

Auditing Practices Board

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19 September 2011

Dear Sir

Proposed ISAE 3000 (Revised), Assurance Engagements Other Than Audits or Reviews of Historical Financial Information

The Auditing Practices Board (APB) welcomes the opportunity to comment on the proposed revision of ISAE 3000. The APB is responsible for setting high quality standards and guidance for the performance of external audit and other assurance services that are within the public interest in the UK and Ireland.

When the current ISAE 3000 (then ISAE 2000) was exposed, the APB commented that although we were supportive of the development of ISAEs for specific types of assurance engagement we had doubts as to whether the proposed ISAE 2000 was sufficiently precise to serve as a standard for a variety of assurance engagements. In the APB's view the ISAE sought to address too broad a range of types of assurance engagement within one pronouncement and, as a consequence, was written in very general terms and added little to the then proposed International Framework for Assurance Engagements. The APB recommended that, rather than producing a generic ISAE, the IAASB should concentrate on producing ISAEs for specific types of assurance engagements. In the event the IAASB finalised the current ISAE 3000 without addressing these concerns and the APB has not adopted it.

We have observed that the IAASB has started to develop further ISAEs for specific types of assurance engagement on the basis that those ISAEs are applied together with ISAE 3000 for those particular assurance engagements. However, it is still evident that, in the absence of a specific ISAE, the IAASB expects that ISAE 3000 can be applied as a standalone standard for other assurance engagements.

Although the proposed revision of ISAE 3000 significantly increases the extent of specified requirements and related guidance, we believe that it is still not sufficiently precise to serve as a standalone standard for a variety of assurance engagements. Indeed, we are doubtful whether it can ever be practicable to develop a single standard that is appropriate to cover the wide variety of assurance engagements that exist and we again encourage the IAASB to concentrate on producing ISAEs for specific types of assurance engagements.

In particular we are concerned that a generic standard such as this will not drive consistency in the performance of specific types of assurance engagements by different practitioners, including with regard to:

- enabling users to understand the level of assurance obtained,
- the nature and extent of assurance procedures to be performed, appropriate to the level of assurance intended to be obtained,
- the identification and/or development of ‘applicable criteria’.

We comment further on these concerns below.

We recommend that the IAASB ceases to develop ISAE 3000 on the basis that it can be applied as a standalone standard. It would be more helpful to focus on enhancing the International Framework for Assurance Engagements to provide the basis for the development of further ISAEs for specific types of assurance engagement where such standards are considered appropriate.

If ISAE 3000 is to be retained as an overarching assurance standard it should be on the basis that it will always be applied in conjunction with other assurance standards for specific types of engagement. Under this model, the requirements in ISAE 3000 should be limited to those that are expected to be applicable in virtually all assurance engagements and with no duplication of requirements in other ISAEs.

Levels of assurance

The APB appreciates the difficulties associated with expressing succinctly the level of assurance obtained by a practitioner, and conveyed in an assurance report, but has strong reservations regarding the use of the terms ‘reasonable assurance’ and ‘limited assurance’ for this purpose and how they are distinguished in the exposure draft.

Under the proposed definitions in paragraph 8(a)(i), a ‘limited assurance’ engagement is in effect defined as one where the planned engagement risk is higher than for a ‘reasonable assurance’ engagement, but there is no indication at all as to the relative levels of engagement risk. In the absence of specific standards for particular types of assurance engagement, there is a danger that different practitioners could plan and perform essentially the same types of procedures but with one practitioner deeming them to achieve reasonable assurance while another practitioner deems them to achieve only limited assurance. There is also a danger that a practitioner could plan a reasonable assurance type engagement but elect to provide only a limited assurance type report.

Restricting the term ‘reasonable’ to engagements with a higher level of assurance could lead some users to conclude that the assurance obtained for a ‘limited assurance’ engagement is less than reasonable. This is clearly wrong as for both types of engagement it is envisaged that the level of risk has to be ‘acceptable’ in the circumstances of the engagements and, for a limited assurance engagement, it is stated the level of assurance has to be ‘meaningful’ to the user. The reality is that for both types of engagement the level of assurance has to be reasonable in the circumstances – therefore restricting the use of the term is wrong.

We recognise that ordinarily levels of assurance are not susceptible to precise quantification. However, we believe that for the purposes of ISAE 3000 ‘reasonable assurance’ engagements could be more appropriately identified as ‘high assurance’ engagements. We also believe that there should be an indication that a limited assurance engagement is substantially less in scope than a high assurance engagement and accordingly the practitioner obtains substantially less assurance (i.e. only “reasonable” assurance).

