



# Issues Paper

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<b>AGENDA ITEM NO.</b>	<b>9(b).2</b>
<b>Meeting Date:</b>	9 June 2015
<b>Subject:</b>	Revision of ASAE 3500 <i>Performance Engagements</i> – Recommended Scope and Content
<b>Date Prepared:</b>	21 May 2015

## Proposed Scope

1. The scope of the revised ASAE 3500 is recommended to address:
  - (a) assurance over performance outcomes rather than outputs, so as to exclude audits of service performance information or other information measured purely by key performance indicators (KPIs) or other performance metrics;
  - (b) both direct engagements and attestation engagements, including “follow-on” engagements but excluding assurance over service performance information reported;
  - (c) both reasonable and limited assurance;
  - (d) both long form and short form reporting;
  - (e) flexible scope and reporting to accommodate different Government reporting requirements; and
  - (f) broad objectives of a performance engagement not limited to economy, efficiency and effectiveness to allow flexibility to address other objectives.
2. Each of these aspects of the proposed scope is discussed below.

### *Performance outcomes*

3. The objectives of a performance engagement relate to the achievement of outcomes by the activity, rather than simply outputs. Outputs, which can be measured using performance indicators, may or may not result in the achievement of the desired outcome/s. The AASB have a project underway, jointly with NZ to develop an accounting standard on *Reporting Service Performance Information*, which focusses primarily on the measurement of outputs. The AASB proposes through this standard to require service performance information to be reported by not-for-profit entities with respect to:
  - (a) An entity’s performance objectives;
  - (b) An entity’s performance indicators (relating to inputs and outputs, the outcomes that the entity is seeking to influence, the link between inputs and/or outputs and outcomes and the link between outputs and/or outcomes and service performance objectives);
  - (c) The assumptions which underlie the service performance information and the methodologies adopted in compiling the service performance information; and
  - (d) Risks and the risk management strategies associated with achievement of the entity’s service performance objectives.

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4. Notably, this service performance information will not seek to directly address whether outcomes and the performance objectives, to which those outcomes relate, have been achieved. The AASB defines “outcomes” as the impacts on society or segments of society, which occur as a result of, or are reasonably attributable to the entity’s outputs. The AASB define “outputs” as the goods and services provided by an entity to recipients external to the entity.
5. The NZAuASB is developing an auditing standard to address the audit of this service performance information in conjunction with the annual financial report audit, which is being monitored by the AUASB technical group. These service performance information audits may be able to be contrasted from the performance engagements encompassed in ASAE 3500 in the following ways:
  - (a) The subject matter for service performance audits is primarily outputs, which are evaluated against key performance indicators or other performance metrics, rather than outcomes, which are evaluated against objectives in performance engagements.
  - (b) The target is usually the entity in a service performance audit, whereas it is restricted to an activity in a performance engagement, which may cut across entity boundaries and will not usually encompass the entirety of the entity.

Service performance audits are attestation engagements and whilst performance engagements are most commonly direct engagements, they may also be attestation engagements in certain circumstances, such as for “follow-on” engagements, where the responsible party makes a statement regarding whether they have addressed recommendations arising from a previous performance engagement. Service performance engagements are typically short form whereas performance engagements are typically long form focussing on recommendations, nevertheless neither needs to be restricted to short or long form. Neither of these features can be used to differentiate the different types of engagements.

6. The features which distinguish audits of service performance information from performance engagements to be captured by ASAE 3500 will need to be identified and clearly articulated in the revisions.

#### *Direct & Attestation Engagements*

7. Typically, performance engagements are direct engagements as they are initiated by the auditors-general based on their strategy, objectives and priorities without an attestation being provided by the responsible party. Nevertheless, sometimes auditors-general conduct follow-on engagement to assess how well an activity has responded to the recommendations of a previous performance assurance report. For follow-on engagements, the responsible party may provide an attestation or statement regarding their response to the performance engagement recommendations. In other circumstances, the responsible party may make a statement (or certification) regarding performance of the activity in achieving identified outcomes or objectives. There are benefits in the responsible party going through a self-evaluation process in order to provide their own statement on performance in advance of the assurance practitioner conducting a performance engagement. It may be possible for the auditors-general to encourage this self-assessment and seek a statement which may result in better preparedness for the engagement. Consequently, both direct and attestation engagements need to be accommodated in revised ASAE 3500.

