



International Federation of Accountants

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Agenda Item

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Committee: IAASB

Meeting Location: Lisbon

Meeting Date: June 15-18, 2009

Reviews, Compilations and Other Alternatives to the Audit— Issues and Task Force Proposals

I. Objective of this Paper

To obtain the IAASB's views about the project Task Force's proposed direction for the project to revise ISRE 2400¹ and ISRS 4410.²

II. Task Force

The Task Force comprises the following full and correspondent members:

- Full members:
 - Susan Jones, Chair, IAASB Member
 - Dianne Azoor-Hughes, Pitcher Partners, Australia
 - Phil Cowperthwaite, IAASB Member
 - Ashif Kassam, IAASB Member
- Correspondent members:
 - Carolyn McNerney, Chair of the AICPA Accounting and Review Services Committee (assisted by Mike Glynn)
 - Michael Gewehr, IDW (assisted by Wolf Boehm)
 - Jo Iwasaki, Assurance: Audit and Assurance Faculty of the ICAEW.

III. Activities

The Task Force met in April and May to consider key issues concerning the project objectives, scope and direction.

The Task Force Chair presented the project to the 2009 National Auditing Standards Setters (NSS) Meeting, and also discussed with the NSS the proposed project scope and direction and a number of the key issues identified, to obtain their views and feedback.

¹ International Standard on Review Engagements (ISRE) 2400, "Engagements to Review Financial Statements."

² International Standard on Related Services (ISRS) 4410, "Engagements to Compile Financial Statements."

IV. Introduction

OBJECTIVE AND SCOPE OF THE PROJECT

1. The objective of the project, as stated in the Project Proposal approved in March 2009, is to revise ISRE 2400 and ISRS 4410 to provide standards for services that are acceptable alternatives to an audit of financial statements.
2. The project is linked to the strategic priority to address the needs of small- and medium-sized entities (SMEs) and small and medium practices (SMPs) for assurance and related services in settings where there is no mandatory audit requirement. There is need for alternative assurance services in the regulatory environments of both developed and emerging economies, where the audit service may often exceed what users require in terms of both service and cost. A primary consideration is to address SME clients' needs through alternative services that give them a viable choice to select from different services, or combinations of services, that meet their needs in an appropriate and cost-effective manner.
3. The project proposal acknowledges the following public interest considerations for the project:
 - responding to the needs of the marketplace;
 - the need to preserve the meaning and integrity of the audit concept;
 - the need for common standards internationally; and
 - the need to improve users' understanding of the practitioner's limited assurance report.
4. Further, the proposal acknowledges that development of standards for alternatives to the audit might involve consideration of pertinent ethical issues, such as independence considerations.

OUTLINE OF THIS PAPER

5. This paper is organized into the following sections:
 - The proposed direction for the project.
 - Some of the major issues that the Task Force considers should be addressed in this project.
 - The proposed project timetable.

V. Direction

THE PROPOSED DIRECTION

6. The Task Force believes the first priority is to develop review and compilation engagement standards to replace ISRE 2400 and ISRS 4410 respectively, for the following reasons:
 - In some jurisdictions, the demand for audits is falling:
 - As the threshold for the statutory audit requirement is being raised in some countries, many entities no longer require an audit.

- In some jurisdictions there is concern that an audit in accordance with the clarified ISAs will be more costly to obtain than in the past.
 - There is continued demand, by either regulators or markets in those jurisdictions, for services that carry some level of assurance or that otherwise have a practitioner's involvement.
 - Stakeholders expect the IAASB to develop an effective and appropriate response to these environmental demand factors with some urgency.
7. The Task Force believes that the project objectives can best be served by developing the standards for review and compilation engagements together (i.e., in tandem).