Although precise quantification of levels of assurance/risk is not possible we are aware that some practitioners do make judgements as to the levels of assurance/risk to be obtained. A possible ‘rule of thumb’ for a high assurance engagement could be one where the practitioner aims to achieve, in their judgment, 95% assurance (5% risk). The nature and extent of the limited procedures performed for a limited assurance engagement makes it more difficult to judge quantifiably levels of assurance/risk; however, it needs to be clear that it will be substantially less than 95%/5% but still sufficient to be ‘meaningful’. In our view this would have to be more than 50% to be in any way meaningful (otherwise, why not just throw a die) but perhaps should be more than this, say 60%.

For the purpose of clarity for users, we believe that the report for a high level assurance engagement should identify that the procedures performed are intended to provide an overall high, but not absolute, level of assurance. For a limited assurance engagement the report should identify that the procedures performed are substantially less in scope than for a high level assurance engagement and accordingly the practitioner does not express a confirmatory conclusion.

Nature and extent of procedures

We are concerned that paragraph 42 of the exposure draft is not sufficiently clear as to the nature and extent of procedures to be performed in a limited assurance engagement. We understand that engagements can, by virtue of the subject matter, vary considerably and, therefore, it is not appropriate to mandate certain types of procedures (such as inquiry and analytical procedures) as the primary means of obtaining evidence. However, we believe more could be done to differentiate the work from that performed for a high level assurance engagement. For example, paragraph 42(a) could be reworded along the following lines:

“Based on the practitioner’s understanding (see paragraph 37) and consideration of areas where material misstatements, if they exist, are likely to arise, determine the nature, timing and extent of procedures to be performed to obtain a limited level of assurance that, although substantially lower than the level obtained for a ‘high assurance’ engagement, is meaningful to the intended users.”

This area of concern and our concern above regarding the levels of assurance, are reasons why we believe that there should be engagement specific ISAEs to identify the appropriate approach for particular types of engagement. Without such specific ISAEs the extent and nature of the procedures undertaken, the extent and nature of the evidence obtained and, therefore, the level of assurance obtained in different limited assurance engagements will not be consistent and will be entirely a matter for the judgment of the practitioner. This could result in the nature and extent of procedures performed and the range of assurance being obtained varying considerably. We believe that this will result in confusion on the part of users of the assurance report about the level of assurance actually obtained by the practitioner

when issuing a limited assurance report. This view is supported by the guidance given in paragraph A150 in the exposure draft which states (emphasis added):

“The summary of the work performed helps the intended users understand the nature of the assurance conveyed by the assurance report. For many assurance engagements, infinite variations in procedures are possible in theory. In practice, however, these are difficult to communicate clearly and unambiguously. *ISA 700, the ISREs and subject matter-specific ISAEs may provide guidance to practitioners on the appropriate type of summary.*”

We agree that there should be an informative summary in the practitioner’s report of the work performed. However we are concerned that paragraph 60(k) is not sufficiently strong in setting out what the practitioner is required to achieve with the summary. We recommend that this paragraph is redrafted to include some of the guidance from paragraphs A152 and A153:

“The summary of work performed is ordinarily more detailed than for a ~~reasonable~~ high assurance engagement and identifies the limitations on the nature, timing, and extent of procedures. In some circumstances it may be appropriate to indicate certain procedures that were not performed that would ordinarily be performed in a ~~reasonable~~ high assurance engagement. It is important that the summary be written in an objective way that allows intended users to understand the work done as the basis for the practitioner’s conclusion.”

It is particularly important that the summary makes clear the distinction between and high and limited assurance engagements. There is a risk that providing detailed summaries of procedures performed just for limited assurance engagements may result in users mistakenly deducing that greater assurance was obtained compared to a high assurance engagement where a detailed summary of procedures is not provided. We believe engagement specific ISAEs are important to drive summaries of procedures that are similar for particular types of engagement.

Even with these changes, the level of assurance obtained in a limited assurance engagement will not necessarily be clear to users. This is likely to be the case, for example, when assurance on a new subject matter area is being developed. Where this is so, the IAASB should consider whether to require the summary of procedures to include a note of the additional work that would be required in order to provide high assurance. Although this approach would increase the level of disclosure provided, we believe that in such circumstances it would be useful to build up an understanding of the practical differences involved in providing high, as opposed to limited, assurance. Once such experience has been gained, it would be easier to develop a soundly based understanding of when it is appropriate to adopt a limited or a high assurance reporting approach and how to distinguish between such reports in a way that conveys to users an accurate perception of the level of assurance obtained in each case.

