

Consultation Paper
September 2008

Matters to Consider in a Revision of
International Standard on Review
Engagements 2400, *Engagements to
Review Financial Statements*

A joint paper by Staff of the:

Professional Standards Board, New Zealand

Auditing and Assurance Standards Board, Canada

Independent Regulatory Board for Auditors, South Africa

INTRODUCTION BY THE IAASB

The International Auditing and Assurance Standards Board (IAASB) held its annual liaison meeting with major national auditing standard setters (NSS) in March 2008. Among the items on the agenda was a discussion of matters that the IAASB should consider if it proceeds to revise International Standard on Review Engagements (ISRE) 2400¹ and International Standard on Related Services (ISRS) 4410² as envisaged in its *Strategy and Work Program, 2009-2011*.³ Arising from this discussion, Staff from a subgroup of the NSS (NSS Subgroup Staff) agreed to collaborate to develop this Consultation Paper to assist the IAASB in obtaining some preliminary input into the significant matters that should be considered in a project to revise ISRE 2400 (which is planned to start in the first half of 2009, subject to project approval), and thus help accelerate the development of this project.⁴ The NSS Subgroup comprises

- New Zealand (Professional Standards Board);
- Canada (Auditing and Assurance Standards Board); and
- South Africa (Independent Regulatory Board for Auditors).

The work of the NSS Subgroup Staff has been facilitated by IAASB staff but responsibility for this Paper rests entirely with the NSS Subgroup Staff.

The IAASB would like to thank the NSS Subgroup Staff for this initiative, and in particular Ms. Joanne Moores (Director of Professional Standards at the Professional Standards Board of the New Zealand Institute of Chartered Accountants) for leading it.

REQUEST FOR COMMENTS

The NSS Subgroup Staff invites the views of those stakeholders and other parties interested in review engagements and the subject of alternative assurance services on the matters highlighted in the Consultation Paper.

While the views or opinions expressed in this Consultation Paper, and the questions raised therein, do not necessarily represent those of the IAASB, and have not been reviewed and considered by the IAASB, the NSS Subgroup Staff anticipates that the responses provided by interested parties will be considered by the IAASB in any revision of ISRE 2400. Accordingly, respondents should submit comments directly to the IAASB.

The Consultation Paper raises specific questions for consideration. Respondents are welcome to raise any other matters not addressed in this Consultation Paper that may be of relevance to the topic. While respondents should not feel obliged to answer all the questions posed in the Consultation Paper, it will assist IAASB staff's collation of views if those questions are used to structure responses on the topic. Also, it is helpful if respondents provide reasoning to support their views in a level of detail that will assist the IAASB's consideration of the issues.

¹ ISRE 2400, *Engagements to Review Financial Statements*.

² ISRS 4410, *Engagements to Compile Financial Statements*.

³ The IAASB's *Strategy and Work Program, 2009-2011*, can be accessed at <http://www.ifac.org/Store/Details.tpl?SID=1216051339304536>

⁴ This Consultation Paper does not extend to consideration of ISRS 4410.

Please submit your comments, preferably by email, so that they will be received by **15 December 2008**. All comments will be considered a matter of public record. Comments should be addressed to:

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Comments should be emailed to reviewengagements@ifac.org. They may also be faxed to +1-212-286-9570 or mailed to the above address.

Copies of the Consultation Paper may be downloaded free-of-charge from the IFAC website at <http://www.ifac.org>.

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A. INTRODUCTION

A.1. Purpose and Scope

1. The purpose of this Consultation Paper is to seek views on a number of significant matters that require consideration in relation to the IAASB's planned revision of ISRE 2400.
2. The Paper particularly addresses reviews of historical financial information rather than reviews of other broader subject matter or subject matter information. It discusses reviews primarily in the context of reviews of historical financial statements prepared in accordance with an applicable financial reporting framework. However, the same issues are generally of relevance also to reviews of other historical financial information.
3. In developing this Paper, the NSS Subgroup Staff recognises that various types of services can be explored that provide a level of assurance lower than that provided by an audit, and that the IAASB may in future wish to consider the range of those services in view of the changing environment for the supply and demand of audits. The focus of this paper is limited to consideration of engagements to review historical financial information because such reviews have wide acceptance in some countries, and because the IAASB has issued International Standards on Review Engagements (including ISRE 2400) to support performance of those engagements.
4. The matters raised in this Paper are not intended to prejudice the approach the IAASB may take in a revision of ISRE 2400, the objectives it should achieve, or what the final outcome might be. Nevertheless, the IAASB will consider the views expressed by respondents in determining a way forward that will best meet the needs of users and practitioners in relation to review services.