BASIS FOR THE PROPOSED DIRECTION

8. Reviews and compilations are the principal alternatives to the audit. In a number of countries, these services and the markets for them are well-developed. Further, a number of countries are looking to expand use of reviews and compilations, or combinations of these services used together with additional procedures, to develop and/or respond to user demand for alternatives to the audit in their domestic market.
9. The Task Force has looked at models that exist, or are under development in some countries. The impression of the Task Force is that these developments are seeking to address particular practice issues related to the existing review and compilation services. They are not *new* alternative services.³
10. Given anecdotal evidence indicating that some users may not have a good understanding of the difference between a review and an audit, the Task Force believes there is significant risk in developing a "new" alternative service if it cannot be differentiated clearly from existing services. This view was confirmed by the NSS group.
11. The existing review and compilation services offer a relatively simple solution to address user needs for alternative assurance and non-assurance services respectively, albeit it is acknowledged that revised standards are needed in each case. They are viewed as services that have continuing viability to respond to user needs in the current environment. They also have the advantage of already having achieved market acceptance in a number of countries. This view was confirmed by the NSS group.
12. Based on the inputs received to date,⁴ the Task Force believes the objectives of this project can best be achieved by developing revised standards for review and compilation engagements to replace the existing standards. The Task Force considers that these standards should be developed together, as these services are to some extent related, and

³ One model combines compilations with direct reporting, and another two identify with the existing review engagement.

⁴ IAASB Consultation Paper, "Proposed Strategy 2009-2011," and IAASB Strategy and Work Program, 2009-2011; NSS Consultation Paper on matters to consider in a revision of ISRE 2400 (2008); further information – gathering and discussion with the IAASB NSS in April 2009; review by the Task Force of some models currently under development by AICPA, IDW and ICAEW, which are based on existing review and/or compilation services.

share a number of issues in common which can best be addressed contemporaneously.

Matters for IAASB Consideration

- Q1. Does the IAASB agree that the immediate priority of this project should be to develop revised review and compilation engagement standards to replace the existing ISRE 2400 and ISRS 4410?
- Q2. Does the IAASB agree that these revisions should be done together (i.e., in tandem)?

VI. Major Issues

13. The inputs the Task Force has received to date have shed light on a number of issues and questions regarding review and compilation engagements that the Task Force believes will need to be addressed. These issues and questions are briefly discussed below.
14. If the IAASB agrees with the proposed direction, the Task Force will explore these issues in further detail, and present recommended courses of action to the IAASB in subsequent Issues Papers.

A. DEVELOPMENT OF STANDARDS TO REPLACE EXISTING ISRE 2400 AND ISRS 4410

Overall Considerations

15. The following fundamental principles are key considerations to progress the project:
- An audit is an audit.
 - Other services must be distinguished clearly from an audit and from each other.
 - Alternatives to the audit service must be:
 - (i) meaningful, in the sense their value to users through having the practitioner's involvement in the service is made clear, and
 - (ii) cost-effective.
 - The concepts and principles contained in the IAASB's International Framework for Assurance Engagements will inform this project.
16. The standards for reviews and compilations should guide practitioners in performing these engagements to meet the overall ethical obligation not to be associated with misleading information, or information that the practitioner ought reasonably to have known is misleading, or is likely to be misleading.
17. There is support for a "stand-alone" package of standards for review engagements that practitioners can use without making reference to the ISAs. Some practitioners perform reviews exclusively, and therefore may not maintain familiarity with the auditing literature.
18. The standards for reviews and compilations should aim to increase understanding of these services as appropriate alternative services to the audit.
19. The aspects of performance of reviews and compilations of financial statements that are common to audits, reviews and compilations should be addressed on a consistent basis, as appropriate in the context of each type of service.

20. There is no intention to revise ISRE 2410⁵ at this time; however, the project may identify matters relevant to a future revision of ISRE 2410 or matters that would require conforming changes to that standard. It is important to understand the respects in which these standards need to be consistent, and also those in which they need to be different.

Matters for IAASB Consideration

- Q3. Does the IAASB agree that the overall considerations set out above are those the Task Force should attend to? Are there other considerations the IAASB considers important?

Technical Matters – Engagements to Review Financial Statements

21. The Task Force has identified various matters that require clarification, or for which guidance is needed, in developing revised engagement standards for reviews of financial statements. Some of the more significant of those are:
- The level of assurance associated with the review engagement.
 - The objectives and the performance and reporting requirements for reviews of financial statements prepared in accordance with general purpose and special purpose financial reporting frameworks.
 - Engagement acceptance and continuance considerations.
 - The role of professional judgment and professional skepticism in applying the requirements for reviews.
 - The degree of relative emphasis of principles and procedures in a revised standard.
 - The practitioner’s consideration of risk and how it influences the planning and performance of the review.
 - The practitioner’s consideration of the entity’s internal control and how it influences the work effort required for the review.
 - The required procedures to perform the review, and how inquiry and analytical review procedures are performed most effectively to enable practitioners to obtain the required level of assurance.
 - The practitioner’s response when:
 - (i) having performed the review procedures required, the practitioner believes there is not sufficient appropriate review evidence to support a review conclusion on the financial statements; and/or
 - (ii) matters come to the practitioner’s attention which would suggest that the financial statements may be materially misstated.