#### *Reasonable and limited assurance*

8. Whilst reasonable assurance is required to be obtained for most performance engagements, limited assurance can be required and consequently there is no need to preclude application of ASAE 3500 to limited assurance engagements.

#### *Long form and short form reporting*

9. Whilst most reports on performance engagements are required by users to be presented in long-form including information such as the objectives, scope, criteria, methodology, sources of data, any limitations on data used, findings and detailed recommendations, there may be instances where a short form report is required by users or both a summary short form report alongside the detailed long form report meets the needs of users. Consequently the both short and long-form reports need to be addressed within the revised standard.

### *Flexible scope and reporting*

10. The scope of a performance engagement is usually determined by an auditor-general in response to priorities arising from government policy objectives, risk assessment or strategic planning. Consequently the auditors-general require flexibility on scoping these engagements to address the risk or policy objectives identified.
11. Reports on performance engagements are read by a variety of users who are not necessarily familiar with audit or assurance terminology or methodologies, such as the responsible party for the activity, Parliament and the general public. It is important that plain English is used in reports so that they can be understood by the layperson. It may not be appropriate or necessary for the assurance practitioner to express an overall opinion or conclusion on performance for the report to meet the needs of users, consequently a standardised assurance report is not likely to be appropriate. However, if any overall opinion or conclusion is provided it will be important to include the circumstances and context in which that conclusion was reached. Modifications may not be well understood by users of performance assurance reports and so a more simplified style of conclusion may be appropriate. The performance assurance report may benefit from providing the conclusion first and the detailed long form report afterwards. The conclusion itself should be able to stand alone and be understood without reference to the detailed approach, findings and recommendations.
12. Flexibility in the style and content of reporting on performance engagements will need to be allowed for in the revised standard.

### *Broad objectives*

13. The objectives of economy, efficiency and effectiveness which underpin the existing ASAE 3500 may not be applicable to all performance engagements and so a broader range of objectives need to be accommodated in ASAE 3500. Performance objectives may be expressed in terms such as: probity, ethical, appropriate, accessible, reliable or quality.
14. The objective of a performance engagement needs to be broad and allow for any of these possibilities, perhaps providing some objectives as examples, rather than a definitive list.

### **Proposed Content**

15. The recommended content of the revised ASAE 3500 would include:
  - (a) requirements anchoring to ASAE 3000, but as the subject matter specific standard would need to override ASAE 3000 if any inconsistency arose;
  - (b) tabular format to separate limited and reasonable assurance requirements;
  - (c) explanation of materiality and risk assessment in the context of performance engagements;
  - (d) consideration of the needs of users, such as plain English wording of conclusions so they are more meaningful to Parliament and other users;
  - (e) management representations supported by documentation at the entity;
  - (f) the manner in which “acceptance and continuance” of engagements is undertaken in a performance engagement, where the engagement is usually chosen by an auditor-general as part of strategic planning rather than requested by the entity; and
  - (g) incorporation of public sector specific needs in reporting such as descriptive sections as engagements are primarily public sector.

### *Anchoring to ASAE 3000*

16. Whilst ASAE 3000 provides the overarching requirements for all assurance on non-historical financial information including engagements on performance, it is primarily directed at attestation engagements and the objective does not readily relate to the objectives of a performance engagement, which are more commonly direct engagements.

