may also provide useful guidance regarding non-financial information, or whether the scope would be extended to both financial and non-financial information. In considering this issue, the WG notes that preliminary input from the SMPC's Rapid Response Task Force and a number of NSSs did not identify any specific issues with regard to applying ISRS 4400 to non-financial information.

#### *Duty of Care*

20. In some circumstances, a funder, regulator or other user of an AUP engagement may set out the procedures to be performed, but is not a party to the contractual agreement. This situation creates issues such as *whether the practitioner should be required to:*
  - Agree the terms of engagement with the intended users (or a representative of the intended user such as a regulator) or obtain evidence that the intended users (or their representative) would be amendable to the agreed terms of engagement between the practitioner and the contracting party before performing the engagement.
  - Obtain evidence that the intended users (or their representative) agree to an amended procedure before amending the procedure or whether the practitioner is permitted to amend a procedure during the course of the engagement by obtaining agreement with the contracting party.

An issue to explore is how to appropriately balance the practical difficulties that may be created by such requirements with ensuring that intended users are able to take responsibility for drawing their own conclusions on the practitioner's work.

#### *The Agreed-upon Procedures Report*

21. ISRS 4400 requires that the practitioner's report includes "a statement that the report is restricted to those parties that have agreed to the procedures to be performed."<sup>3</sup> This restriction is in place as

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<sup>3</sup> ISRS 4400, paragraph 18(l). However, public sector perspective paragraph 1 provides guidance that a "report in a public sector engagement may not be restricted only to those parties that have agreed to the procedures to be performed, but made available also to a wider range of entities or people (for example, a parliamentary investigation about a specific public entity or governmental department)."

parties other than those who have agreed to the procedures may be unaware of the reasons for the procedures and therefore, may misinterpret the results. The WG is aware that restrictions on distribution of the report have caused issues as the AUP report may be required to be provided to other parties either by law or regulation, or by contractual agreement. An issue to be explored is whether it is appropriate to allow (in particular circumstances) a wider distribution of the AUP report, or whether an assurance engagement is more appropriate in the circumstance when a wider distribution of the report is necessary.

22. The WG is also aware of concerns that the AUP report does not adequately convey the value provided by practitioners. An AUP engagement is not an assurance engagement and the AUP report reflects this fact with the caveat that “no assurance is expressed.”<sup>4</sup> However, users do take “comfort” from the fact that the procedures are performed, and the findings reported, by a practitioner who possesses professional competence and has undertaken the engagement with due care. At issue is how to word the report so that a layperson can understand the value provided by an AUP engagement derives from professional competence and due care that the practitioner exercises in conducting the procedures and reporting factual findings, rather than conveying any degree of assurance. This issue would need to be considered in conjunction with issues relating to use of assurance terminology in an AUP report as set out in paragraph 17 above.
23. Based on examples of AUP reports obtained by the WG, the WG notes that the “short-form” AUP report as set out in Appendix 2 of ISRS 4400 does not appear to be commonly used in practice. It would be useful for the illustrative AUP report in the revised ISRS to be more reflective of AUP reports issued in practice. More importantly, an examination of AUP reports might also show how they can be enhanced to communicate more effectively.

#### *Hybrid Engagements*

24. Input from NSSs, members of the SMPC’s Rapid Response Task Force and other parties seem to indicate that there is no common understanding of what constitutes a hybrid engagement. Based on input received, it appears that hybrid engagements involving AUP generally fall under two categories:
  - Category 1 – Two or more separate engagements on the same or related subject matter information such as an audit of the financial statements and AUP on internal controls over financial reporting, or a review of the financial statements and AUP on certain elements within the financial statements.
  - Category 2 – Specified procedures and “findings” that are in the form of a conclusion on subject matter information (e.g., procedures that involve reviewing supporting documents for personnel costs and verifying eligibility of the personnel costs for the funding program, and conclusions such as personnel costs are adequately supported and meet the criteria for the funding program.
25. In the WG’s preliminary view, category 1 hybrid engagements do not present performance issues, but there are reporting issues as to how to present the report or reports (i.e., two separate reports or one report with two separate sections). The key consideration is to how to clearly segregate the description of the assurance engagement from the AUP engagement so that users are not confused

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<sup>4</sup> ISRS 4400, paragraph 18(j)

as to the nature of the work done and the conclusions or factual findings reached. A related reporting issue is whether the practitioner is permitted to issue an AUP report if the practitioner has previously issued an adverse opinion or disclaimed an opinion on the same or related subject matter information. The key consideration in this case is to avoid giving the impression of a “piecemeal opinion”. This matter will be considered in conjunction with the distribution of factual findings versus assurance reports as set out in paragraph 21 above.