B. BACKGROUND INFORMATION FOR THIS CONSULTATION PAPER

B.1. The Review as an Alternative to the Audit⁵

5. A common theme in many countries is that where the statutory requirement for the audit of the financial statements of various types or classes of entities has been removed,⁶ consideration is being given to whether there remains demand for assurance on the

⁵ Broadly speaking, the existing available alternatives when an audit of the entity's financial statements is not required are:

- (i) a review of the financial statements performed by a practitioner;
- (ii) a compilation of the financial statements by a practitioner, without providing any assurance opinion or conclusion on the compiled financial statements; and
- (iii) 'agreed-upon' procedures, where the practitioner performs agreed-upon procedures on the financial statements or elements of the financial statements for a particular purpose specified by the entity, without issuing any assurance opinion or conclusion on these.

In some countries, and subject to the applicable ethical requirements, a practitioner may undertake one or more of (i) to (iii) above to meet the particular purposes of a client.

⁶ For example, legislative changes in some European Union countries (including the UK), South Africa, Australia and New Zealand have removed the audit requirement for certain types of entities (for example, small entities or entities that meet certain criteria pertaining to size and/or public accountability characteristics).

financial statements of such entities. In some cases, it is clear that demand exists, driven by the need to establish a level of credibility for the financial statements for the benefit of internal or external user groups, although that level need not always be as high as that provided by an audit.

6. The development of the review engagement as an alternative to the audit differs internationally. In some countries or jurisdictions, for example the United States and Canada, the review has a high degree of acceptance among user groups. In other countries, the demand for reviews as an alternative to the audit varies considerably,⁷ and in some the only significant context for performance of reviews is the review of interim financial information of listed entities.

B.2. ISRE 2400

7. The IAASB has determined that ISRE 2400 needs to be updated. In particular the IAASB needs to consider the proper alignment of ISRE 2400 with:
 - the *International Framework for Assurance Engagements*⁸ (the International Framework);
 - other ISREs,⁹ being ISRE 2410;¹⁰ and
 - the revised and redrafted International Standards on Auditing (ISAs).

B.3. ISRE 2410

8. ISRE 2410 addresses the particular context of performance of a review of interim financial information by the auditor of an entity. ISRE 2410 recognises that the auditor of an entity may undertake a review of the entity's interim financial information in the context of applicable statutory or regulatory reporting requirements.

⁷ The Public Oversight Board for Accountancy in the United Kingdom issued a report in March 2006 titled *Review of How Accountants Support the Needs of Small and Medium-sized Companies and their Stakeholders*. The report recorded the following conclusion (among others): "... we identified no interest among users for a new level of assurance opinion, and believe that the introduction of an alternative form of assurance at this time would only lead to confusion."

⁸ The IAASB issued *The International Framework for Assurance Engagements* in January 2004.

⁹ The IAASB's amended *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services* describes the authority attaching to the ISREs as follows: "ISREs are to be applied in the review of historical financial information". The amended Preface was approved by the IAASB in December 2006 and is effective as of 15 December 2009. It can be accessed at: <http://www.ifac.org/Store/Category.tmpl?Category=Auditing%2C%20Assurance%20%26%20Related%20Services&Cart=1215633393183495>.

¹⁰ The IAASB issued ISRE 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*, in July 2005.

B.4. IAASB’s Scope Clarifications for ISREs 2400 and 2410

9. In February 2008, the IAASB issued amendments to ISREs 2400 and 2410 to clarify their respective applicability in differing engagement contexts.
10. ISRE 2400 applies when a practitioner who is *not* the auditor of an entity undertakes an engagement to review financial statements. ISRE 2400 is to be applied, adapted as necessary in the circumstances, to engagements to review other historical financial information.
11. ISRE 2410 applies when the entity’s auditor is engaged to perform a review of interim financial information. It is to be applied, adapted as necessary in the circumstances, when the entity’s auditor undertakes an engagement to review historical financial information other than interim financial information.
12. A practitioner engaged to review an entity’s interim financial information and who is not the entity’s appointed auditor would need to perform the review in accordance with ISRE 2400.
13. The following diagram shows which ISRE applies to a review engagement, depending on whether:
 - an entity’s auditor is performing the review, or
 - the review is being performed by a practitioner who is not the entity’s auditor.

		Type of Historical Financial Information subject matter		
		<i>Financial Statements</i>	<i>Interim Financial Statements</i>	<i>Other Historical Financial Information</i>
Review performed by:				
The entity’s auditor	–	ISRE 2410	ISRE 2410	ISRE 2410
A practitioner other than the entity’s auditor	ISRE 2400	ISRE 2400	ISRE 2400	ISRE 2400

14. The delineation of the scopes of ISRE 2400 and of ISRE 2410 is predicated on the fact that when the entity’s auditor performs a review of the financial statements, the auditor uses audit-based knowledge to plan and perform the review.
15. The next section of the Paper highlights a number of significant matters that require consideration in a revision of ISRE 2400.