Applicable criteria

There are many assurance engagements for which there are no ‘established criteria’ and it will be necessary for the practitioner or another party to develop or identify suitable criteria in the context of the engagement. We are concerned that the guidance in paragraphs A42 to

A47 is not sufficient to ensure that there is consistency in the criteria applied in different engagements to report on the same type of subject matter. However, we do not believe that it is possible to develop requirements and guidance in a generic standard that would ensure such consistency – another reason why we believe that ISAE 3000 should not be a standalone standard and that the development of ISAEs for specific types of assurance engagement is more important. Specific ISAEs could identify suitable criteria for the assurance engagements covered.

We do not consider that the characteristics set out in paragraph A42 are those required for ‘suitable criteria’. Rather they are the characteristics of subject matter that would meet the needs of users, in particular (not all) circumstances, resulting from the application of suitable criteria for those circumstances. For example, although ‘neutrality’ may often be a desirable characteristic there will be circumstances where users may want the subject matter to be intentionally biased, such as when financial information is desired to be presented on a prudent basis. Such bias should be acceptable providing the fact of it is disclosed.

The key characteristics of suitable criteria are alluded to in paragraph A9. These are criteria that, allowing for the exercise of judgment where appropriate, enable reasonably consistent measurement or evaluation of an underlying subject matter and thereby facilitate consistent interpretation of the resulting subject matter by the intended users. As stated in paragraph A9 the suitability of criteria is context sensitive; therefore a link to the reported subject matter the user is interested in is important.

Additionally, it is important to consider that in many cases the subject matter information may be a conclusion as to whether an outcome has been achieved. Developing specific criteria for that conclusion can detract the focus of the assurance engagement away from the overall outcome and onto a limited set of disaggregated criteria that cannot capture the whole outcome. Such criteria are of secondary importance to the overall criterion that the subject matter should have met the specific desired outcome. For example, UK auditors forming a view on whether financial statements give a “true and fair view” cannot reach a conclusion solely on the basis of whether the financial statements were prepared in accordance with accounting standards and any other applicable legal requirements. The meaning of “true and fair” is not precisely defined in accounting standards and legislation and an overarching judgment, for which there are not specific criteria, has to be made.

Applicability to existing assurance engagements

Although the APB has not promulgated the current ISAE 3000 in the UK it has tested how it works in practice with respect to some specific types of assurance engagements. During 2004 and 2005 the APB undertook a revision of its Standards for Investment Reporting (SIRs) and, in particular, developed two new SIRs relating to the provision of assurance on profit forecasts (SIR 3000) and pro forma financial information (SIR 4000). In February 2006 we wrote to the then chairman of the IAASB and described our experience of using ISAE 3000 when developing these SIRs. Although we found that using ISAE 3000 provided a helpful structure, we encountered a number of practical difficulties in using it. A copy of that letter, which includes a description of the difficulties we encountered, is attached. We believe we would still experience such difficulties were we developing the SIRs by reference to the proposed revised ISAE 3000.

If you wish to discuss our comments please contact Marek Grabowski (Telephone +44 (20) 7492 2325).

Yours faithfully

A handwritten signature in black ink, appearing to read "Richard Fleck". The signature is written in a cursive style with a long horizontal stroke extending to the right. Below the signature is a solid horizontal line.

Richard Fleck
Chairman, APB

**Attachment to the APB response to the April 2011 exposure draft of
proposed ISAE 3000 (Revised) – copy of letter sent in 2006**

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23 February 2006

Dear John,

APB's experience of using ISAE 3000 when developing assurance standards relating to specific engagements

When responding to the exposure drafts of IAASB's "International Framework for Assurance Engagements" and the (then) proposed ISAE 2000 "Assurance Engagements on Subject Matters Other Than Historical Financial Information", APB commented that although we were supportive of the development of International Standards on Assurance Engagements for specific types of assurance engagement we had doubts as to whether the proposed ISAE 2000 was sufficiently precise to serve as a standard for a variety of assurance engagements. In the APB's view the ISAE sought to address too broad a range of types of assurance engagement within one pronouncement and, as a consequence, was written in very general terms and added little to the proposed International Framework for Assurance Engagements. The APB recommended that, rather than producing a generic ISAE, IAASB should concentrate on producing ISAEs for specific types of assurance engagements. In the event IAASB finalised ISAE 3000 but the APB has not promulgated it in the UK and Ireland.

