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OF ACCOUNTANTS**

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Agenda Item 10

Committee: IAASB
Meeting Location: Berlin
Meeting Date: December 8-12, 2003

Review of Interim Financial Information

Objectives of Agenda Item

1. To review significant issues raised by commentators on the June Exposure Draft *Review of Interim Financial Information Performed by the Auditor of the Entity*.
2. To agree on the resolution of these significant issues.

Background

In June 2003, the IAASB issued the exposure draft *Review of Interim Financial Information Performed by the Auditor of the Entity*.

Activities Since Last IAASB Discussions

The comment period ended on September 30, 2003 and 29 comment letters were received (see Appendix 1 for a list of the respondents). The Task Force met on November 17-18, 2003 to review the comments received and to identify the significant issues.

The significant issues identified by the Task Force are fundamental and need to be addressed before the ISA is finalized; the Task Force is therefore seeking the concurrence of the Board with a proposed approach before any revisions to the ISA take place. The Task Force plans to bring a revised ISA for approval to the February 2004 IAASB meeting.

Issues

ISSUE 1: SCOPE

The proposed ISA applies to engagements to review interim financial information when *all* of the following criteria are met:

1. The review is performed by the entity's auditor;
2. The interim financial information is prepared in accordance with an identified financial reporting framework;
3. The entity is required or permitted under legislation, regulation or equivalent authority to issue such interim financial information; and
4. The audited financial statements of the entity are required to be filed with a regulatory authority, or equivalent, and are publicly available.

The Exposure Draft (ED) requested views as to whether the scope of the proposed ISA was appropriate or whether the IAASB should expand the scope of the proposed ISA to include all reviews of financial information performed by the entity's auditor, and limit ISA 910 to only those reviews performed by a practitioner who is not the entity's auditor.

Summarized below are varying comments received by respondents on the scope of the proposed ISA followed by the Task Force's recommendations.

Need for a Separate ISA on Review of Financial Information

Four respondents (AuASB, JICPA, ICAP & CICA) supported the scope of the proposed ISA. One respondent (CICA) stated that a review of interim financial information provided for regulatory purposes is sufficiently different from a review of other forms of interim financial information to warrant separate review standards. This respondent felt, however, that an auditor of the entity should not be precluded from using ISA 910 in performing a review of interim financial statements.

Six respondents (APB, ACCA, NYCPA, IDW, FEE & RR) stated that there should be one standard addressing reviews of financial information and that the scope of ISA 910 be expanded to include all such reviews. The respondents were unconvinced that the four criteria necessary for performing a review in accordance with the ED distinguished such an engagement from an ISA 910 engagement. However, it was noted that the ED contains essential procedures that are over and above those contained in ISA 910.

One respondent (NIVRA) stated that the scope of ISA 910 and the proposed ISA should be based on the relevant subject of the review and not based on whether the review is performed by the auditor of the entity. Under this approach, ISA 910 would include guidance on reviews of financial statements and the proposed ISA would be broadened to the review of all other financial information. When specific requirements should exist that the reviewer is also the auditor of the entity, these requirements should be specifically addressed in the proposed ISA.

Task Force recommendations:

- The proposed ISA and ISA 910 should not be combined
- The distinguishing factor between the proposed ISA and ISA 910 should be audit-based knowledge

The Task Force believes that the fundamental distinction between the ED and ISA 910 is that in the proposed standard the review is performed by the auditor who has an understanding of the entity acquired through previous audits. This understanding is used to determine the inquiries to be made and the analytical procedures to be applied and to identify the particular events transactions or assertions to which inquiries may be directed or analytical procedures applied.

The Task Force feels that it would be confusing to have one standard that addresses the two situations as it would be very difficult to appropriately differentiate the two situations in one standard. Further, combining the two situations would not be useful to the majority of the users of extant ISA 910 – smaller practitioners who perform reviews of financial statements of smaller enterprises.

Entity is Required or Permitted Under Legislation to Issue Interim Financial Information

Seven respondents (ICANZ, LSCA, KPMG, MICA, MM, PwC, RR) questioned the criterion that the proposed ISA only applies when “the entity is required or permitted under legislation, regulation or equivalent authority to issue such interim financial information.” It was noted that it is highly unlikely that, in practice, any legislation, regulation or equivalent authority would explicitly prohibit the issuance of interim financial information (LSCA). One respondent did recommend that the criterion be further restricted to situations where the entity is required to issue such information but the remainder of the respondents recommended that either the criterion be deleted or clarified – for example “if a company is required or elects to publish an interim report” (PwC).

Task Force recommendation:

The criterion that the entity is required or permitted to issue the interim financial information should be deleted

Requirement to File the Annual Financial Statements with Regulator

Eight respondents (CNCC, E&Y, ICAI, ICANZ, LSCA, MICA, MM, PwC) questioned the criterion that the proposed ISA only applies when “the audited annual financial statements are required to be filed with a regulatory authority, or equivalent, and are publicly available.”

Two respondents (ICAI & ICANZ) stated that the criterion that the annual financial statements be filed with a regulator is not necessary noting that whether or not the financial statements are publicly available and filed with a regulator is irrelevant to the procedures necessary to achieve the level of assurance provided. These respondents believed the criterion should be deleted.

Two respondents (PwC & LSCA) stated that while it was important that the annual financial statements be publicly available, to allow the users to have the appropriate context for the interim

information, the method of making the information publicly available was not relevant. These respondents recommended removing the reference to the financial statements being filed with a regulator. Conversely, two other respondents (MICA & MM) stated that there was no need for the annual financial statements to be publicly available.