C. SIGNIFICANT MATTERS FOR CONSIDERATION

C.1. Objective of a Review of Historical Financial Statements

16. The purpose of any assurance engagement, and therefore of a review of financial statements, is to enhance the degree of confidence of intended users in the financial statements.
17. In the context of a review of financial statements, the overall objective is for a practitioner to express a conclusion as to whether, on the basis of performance of procedures which do not provide all the evidence that would be required in an audit, anything has come to the practitioner's attention that causes the practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.¹¹

C.2. Moderate Level of Assurance and Engagement Risk

18. ISRE 2400 states that the review engagement provides “*a moderate level of assurance that the information subject to review is free of material misstatement ... expressed in the form of negative assurance.*”¹²
19. The meaning of the term ‘moderate assurance’ is undefined in ISRE 2400. In view of this, its interpretation is likely to vary among practitioners.
20. Reviews of financial statements are *limited assurance* engagements,¹³ and accordingly:
- (i) the acceptable level of engagement risk for reviews is higher than that considered acceptable for the purpose of an audit (which is a reasonable assurance engagement);
 - (ii) the nature, timing and extent of evidence-gathering procedures performed for reviews is deliberately limited relative to an audit; and
 - (iii) due to the lower level of assurance obtained in a review relative to that obtained for an audit, the limited basis for the expression of the review conclusion is indicated by a negative form of expression of the review conclusion in the engagement report.
21. Importantly, the level of assurance obtained from evidence-gathering procedures in limited assurance engagements must at least be sufficient to obtain a meaningful level of assurance as the basis for expression of the conclusion for the engagement.¹⁴ For a

¹¹ ISRE 2400, paragraph 3; ISRE 2410, paragraph 7.

¹² ISRE 2400, paragraph 9.

¹³ The International Framework describes the purpose of a limited assurance engagement as “*a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner's conclusion*” (paragraph 11). Assurance engagement risk is the risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated (paragraph 48).

¹⁴ International Framework, paragraph 48. To be meaningful, the level of assurance obtained is likely to enhance the intended users' confidence about the subject matter information (financial statements) to a degree that is clearly more than inconsequential.

review of financial statements, the required level of assurance to be obtained is ‘moderate assurance.’

22. A practitioner undertaking a review of financial statements is expected to obtain a moderate level of assurance, as a minimum, to express a conclusion on the financial statements, having regard to the circumstances of the engagement as an overall consideration to determine the acceptable level of engagement risk.¹⁵
23. The IAASB’s 2002 publication Study 1, *The Determination and Communication of Levels of Assurance Other than High*,¹⁶ reported on a survey in which over fifty firms from around the world responded to a series of questions, including: *What is the percentage of confidence you believe you provide in case of a moderate level of assurance engagement and in case of a high level of assurance engagement?*
24. The responses to that question are presented in the table below.

	Average percentage of confidence				
	N	Minimum	Maximum	Mean	Std. Deviation
‘Moderate level of assurance’ engagement	52	0.10	0.88	0.60	0.14
‘High level of assurance’ engagement	52	0.55	0.98	0.88	0.08

25. As the authors of the Study pointed out, *“The different results for high assurance versus moderate assurance are as expected. Perhaps because auditors are less familiar with moderate assurance assessments, both the range and the standard deviation are higher. The higher standard deviation for moderate assurance indicates greater agreement about the meaning of a high level of assurance than about moderate assurance.”*
26. A 1993 survey of public accountants in Canada showed somewhat similar results. In that survey, respondents were asked to indicate the level of assurance provided by the three types of communications by public accountants. The results were as shown in the table below:¹⁷

¹⁵ The International Framework (paragraph 11, footnote 6) explains that the engagement circumstances include (among other things), the terms of the engagement, characteristics of the subject matter, the criteria to be used, needs of the intended users, relevant characteristics of the responsible party and its environment, and other matters, for example, events, transactions, conditions and practices, that may have a significant effect on the engagement. Also see ISRE 2410 (paragraph 7) regarding the acceptable level of engagement risk for reviews of interim financial information.

¹⁶ Study 1, *The Determination and Communication of Levels of Assurance Other than High*, published by the IAASB in June 2002, reports the findings of an academic research study commissioned by the IAASB.