During 2004 and 2005 the APB undertook a revision of its Standards for Investment Reporting (SIRs) and, in particular, developed two new SIRs relating to the provision of assurance on profit forecasts (SIR 3000) and pro forma financial information (SIR 4000). The development of these SIRs presented the APB with an opportunity to test how ISAE 3000 worked in practice with respect to specific engagements.

The purpose of this letter is to describe APB's experience of using ISAE 3000 when developing assurance standards relating to specific engagements.

In drafting these SIRs, our starting point was to develop specific requirements based on the structure and requirements of ISAE 3000 (Revised). Although we found that using ISAE 3000 provided a helpful structure for the new SIRs, we did encounter a

number of practical difficulties in using it. In particular, as the drafting of the SIRs evolved much of the specific wording of the requirements diverged from the original ISAE 3000 wording. The difficulties that we encountered in applying ISAE 3000 are set out in detail in appendix A to this letter. In summary these difficulties fell into the following three categories:

- ISAE 3000 is rather theoretical and it was difficult to apply the concepts of subject matter, suitable criteria, and subject matter information (outcome) in practice;
- Certain of the ISAE 3000 requirements seemed redundant in the context of the specific EC regulations applicable to reporting on profit forecasts and pro forma financial information; and
- Certain of the ISAE 3000 requirements introduced practical difficulties.

We also identified an important generic requirement that had been omitted from ISAE 3000, namely that “The reporting accountant should not express an unmodified opinion when the directors have not applied the criteria and in the reporting accountant’s judgment the effect of not doing so is, or may be, material”.

I would be happy to discuss our experience at the meeting between IAASB and National Standard Setters on 30/31 March 2006 if you would find that helpful. We would also be delighted to provide copies of the final SIRs and/or a mapping of bold letter requirements in ISAE 3000 to the requirements of SIRs 1000, 3000 and 4000 if you would find that of assistance.

Yours faithfully



Richard Fleck
Chairman

cc J. Sylph, IAASB

Difficulties encountered

1. DIFFICULTIES IN APPLYING THE CONCEPTS OF SUBJECT MATTER, CRITERIA AND OUTCOME IN PRACTICE.

In paragraph 2 of each SIR we defined ‘Subject matter’, ‘Suitable criteria’ and ‘Outcome (Subject matter information)’ in the context of each engagement. In doing so we encountered a number of difficulties that seemed to arise because in ISAE 3000 these three terms are used in the context of the obligations and work effort of both preparers and reporting accountants and the terms are used interchangeably. However, there are differences in the meaning of the terms when applied to reporting accountants as opposed to preparers; in particular management’s “outcome” is the reporting accountant’s “subject matter”.

Appendix B illustrates the issue of overlapping terminology. We had some difficulty in using the terms because, in the absence of a lengthy explanation, it was not always clear if it was managements’ subject matter, criteria, or outcome, or those of the reporting accountant that was being discussed.

This problem was exacerbated by confusion as to what subject matter was. The position with regard to the EC prospectus Directive is:

- the EC Prospectus Directive requires the reporting accountant to report on the process of “proper compilation”;
- the preparer has to publish a profit forecast or a pro forma statement, it does not have to make an explicit assertion about the process of proper compilation,
- reporting accountants tend to see the preparers process as being the subject matter whereas the regulators see the subject matter in terms of the preparers expectation of the entity’s profit for the period.

The confusion as to the nature of the subject matter led, in turn, to difficulties with the identification of suitable criteria. We had hoped that the Prospectus Directive and supporting regulations and guidance would contain suitable criteria that the reporting accountant should use when evaluating the “proper compilation” of management’s profit forecast or pro forma financial information. However, most of the applicable regulations relate to management’s outcome (eg the profit forecast itself) rather than to the process for its compilation.

In working this issue through it became clear that the suitable criteria to be applied by reporting accountants (for process) was a sub-set of the suitable criteria to be applied by management (for the outcome). In order to distinguish those criteria that reporting accountant’s use from those that are applicable only to preparers we introduced the term “reporting accountant’s criteria”.

However the “reporting accountant’s criteria” sub-set was quite limited and, as a result, SIRs 3000 and 4000 had to include requirements in addition to the explicit requirements of laws and regulations¹. These issues made it very difficult to meet the

¹ For example paragraph 41 of SIR 3000

requirement of paragraph 49(d) of ISAE 300 that the assurance report should identify the criteria against which the subject matter was evaluated or measured so the intended users can understand the basis for the reporting accountant's conclusion (see point 3(b) below).