26. In the WG’s view, category 2 hybrid engagements represent a departure from ISRS 4400 or lack of understanding of the scope of the existing assurance and related services standards. This issue is related to the issues as described in paragraphs 11-17 above regarding the lack of distinction between an AUP engagement and an assurance engagement. The WG would further explore the demand and application of category 2 hybrid engagements in practice. Next, the WG can analyze the issues relating to the lack of distinction between AUP engagements and assurance engagements and consider the implications arising from category 2 hybrid engagements. Once further insight is obtained, the WG may consider the use of non-authoritative staff guidance or other educational tools to address hybrid engagement issues. However, at this time, the WG has not reached a conclusion on whether, and if so how, such engagements would be addressed.

**Matters for CAG Consideration**

1. Representatives and Observers are asked to share their views on the issues identified by the WG:
- Distinction Between an AUP Engagement and an Assurance Engagement
  - Non-Financial Information
  - Duty of Care
  - The Agreed-upon Procedures Report
  - Hybrid Engagements

**C. Key Views Expressed at the IAASB June 2015 Meeting**

27. The Board discussed the key features of AUP engagements. The Board noted that practitioners seem to experience more challenges in reporting under ISRS 4400 and that reporting on findings may include more references to assurance than what is envisaged in ISRS 4400. The Board highlighted the need to:
- More fully understand how AUP engagements are being conducted in practice, and where practitioners are departing from ISRS 4400 and why, as this may identify changes needed to an AUP engagement or another type of engagement to be developed to meet user demand.
  - Obtain further information with respect to hybrid engagements that relate to specified procedures that require the practitioner to provide a conclusion on subject matter information, with a focus on the different types of engagements currently being performed in practice, including those on non-financial information.
28. Other matters for the WG to consider before undertaking a revision of ISRS 4400 in the Clarity format, include:

- The implications of the practitioner's involvement in developing the procedures in an AUP engagement, noting the expertise that the practitioner may bring in this regard and the similarity between those procedures and audit procedures.
- The demand for, and implications of, AUPs addressing non-financial information, in light of the evolving needs of users.
- The need for greater education to explain what an AUP engagement is (and what it is not) as compared to assurance engagements.

## **D. Way Forward**

29. The IAASB directed the WG to continue its information-gathering activities on the issues related to ISRS 4400, including via further outreach. As an initial next step, the WG plans to continue its research and consultation to further explore issues related to AUP engagements and engagements that appear to be broader than a strict adherence to AUP engagements.

### **Matters for IAASB Consideration**

2. Representatives and Observers are asked to provide further suggestions that may support the WG in its information-gathering activities.

## **APPENDIX**

### *Agreed-upon Procedures – Revision of ISRS 4400 and Consideration of More Holistic Issues Involving Agreed-upon Procedures*

#### **Issues that May Be Addressed**

In relation to agreed-upon procedures and the need to revise ISRS 4400—To respond to broad calls from SMPs and other stakeholders who have indicated that investors, banks and other providers of capital often request an entity to have agreed-upon procedures performed by a practitioner, either in lieu of an audit or in order to ensure that specific procedures are performed on key account balances, a project to revise this standard was planned for the 2012–2014 Strategy and Work Program. One of the main objectives of the planned project was to revise the standard in the Clarity format. However, the commencement of the project in the 2012–2014 period was delayed because of the acceleration of work on the Auditor Reporting project.

In relation to more holistic issues involving agreed-upon procedures and other similar engagements addressed by the IAASB's standards—As the IAASB contemplates work on the topic of agreed-upon procedures in the next Work Plan, it has been noted that “hybrid” engagements, using a combination of procedures derived from review, compilation and agreed-upon procedures engagements, are being performed in some jurisdictions as a means of meeting the emerging needs of SMEs, among others. Accordingly, wider consideration will be given to exploring these evolving types of engagements to consider whether standard-setting or other activities may be appropriate, in light of the existing standards that may be applicable to these services in the IAASB's current suite of standards.

#### **Standards that May Be Addressed**

Revision of ISRS 4400, with conforming amendments to other standards as necessary.

#### **Possible Other Outputs**

A new standard or guidance that would address engagements where there is a combination of agreed-upon procedures and assurance (either reasonable or limited).

#### **Preliminary Views on the Approach to the Project**

Initial information gathering activities will include consideration of:

- a) The way forward with respect to the revision of ISRS 4400, taking into account the work of various NSS in this area.
- b) The evolving use of “hybrid” engagements, including what needs such engagements are intended to address and how such engagements are performed (e.g., how the concepts of reasonable assurance and limited assurance are combined with agreed-upon procedures).

IAASB discussions for this initiative are planned to commence in mid-2015 to allow sufficient time for understanding the market needs in this area and the underlying conceptual considerations for these new types of services. A project proposal for the revision of ISRS 4400 is expected at the end of 2015, with consideration to be given at that time as to whether actions are needed in relation to “hybrid” engagements.