¹⁷ For a summary of this survey, see “Reviews Redux” by Karen M. Duggan, *CAMagazine*, January/February 1995 published by the Canadian Institute of Chartered Accountants (CICA)

Type of communication	Level of assurance provided			
	Average	Median	High	Low
Audit opinion	88%	93%	100%	60%
Review engagement report	61%	60%	90%	0%
Notice to Reader (compilation)	24%	20%	75%	0%

27. The results of these surveys identify considerable uncertainty in this area amongst practitioners, which may indicate significant differences in the nature, timing and extent of procedures, and/or significant differences in the interpretation of what level of confidence results from the same procedures.¹⁸
28. This, in turn, highlights the difficulty of communicating to users (who can be expected to be less familiar with moderate assurance assessments than practitioners) what level of confidence they should attach to a review engagement report. Reporting and communication considerations are discussed further in section C.6.

Questions

1. Is the concept of a ‘moderate level of assurance’ meaningful for practitioners?
2. How should a practitioner determine what constitutes a moderate level of assurance for a review of financial statements?

C.3. Conditions for Engagement Acceptance

29. The International Framework states that a practitioner accepts an assurance engagement *“only where the practitioner’s preliminary knowledge of the engagement circumstances indicates that (among other things) ... the practitioner has access to sufficient, appropriate evidence to support the practitioner’s conclusion.”*¹⁹
30. The existing ISREs do not contain requirements and guidance to guide practitioners’ judgments in deciding whether to accept a review engagement. However, a practitioner’s consideration of relevant knowledge and information available at the time the practitioner is making a decision about whether to accept an engagement to undertake a review of an entity’s financial statements is an important step.
31. Given the inherent limitations of reviews discussed above, it may be beneficial to develop requirements and guidance that aim to assist practitioners’ judgments at the pre-acceptance stage about whether the entity’s circumstances, including the needs and

¹⁸ Standards on review engagements in some countries (for example, Canada) apply the term ‘plausible’ to describe the degree of confidence that a review engagement conveys to users. The plain language meaning of this term is ‘worthy of belief’ based on the evidence obtained for the review.

¹⁹ International Framework, paragraph 17(b)(iii).

expectations of the engaging party and of the intended users of the entity's financial statements, warrant performance of a review.

32. In some jurisdictions, review engagements are widely used as an alternative to audit engagements. Review engagements often provide an adequate level of assurance for private enterprises (or entities without public accountability requirements) when there are limited external financial statement users who are willing to accept a moderate level of assurance.
33. Depending on what the underlying purpose is for preparing the financial statements, and the needs and expectations associated with the intended users, other forms of engagement may be more beneficial for all the parties concerned. For example, an audit will be more appropriate when the credibility of the financial statements is of high importance to users, whereas a compilation or some combination of services may possibly be more efficient and effective where there is a primary need to simply produce reliable financial statements (with assurance attached to those financial statements as needed for the purposes of particular users).
34. It may be beneficial for both practitioners and user groups if conditions that make an entity not suited to having its financial statements reviewed are explained in the ISREs. Often the reasons for not being able to accept a review engagement are the same as would constitute reason to decline an audit engagement. Reasons might include, for example:
 - Inability to verify the underlying accounting information from which the financial statements are prepared.
 - An entity's reputation for disregarding sound business practice, or for poor corporate governance.
 - An entity's management is of questionable integrity.
35. In addition, the practitioner performing a review is responsible for the appropriateness of the conclusion expressed in the engagement report, and the scope of the work undertaken for the review is a matter for the practitioner's professional judgment. Accordingly, where there are indications that management or those charged with governance would seek to impose any limitations on the scope of the review, the practitioner cannot accept such limitations and should decline the engagement.

C.3.1. Acceptance of Obligations by the Party (Parties) with Responsibility for Preparation of the Entity's Financial Statements

36. The ISAs contain explanation of the fundamental premise underlying an audit in that an entity's management and, when appropriate, those charged with governance are responsible for the preparation and presentation of the entity's financial statements, including having responsibility for: ensuring the entity's accounting system is suited to preparation of accounting information that can be used for preparation of financial statements in accordance with the applicable financial reporting framework; designing

and implementing the entity's internal controls over financial reporting; and providing the auditor with the information the auditor needs to complete the audit.²⁰

37. In view of the critical role of the management of an entity whose financial statements are reviewed, and of those charged with the entity's governance who have responsibility for oversight of the financial statement preparation process, the question arises whether it would be beneficial to extend the scope of the requirements and guidance in ISRE 2400 to include recognition of the obligations those parties have as pertaining to the review performed by the practitioner.
38. The responsibilities of management and those charged with governance regarding the financial reporting framework applied to prepare and present the financial statements, as disclosed within the financial statements, are particularly important considerations affecting the practitioner's expression of a conclusion on the financial statements with reference to the applicable financial reporting framework.