⁵ International Standard on Review Engagements (ISRE) 2410, “Review of Interim Financial Information Performed By the Independent Auditor of the Entity.”

Matters for IAASB Consideration

Q4. Does the IAASB agree the technical matters outlined above should be addressed in developing revised review engagement standards?

Technical Matters – Engagements to Compile Financial Statements

22. Some of the important technical questions raised about performance of compilations of financial statements are:

- What is the practitioner’s objective in performing an engagement to compile financial statements?
- What are the minimum procedures the practitioner should carry out to meet the practitioner’s objective?
- What application guidance can be provided to assist practitioners to meet the requirements for performing a compilation engagement?

Matters for IAASB Consideration

Q5. Does the IAASB agree the technical matters outlined above should be addressed in developing revised compilation engagement standards?

B. REPORTING CONSIDERATIONS

23. The Task Force has identified a number of reporting considerations.

24. There is fairly consistent anecdotal evidence (and some research evidence) that:

- work performed by practitioners is not well described by the reports produced, and
- practitioners’ messages conveyed through the content and wording of their reports, and users’ expectations based on those reports, are not well-aligned.

25. This evidence raises the question: how should the practitioner clearly and effectively report to users on:

- (a) the work undertaken for the engagement; and
- (b) (in a review engagement) the conclusion the practitioner has reached on the financial statements;

in a manner that would minimize user expectations gaps?

26. Despite the “no assurance” report given for a compilation, users appear to take assurance from the practitioner’s involvement in compilation of the financial statements, and/or to associate a level of reliability with those financial statements.

27. Similarly, some research indicates that the negative expression of the conclusion in a review report is misunderstood by users. There is support for exploring whether a positive expression of the review conclusion would result in better and more effective communication.

28. There is a need to clarify circumstances when a review report should be for “restricted use” and/or “restricted distribution”, because in some countries reviews are often performed for financial information that is for a special-purpose.

Matters for IAASB Consideration

- Q6. Does the IAASB agree that the reporting considerations outlined above should be addressed in developing revised review and compilation engagement standards?

C. INDEPENDENCE CONSIDERATIONS

29. The Task Force has identified certain independence considerations regarding practitioners undertaking review and compilation engagements.
30. Practitioner involvement in provision of other services relevant to preparation of financial statements in conjunction with performance of review and/or compilations is the subject of debate among practitioners and users. Specifically, such other services include practitioner involvement in the entity’s accounting and/or internal control relevant to preparation of financial statements.
31. Practitioners performing assurance engagements, including reviews, are permitted to provide services related to the preparation of accounting records and financial statements for clients that are not public interest entities⁶ where the services are of a routine or mechanical nature, so long as any self-review threat is created is reduced to an acceptable level⁷. Anecdotally users would value more extensive involvement by practitioners in accounting services that directly support preparation of the financial statements.
32. Independence requirements have more onerous effects in SME settings, where the responsible party, while willing to take responsibility for financial statements, may not have sufficient expertise to prepare financial statements in accordance with the applicable financial reporting framework. The Task Force is aware of at least one country where this issue has been recognized and accommodated by the relevant national standard setter.⁸ Other national standard setters are also working to try to address this issue in the context of practitioners performing attest assurance engagements.⁹
33. The question arises whether and how performance of certain accounting and internal control services by practitioners undertaking assurance engagements might possibly be accommodated in the performance of assertion-based engagements.
34. If addressing independence considerations were viewed as a part of the possible set of responses that ought to be considered as part of meeting the objectives of this project, then there would be the need to reconcile possible avenues the Task Force views as being

⁶ The term ‘public interest entity’ is defined in the IFAC Code of Ethics for Professional Accountants.

⁷ IFAC Code of Ethics for Public Accountants, paragraph 290.171.

⁸ For example, the UK Auditing Practices Board’s *Ethical Standards – Provisions Available for Small Entities* contain provisions that provide relief to practitioners undertaking audits of small entities in relation to performing accounting services.