17. The objectives of an assurance engagement in ASAE 3000 include “to obtain either reasonable or limited assurance, as appropriate, about whether the subject matter information is free from material misstatement”. This objective needs to be adapted and interpreted for performance engagements which will usually not have a “subject matter information” at the outset of the engagement, being the outcome of the evaluation of performance against suitable criteria, as they are typically direct engagements. Furthermore, the assurance practitioner will not be looking for misstatements in that subject matter information. The objective in ASAE 3000 can be adapted and interpreted for performance engagements and this will be explained in revised ASAE 3500. For example, the objective of a performance engagement could be expressed as:

*To obtain either reasonable or limited assurance, as appropriate, about whether, in all material respects based on suitable criteria, the activity achieved its performance objectives.*

18. Whilst ASAE 3500 will need to anchor to ASAE 3000, the PAG noted that ASAE 3500 will be used by assurance practitioners who are typically not familiar with other AUASB Standards, consequently the need to refer back to ASAE 3000 should be limited. This can be overcome by inclusion of core requirements from ASAE 3000 and clear reference to the other relevant requirements in ASAE 3000 by way of footnote, so readers can easily see when to refer back to ASAE 3000. It is likely to be too cumbersome to repeat all requirements from ASAE 3000. ASAE 3500, as the subject matter specific standard, will override ASAE 3000 where there is a difference in approach, although any difference or interpretation should be explained in revised ASAE 3500.

#### *Tabular format*

19. The tabular format which identifies the requirements relevant to limited assurance engagements separately but alongside the requirements relevant to reasonable assurance engagements, as presented in ASAE 3000, to differentiate the procedures required for limited as opposed to reasonable assurance engagements, is recommended for the revisions to ASAE 3500.
20. This format allows for a clear comparison of the minimum requirements for both limited and reasonable assurance engagements so that the assurance practitioner can readily identify the additional work effort required for a reasonable assurance engagement. The tabular format has been effective in ASAE 3000, ASAE 3410 and ASAE 3150.

#### *Materiality and Risk Assessment*

21. Materiality is usually more difficult to apply in a performance engagement, where quantification is not necessarily relevant, than in a financial report audit. Nevertheless, materiality relates to the matters which are relevant to users and which impact the decision making of those users. Consequently the revisions to ASAE 3500 will need to flesh out the matters to consider in applying materiality in a performance engagement.
22. Likewise, the factors to consider in conducting a risk assessment for a performance engagement need to be developed further in the revisions to ASAE 3500 as this is also a difficult area to apply in these engagements.

#### *Needs of Users*

23. The scope of a performance engagement and the matters addressed in the report on a performance engagement need to directly address the needs of users. Particularly as there is no prescriptive form or content of for the performance engagement report, users’ understanding of the report will be critical to its value. One of the purposes of a performance engagement is transparency so that Parliament and the general public can see value for money for government expenditure, so both the scope and reporting of a performance engagement need to be clearly directed at the purposes of the engagement as they relate to users.

#### *Representations*

24. Whilst representations are not generally obtained currently for performance engagements, it may be beneficial for auditors-general to seek them in order to clarify the responsible party’s responsibilities with respect to performance, as well as to confirm that information and access have been provided for the assurance team. Representations may be more important for performance engagements, where the target is not familiar with the assurance process or their responsibilities to assist an Auditor-general, than in a financial report audit.

### *Acceptance and Continuance Procedures*

25. Not all of the acceptance and continuance procedures as set out in ASAE 3000 will be relevant to performance engagements as most engagements are initiated by auditors-general, such as agreeing the terms of engagement or accepting a change in the terms of engagement. Whether these requirements may be usefully applied in in some way to performance engagements will need to be explored. An explanation in the introduction to the standard as to how auditors-general typically select activities and performance objectives as the subject of an engagement could be useful. This would help to put the approach to performance engagements in context.

### *Public Sector Specific Needs*

26. As the majority of performance engagements are conducted in the public sector by auditors-general, the nature of engagements could be described in the introduction again for some context to the standard. Nevertheless some private sector performance engagements are emerging and the nature of these engagements could also be described.