Questions

3. Should ISRE 2400 contain requirements and guidance to assist practitioners' judgments at the pre-acceptance stage as to whether a request to undertake a review of an entity's financial statements is:
 - (a) practicable; and
 - (b) appropriate, in the sense of being likely to meet the needs and expectations of the engaging party and those parties who are intended users of the report?
4. Should ISRE 2400 explicitly describe the respective obligations of the entity's management and those charged with governance, and of the practitioner performing the review of the entity's financial statements?

C.4. Evidence to Support the Review Engagement Report

39. In a review of financial statements prepared in accordance with an applicable financial reporting framework, the level of assurance the practitioner obtains is a direct function of the sufficiency and appropriateness of the evidence obtained from performing review procedures.
40. A key consideration for a practitioner performing a review is whether the evidence obtained from the procedures performed provides a reasonable basis for expression of the conclusion.
41. The evidence obtained provides a reasonable basis for the expression of the review conclusion when, in the practitioner's professional judgment:

²⁰ The description of the fundamental premise is subject to change as a result of the IAASB's redrafting of ISA 210, *Terms of Audit Engagements*, as part of its Clarity Project. The exposure draft of the proposed ISA 210 (Redrafted), *Agreeing the Terms of Audit Engagements*, and related proposed conforming amendments can be accessed at: <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0105>. The final ISA 210 (Redrafted) and related conforming amendments are expected to be approved at the December 2008 IAASB meeting.

- (i) it is sufficient in quantity and of appropriate quality; and
 - (ii) it reduces the engagement risk for the engagement to a level that is acceptable in the engagement circumstances (being greater than the engagement risk for an audit), as the basis for a negative form of expression of the practitioner's conclusion in the engagement report.
42. The practitioner determines review procedures to be performed having regard to the requirements of relevant assurance standards, legislation and regulation, and also the terms of the review engagement and applicable reporting requirements.²¹
43. ISRE 2400, paragraph 20, sets out the procedures that, under the current standards, a review will normally include. Appendix 2 to ISRE 2400 provides an illustrative list of detailed procedures that a practitioner may consider performing for a review of financial statements.
44. The practitioner applies *professional judgment* to determine the specific nature, timing and extent of the review procedures, and is influenced by:²²
- the practitioner's knowledge of the business, including consideration of
 - the entity's organisation, accounting systems, operating characteristics and the nature of its assets, liabilities, revenues and expenses; and
 - the accounting principles and practices of the industry in which the entity operates;
 - the practitioner's knowledge acquired by carrying out audits or reviews of the financial statements of prior periods;
 - the extent to which a particular item is affected by management judgment; and
 - materiality considerations.

Question

5. To achieve the objective of a review engagement, what factors influence the practitioner's assessment of the work effort required to provide a reasonable basis for reporting the practitioner's conclusion(s) on the financial statements? To what extent are the illustrative detailed procedures contained in Appendix 2 to ISRE 2400 used in practice?

C.4.1. Risk Assessment Procedures

45. A review of financial statements is an assurance engagement, and the International Framework states that part of the objective to be achieved in an assurance engagement is to reduce assurance engagement risk to an acceptably low level in the circumstances of the engagement. More particularly, the acceptable level of assurance engagement risk is determined with reference to the level of assurance the practitioner will obtain as the basis for expressing the conclusion for the engagement. This implies that the practitioner

²¹ ISRE 2400, paragraph 8.

²² ISRE 2400 paragraphs 14 and 18.

- performing a review of financial statements must make an assessment of engagement risk to determine whether that risk is reduced to a level acceptable for the engagement through performance of review procedures.
46. ISRE 2400 makes no reference to the need to assess the risk that the financial statements may be materially misstated. Performance of review engagements as described in ISRE 2400 is based primarily on performance of limited review procedures. Following this procedural approach, a practitioner performs the required procedures applying the practitioner's knowledge of the entity and its business, and materiality considerations as relevant to the financial statements and needs of intended users. It does not entail the practitioner undertaking an explicit assessment of the risks of material misstatement.
 47. Following a risk-based approach, the practitioner performing a review engagement would:
 - (i) assess the risks of material misstatement occurring in the financial statements; and
 - (ii) design procedures to respond to the assessed risks.
 48. The risk assessment procedures performed by an auditor undertaking an audit are not ordinarily undertaken by a practitioner performing a review. However, the question arises whether requirements and guidance are needed, both to assist practitioners to adequately assess the engagement risk associated with a review of financial statements, and to promote better consistency in the performance of reviews among practitioners.
 49. In the absence of standards that contain requirements and guidance about how to perform a risk-based review engagement, it would seem likely that most practitioners are performing procedurally-based reviews, possibly leaving the question somewhat open as to how they have, through the results obtained from those procedures, reduced engagement risk to a level that is acceptable for the engagement. For those practitioners that have implemented a risk-based approach it is likely that there is wide variance in practice.
 50. In some jurisdictions where review engagements have been performed for many years, there is longstanding controversy among practitioners about whether or not review engagements should be risk-based, and if so, how the risk-model can be effectively applied to such engagements. Some practitioners who do not feel that reviews should be risk-based fear that doing so would result in significantly greater work effort and consequently higher costs to the entity obtaining a review. This result would significantly weaken market incentives that drive performance of reviews in preference to audits (primarily in the small private business sector where audits are not required). Other practitioners hold the view that a risk-based review can be implemented effectively without undue escalation of costs, and that doing so will increase the quality of reviews.²³