2. REDUNDANCY WITHIN THE ISAE 3000 REQUIREMENTS

(a) Requirements of ISAE 3000 that could not be complied with because they are precluded by regulation

Two of the bold letter requirements in ISAE 3000 were considered unsuitable for inclusion in SIRs 3000 or 4000 because the reporting accountant would be precluded from complying with them by applicable EC law and regulations. The specific requirements excluded are:

1. Para 49(j) of ISAE 3000 (requirements where an other than unqualified conclusion is expressed)

With respect to reporting accountant engagements it is quite common for regulators to refuse to accept modified reports. The options are clean report or no report. We consider that this alternative should be contemplated by ISAE 3000 which may result in the modification of this black letter requirement.

2. Para 52 of ISAE 3000 (distinction between qualified and adverse conclusion)

As discussed above these are not possibilities in some reporting accountant engagements.

(b) Requirements that were deemed unnecessary because they are implicit in the engagement

An additional four of the bold letter requirements in ISAE 3000 were considered unsuitable for inclusion in SIRs 3000 or 4000 because they were considered to be implicit in the engagement such that it was unnecessary to spell them out. To spell them out would have added nothing of substance to the SIR and given rise to boiler plate requirements. The specific requirements excluded are:

a. Para 7 of ISAE 3000 The reporting accountant should accept an assurance engagement only if the subject matter is the responsibility of a party other than the intended users or the practitioner.

b. Paragraph 11 of ISAE 3000 (changing the nature of the engagement) would not apply in relation to a reporting accountant's engagement in relation to the EC Prospectus Directive.

c. Para 18 of ISAE 3000 The reporting accountant should assess the appropriateness of the subject matter.

d. Para 19 of ISAE 3000 The reporting accountant should assess the suitability of the criteria.

3. PRACTICAL DIFFICULTY

(a) Paragraph 49(a) of ISAE 3000 considered an unnecessary requirement

This paragraph requires the assurance report to include a title that clearly indicates that the report is an independent assurance report. Such a

requirement was considered unsuitable for inclusion in SIRs 3000 or 4000 as reports from reporting accountants are typically included in prospectuses in the form of a letter.

(b) Need for identification of the suitable criteria

Paragraph 49(d) of ISAE 3000 requires the assurance report to identify the criteria against which the subject matter was evaluated or measured so the intended users can understand the basis for the reporting accountant's conclusion. Guidance to this requirement notes "The assurance report may include the criteria, or refer to them if they are contained in an assertion prepared by the responsible party that is available to the intended users or if they are otherwise available from a readily accessible source."

Arising from the practical difficulties described in above, the SIRs needed to adopt a somewhat different approach with respect to the identification of suitable criteria which involved:

- Although not included within ISAE 3000 SIRs 3000 and 4000 include a bold letter requirement that "The reporting accountant should not express an unmodified opinion when the directors have not applied the criteria set out in Appendix 2 of this SIR and in the reporting accountant's judgment the effect of not doing so is, or may be, material"². The APB was of the view that it was necessary to have an explicit requirement linking the reporting accountant's unmodified opinion with a requirement for the preparer to follow the suitable criteria.
- In the example report of the reporting accountant the responsibilities section describes, at a high level, the regulations that the directors are required to follow. It was not considered necessary to be any more descriptive than that.
- SIR 1000 requires the basis of the reporting accountant's opinion to include compliance with the SIRs. As individual SIRs reproduce the criteria this was considered to be an adequate reference to the criteria for users of the reporting accountant's report.

² See paragraph 75 of SIR 3000 and paragraph 62 of SIR 4000.

Overlapping Terminology Used in Assurance Framework (Profit Forecast Used as an Example)

Term	As applied to preparer		As applied to reporting accountant
Subject Matter	The directors' expectation of the issuer's profit for the period of the forecast.		The directors' profit forecast and related disclosures that is included in the investment circular
	↓		↓
Suitable Criteria	Provided by the requirements of the PD Regulation and the CESR Recommendations		Reporting accountant's criteria being a subset of the criteria applicable to the preparers. (It is a subset because there are criteria applicable to preparers that are outside the scope of the reporting accountant's engagement)
	↓		↓
Outcome (Preparer) Subject Matter Information (Reporting accountant)	The directors' profit forecast and related disclosures that is included in the investment circular	↗	Reporting accountant's report