⁹ IDW; AICPA.

worthy of further consideration with the relevant provisions of the IFAC Code of Ethics. This would require dialogue with the International Ethics Standards Board for Accountants.

35. Independence considerations are relevant in compilation engagements. In particular, disclosure of the nature of the relationship between the practitioner and the client is viewed as relevant information for users. ISRS 4410 provides guidance about the need for disclosures to users of compilation reports when the accountant is not independent¹⁰. Various national standard setters have established a requirement for this disclosure in their domestic compilation engagement standards. The Task Force believes disclosures concerning the practitioner's independence are an important aspect of compilation engagement reports, and should be further explored.

Matters for IAASB Consideration

- Q7. Does the IAASB agree that the independence considerations set out above should be explored further?

D. COMMUNICATION CONSIDERATIONS

36. The NSS has signaled that communication will be a key element of promoting practitioner and user awareness of existing alternatives to the audit, and about how combinations of services can be used to meet a variety of user needs.
37. An effective program of communication with user groups and practitioners is one way to resolve many of the issues that practitioners currently face regarding provision of alternative services. For example there is apparent lack of understanding about:
- what reviews and compilations entail, and how they differ from the audit, and
 - how reviews, compilations and combinations of services can be customized to user requirements, or to requirements of different users.

Some NSS and professional bodies have developed tools and communications brochures to communicate and illustrate use of alternative services to both users and practitioners.

38. The Task Force believes that there is an opportunity for the IAASB to communicate with both users and practitioners on these services, and illustrate how they can be alternatives to the audit. This could assist development of markets for audit alternatives regarding services already available, particularly in countries where demand is underdeveloped.

Matters for IAASB Consideration

- Q8. Does the IAASB agree that the Task Force should explore developing a program of communications designed to highlight the availability of, and the scope to use, reviews, compilations and other services, including combinations of services?

¹⁰ Paragraph 5

E. ADDRESSING RESIDUAL NEED FOR OTHER ALTERNATIVES, AND FURTHER CONSULTATION

39. The project proposal indicated that the project should include research and possible further consultation, or a global survey, to understand regulatory and market demands and practice around the world regarding alternative services.
40. Based on the inputs the Task Force has received to date, it is not persuaded that undertaking further consultation would contribute additional benefit at this time. There is a clear need to respond in a timely way to those issues and questions about reviews and compilations that have been drawn to the Task Force's attention. Undertaking wider consultation at this stage would delay a response by some 12 months.
41. The Task Force believes that the approach outlined in this paper captures appropriate responses to meet the project objectives in an optimal timeframe. There may be a need to do further work if there is evidence of a residual demand that is not met. Whether this situation is likely to occur cannot be determined at this stage, and would need to be assessed at a later stage in the project.

Matters for IAASB Consideration

- Q9. Does the IAASB support the Task Force's view that assessment of whether there may be residual demand for development of other alternatives to the audit is best addressed at a later stage?

VII. Project Timetable

Project Stage	Timing
Confirmation of project scope and direction	June 2009
Issues Paper	September 2009
First read of exposure draft(s)	March 2010
Approve exposure draft(s)	December 2010
Full review of exposure draft comments and first read post-exposure	September 2011
Approve final standard(s)	December 2011

42. The Task Force's proposed project timetable is set out in the above table. If the IAASB supports the project direction explained above, the Task Force will proceed to develop the Issues Papers for revision of ISRE 2400 and ISRS 4410 for the September IAASB meeting.
43. If the IAASB considers the Task Force should engage in further initial consultation at this stage, then that would delay commencement of development of revised standards for reviews and compilations by some 12 months. The anticipated effect on the project timetable is shown below (see gray-shaded rows).

Project Stage	Timing
Confirmation of project scope and direction	June 2009
Consideration of a consultation paper/global survey	September 2009
Full review of consultation responses and high-level “directions paper”	March 2010
Issues Paper	September 2010
First read of exposure draft(s)	March 2011
Approve exposure draft(s)	December 2011
Full review of exposure draft comments and first read post-exposure	September 2012
Approve final standard(s)	December 2012

Matters for IAASB Consideration

Q9. Does the IAASB agree with the Task Force’s proposed project time table for developing revised review and compilation engagement standards in line with the proposed direction set out in Section V?