²³ For information on contrasting views, see "Reviews Redux" by Karen M. Duggan, *CAMagazine*, January/February 1995 published by the CICA. And for a description of differences between a risk-based approach to review engagements vs. a procedural approach, see "Attestation Standards and Their Effect on Review Engagements" by Sylvia Smith, *CA magazine*, August 1988

Questions

6. How should a practitioner performing a review of financial statements address engagement risk when performing the review?
7. Would the nature, timing and extent of review engagement procedures be significantly different between a review engagement based on performance of procedures without an explicit assessment of risk of misstatement in the financial statements, and a review engagement where a risk-based approach is applied to assess and respond to those risks? Would the costs of the engagement differ significantly?

C.4.2. Internal Control

51. Similar to the discussion of risk assessment above, the procedural approach to performance of a review of financial statements does not include identification and assessment of the entity's internal controls relevant to financial reporting. There may be variation in practice also as to whether and how practitioners address internal controls when performing review engagements.
52. In some jurisdictions where reviews are widely used, it is noted that sometimes the type of entity that has its financial statements reviewed instead of being audited may not have well-developed internal controls over financial reporting. The implication is that there may be little or no scope for a practitioner applying the risk-based approach to perform the review for such an entity to rely on properly designed internal controls that are expected to prevent or detect occurrence of misstatements in the financial statements. In this respect, the evidence-gathering approach for a review of the financial statements may resemble the approach taken for an audit of a small entity.

Questions

8. In general terms, what procedures are needed to obtain an understanding of the entity's internal control over financial reporting for purposes of performing a review of financial statements?
9. If the entity does not have internal controls that would prevent or detect occurrence of misstatements in the entity's financial statements, what are the implications for the practitioner regarding the entity's internal controls for the purpose of the review?

C.4.3. Enquiry Procedures

53. ISRE 2400 places significant emphasis on use of enquiry as a type of review procedure (together with use of analytical review procedures).²⁴
54. Questions arise about the appropriateness of enquiry as a primary source of evidence that will contribute to the expression of the conclusion for a review engagement, for example, regarding:

²⁴ ISRE 2400, paragraph 20; ISRE 2410, paragraph 19.

- (i) the reasonable extent of reliance on management's responses to the practitioner's enquiries, and
- (ii) the possible risk of over-reliance by a practitioner on responses obtained to enquiries of management and those charged with governance.

Question

10. Does ISRE 2400 place appropriate emphasis on the use of enquiry as a source of evidence in a review engagement? To what extent, if at all, do you think use of enquiry in an engagement to review financial statements should differ from its use in an audit?

C.4.4. Analytical Procedures

55. ISRE 2400 emphasises use of analytical procedures using highly aggregated information (for example, comparison of financial statements with prior periods, and analysis of variations in account balances). There is not a great deal of guidance about application of analytical procedures to assist practitioners to maximise the effectiveness of those procedures as a source of evidence for expression of a conclusion.²⁵

Questions

11. Does ISRE 2400 provide sufficient guidance on how to apply analytical review procedures effectively in an engagement to review financial statements? If not, what additional guidance might be provided to assist practitioners?
12. To what extent, if at all, do you think use of analytical review procedures in a review engagement should differ from that in an audit engagement?

C.4.5. Considerations Where Circumstances Warrant Performance of Other Review Procedures²⁶

56. If the practitioner has reason to believe that the financial statements may require material adjustment, additional or more extensive procedures may need to be applied to support the expression of the review conclusion, or to confirm that the review conclusion needs to be modified. The practitioner applies professional judgment to determine whether to extend the nature, timing and extent of the additional procedures.
57. The question arises whether there may be situations when it would be appropriate for a practitioner to extend the nature, scope and extent of the procedures performed for the review to include tests of details of transactions, account balances and disclosures, or

²⁵ In contrast, see International Standard on Auditing 520, *Analytical Procedures*

²⁶ The International Framework states that "if the practitioner becomes aware of a matter that leads the practitioner to question whether a material modification should be made to the subject matter information (financial statements here), the practitioner pursues the matter by performing other procedures sufficient to enable the practitioner to report" (paragraph 53).

other forms of substantive procedures designed to obtain direct evidence concerning amounts presented and disclosed in the financial statements.

Questions

13. What situations might require a practitioner performing a review to consider, based on the results of procedures performed to obtain evidence for the conclusion on the financial statements, whether performance of additional procedures is necessary to ensure that the engagement risk is reduced to an acceptable level?
14. What factors should the practitioner consider to determine the nature and extent of further procedures required to reduce the engagement risk sufficiently to be able to express the conclusion on the financial statements?

C.4.6. Situations Where an Entity's Auditor Reviews the Entity's Financial Statements

58. The requirements stated in ISRE 2410 in the context of a review of interim financial statements undertaken by the auditor of an entity make it clear that the auditor's audit-based knowledge influences the auditor's professional judgment applied to plan and perform the review.²⁷
59. The required knowledge extends also to having an understanding of the entity's internal control as it relates to the preparation of both annual and interim financial information, sufficient to plan and conduct the review engagement.²⁸
60. ISRE 2410 specifies required procedures for the auditor performing the review in some areas, for example:
 - obtain evidence that the financial information agrees or reconciles with the underlying accounting records,²⁹
 - perform procedures directed at the application of the going concern concept in the financial statements and relevant disclosures, when the auditor becomes aware of events or conditions that may cast doubt on the entity's ability to continue as a going concern,³⁰ and
 - obtain written management representations.³¹
61. If a practitioner performing a review engagement under ISRE 2400 has not had prior involvement with the entity in the context of performing an audit of the entity's financial statements, the practitioner's knowledge and understanding of the entity for the purpose of planning and performing the review engagement will not be as comprehensive at the outset as would ordinarily be in the case for an auditor performing a review. This raises

²⁷ ISRE 2410, paragraph 3 and 12.

²⁸ ISRE 2410 paragraphs 3, 12 and 17.

²⁹ ISRE 2410, paragraph 25.

³⁰ ISRE 2410, paragraph 27.

³¹ ISRE 2410, paragraph 34.

questions about possible variation in the approach to performing reviews of financial statements or other historical financial information.

62. As a further matter to consider, auditors' involvement in reviewing historical financial information is most commonly in relation to reviews of interim financial statements or financial information the audited entity is required to prepare, and which the entity is typically also required to file for public access. In some countries the review report issued for the interim financial statements is required to be made public along with the interim financial statements. When that is the case, this factor can be expected to influence the approach to performing the review.

Questions

15. How, if at all, should a review of financial statements performed by a practitioner who is the entity's auditor differ from a review of financial statements performed by a practitioner who is not the entity's auditor?
16. How, if at all, should the nature, scope and extent of the work carried out for an engagement to review financial statements differ depending on whether or not the report issued for the review engagement will be made public, or be published together with the financial statements reviewed?

C.5. Communication with those Charged with Governance

63. The practitioner performing a review engagement needs to ensure that proper communication occurs with those charged with governance of the entity at key stages of the engagement.
64. Those communications will ordinarily include the written communication of the agreed terms of engagement and issuance of the review report containing the written reported conclusion. In the course of the practitioner's communications with those charged with governance, it is vital to ensure that those charged with governance are made aware of the significant limitations of a review engagement, including the greater level of risk, relative to an audit, that the financial statements could contain a material misstatement.
65. The practitioner performing a review needs to consider types of circumstances where communication with those charged with governance might be particularly important. Some examples are when the practitioner identifies circumstances that indicate or would appear to indicate:
- the occurrence of fraud, or significant non-compliance with applicable laws and regulations by the entity, including where there is the likelihood of significant impact on the financial statements;
 - that one or more material adjustments to the financial statements are likely to be required in order for those statements to be prepared, in all material respects, in accordance with the applicable financial reporting framework;
 - a limitation of scope that would prevent the practitioner from completing the review; or

- matters of supplementary interest in relation to the entity's governance.

Question

17. What are the key matters a practitioner performing a review of historical financial statements should be required to communicate with those charged with governance of the entity?

C.6. Reporting and Communication with Intended Users

66. Effective communication to readers or users of the results of a review of financial statements requires a clear and succinct description in the report of:
- (i) the key elements of the work the practitioner has performed for the review; and
 - (ii) the results of those procedures.
67. The International Framework states that in a limited assurance engagement the practitioner expresses the conclusion conveying the assurance obtained about the subject matter information in negative form. The purpose of using the negative form of expression is to convey a level of 'limited assurance' that is proportional to the level of the practitioner's evidence-gathering procedures applied in the context of the particular engagement.³²
68. For a review of financial statements, the practitioner's report states whether, based on the procedures performed, anything has come to the practitioner's attention that causes the practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework.³³
69. To further emphasise the limited nature of a review, the engagement report must also clearly state that
- a review is substantially less in scope than an audit conducted in accordance with ISAs
 - and, consequently, does not enable the auditor to obtain assurance that the auditor would become aware of all significant matters that might be identified in an audit,
 - and that, accordingly, no audit opinion is expressed.³⁴
70. From the information contained in the review report, readers ought to be able to discern, at a minimum, that there is greater risk that the financial statements that are the subject of the report could contain a material misstatement, than would be the case had the financial statements been audited.

³² International Framework, paragraph 59

³³ ISRE 2410, paragraph 43(j)

³⁴ ISRE 2410, paragraph 43(h)

71. Some commentators and researchers have noted that readers or users of review engagement reports tend not to have a clear understanding of what assurance, if any, can be associated with the negative expression of the conclusion in the report.
72. A key question about the effectiveness of the practitioner's communication with readers or users of the review report therefore concerns the level of confidence that they can associate with the conclusion expressed on the financial statements in the report.
73. It has also been questioned whether readers or users of review reports understand the limited nature of the assurance the practitioner obtains as the basis for expressing the review conclusion, relative to the assurance obtained as the basis for expressing an audit opinion.

Questions

18. How can a practitioner effectively communicate the concept of a level of assurance that is less than high, as obtained in a review engagement, to the intended readers or users of a review report, so that they will be able to properly estimate the level of confidence they can associate with the review conclusion?
19. Can the term 'moderate level of assurance' usefully be restated as a 'plain language' term in order to assist users of review reports to better understand the underlying message conveyed by the conclusion expressed in a review report?
20. What form of expression of the conclusion on the financial statements in the review report might increase the perceived usefulness of a review as an alternative form of assurance engagement? Would a different expression of the practitioner's conclusion other than in negative terms increase readers' or users' understanding of the level of assurance conveyed and, if so, how should the practitioner's conclusion be expressed?
21. Given the limited work effort ordinarily undertaken for a review engagement (i.e. enquiry and analytical review procedures), what level of detail is appropriate to properly inform readers or users of the review report about the scope of the review engagement and the work undertaken for the engagement? Should practitioners be permitted to use a flexible format for their review reports to communicate the nature of the work undertaken?

C.7. The International Standards on Review Engagements

74. Both the ISAs and the ISREs contain requirements and guidance relating to performance of assurance engagements for historical financial statements. However, the ISREs have not as yet been reviewed against the revised ISAs with a view to ensuring appropriate alignment between the ISREs and the ISAs.
75. It would seem appropriate to consider the following areas in the context of revising the ISREs (including ISRE 2400):
 - removal of references to ISAs within the ISREs so that the requirements and guidance contained in the ISREs will 'stand alone';
 - use of terminology on a basis consistent with terminology used in the ISAs; and

- application of the drafting conventions used in the revised and redrafted ISAs, to the ISREs.

Question

22. Do the review engagement standards need to be complete in themselves so that they ‘stand alone’ as standards separate from the ISAs? If so, which aspects of the ISAs should be incorporated into the review engagement standards?

D. CONCLUSION

76. The matters and questions raised above are among those that the NSS Subgroup Staff considered most important to raise for consideration and discussion. There may be other matters not addressed in this Paper that respondents may deem of sufficient importance for consideration in a revision of ISRE 2400. We encourage respondents to raise these matters in their responses.
77. The acceptance of reviews as a viable form of assurance engagement varies widely among countries. Much can be learned from those countries or jurisdictions where reviews already exist as a viable assurance alternative, with high level of public acceptance of their usefulness. Similarly, the perspectives of standard setters in those countries or jurisdictions where the review has not developed successfully as an alternative to the audit will also be valuable in the context of the IAASB’s revision of ISRE 2400, particularly in relation to those aspects of reviews that pose impediments to the more extensive use of such engagements.
78. As a possibility to consider, there may be scope to apply combinations of services that will potentially better deliver the outcomes desired by those parties who require assurance on information or other subject matters.
79. It is noted also that the application of the ‘model’ of a limited assurance engagement that a review of historical financial statements provides has already been extended to other subject matter, including non-financial information. There is scope to explore how limited assurance engagements, whether described as review engagements or otherwise, can be applied to other types of subject matter for which there is clear demand for provision of assurance.
80. All perspectives will be welcomed as input to the IAASB’s further work in this area. We thank respondents to this Paper for submitting their views, and for any relevant information pertaining to their countries’ experiences in the use and acceptance of review engagements.