One respondent (E&Y) noted that some jurisdictions provide for a pre-sale of securities to qualified institutional investors prior to the public availability of the annual financial statements. This respondent recommended that the scope of the proposed ISA address this situation.

Task Force recommendations:

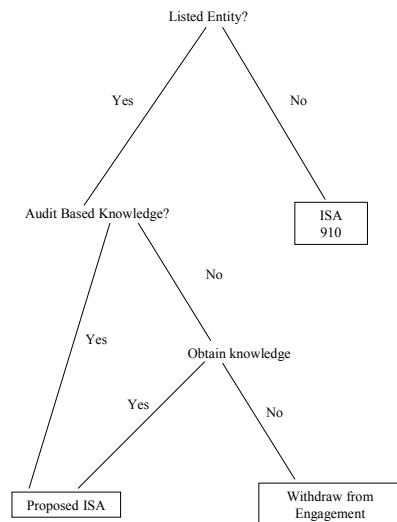
- Retain the requirement that the annual financial statements be publicly available
- Allow for the situation where the review is performed before the annual financial statements are available
- Clarify that reviews of interim financial information issued by a listed entity must be conducted in accordance with the proposed ISA

The Task Force believes that it is critical that the audited annual financial statements of the entity be publicly available. In the majority of cases, interim financial information is comprised of a condensed set of financial statements. Access to the audited annual financial statements is critical to the understanding of the interim financial statements as the annual financial statements contain full disclosures.

Applicability of the Proposed ISA to Only Listed Entities

One respondent (CNCC) noted that it was unclear whether the scope of the proposed ISA was restricted to the review of interim financial information of only listed companies. This respondent noted that the use of the term “or equivalent” is ambiguous and questioned whether this was meant to include, for example, the filing of financial statements with a public authority as required by the First Company Law directive in the European Union, or whether this was meant to cover the different forms of regulatory authorities that govern the various stock exchanges.

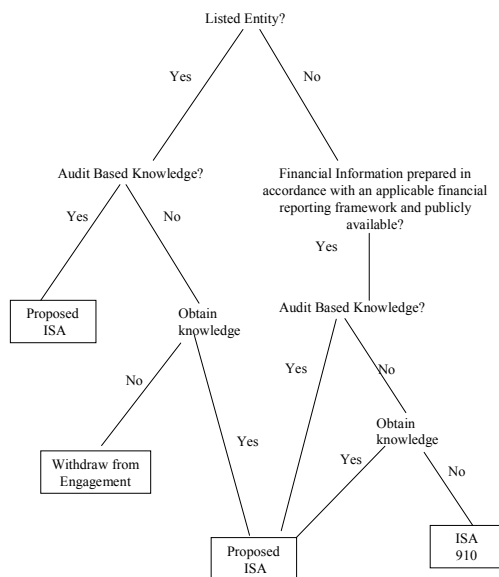
The task force has discussed the following two alternatives to deal with this issue.

Alternative I

The proposed ISA is applicable only to the review of interim financial information conducted by the auditor of a listed entity.

A recently appointed auditor who has not yet obtained audit based knowledge of the entity would be required to obtain such knowledge before performing the review under the proposed ISA.

If the auditor is unable to obtain such knowledge, then the auditor would be required to withdraw from the engagement. Performing a review under ISA 910 is not, in such circumstances, an option.

Alternative II

The proposed ISA is also applicable to the review of interim financial information conducted by the auditor of a non-listed entity, provided the following criteria are met:

- the interim financial information is prepared in accordance with an applicable financial reporting framework; and
- the audited annual financial statements are publicly available.

A recently appointed auditor who has not yet obtained audit based knowledge of the entity would be required to obtain such knowledge before performing the review under the proposed ISA.

If the auditor is unable to obtain such knowledge, then the auditor would be required to apply ISA 910 in such circumstances.

A listed entity is defined in the Code of Ethics as “an entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body”.

Alternative I	Alternative II
<p>1.1. The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on the auditor's professional responsibilities, and on the form and content of the report that the auditor issues, when the auditor undertakes an engagement to review the interim financial information of an audit client <u>that is a listed entity</u>. For purposes of this ISA, interim financial information is financial information that is prepared in accordance with an <u>identified applicable</u> financial reporting framework and contains either a complete or a condensed set of financial statements for a period that is shorter than the entity's financial year. The term "auditor" is used throughout this ISA, not because the auditor is performing an audit function but because the scope of this ISA is limited to a review performed by the auditor of the <u>listed</u> entity</p>	<p>1.1. The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on the auditor's professional responsibilities, and on the form and content of the report that the auditor issues, when the auditor undertakes an engagement to review the interim financial information of an audit client. For purposes of this ISA, interim financial information is financial information that is prepared in accordance with an <u>identified applicable</u> financial reporting framework and contains either a complete or a condensed set of financial statements for a period that is shorter than the entity's financial year. The term "auditor" is used throughout this ISA, not because the auditor is performing an audit function but because the scope of this ISA is limited to a review performed by the auditor of the entity.</p>
<p>2.2. This ISA applies to an engagement performed by an entity's auditor to review interim financial information that is issued by <u>an listed entity</u> entity in accordance with legislation or regulation, or equivalent authority, when all of the following criteria are met:</p> <p>(a) The interim financial information is prepared in accordance with an <u>identified applicable</u> financial reporting framework;</p> <p>(b) The entity is required or permitted under legislation, regulation, or equivalent authority to issue such interim financial information; and</p> <p>(be) The audited annual financial statements of the listed entity <u>are required to be filed with a regulatory authority, or equivalent, and are publicly available or will be within a specified period of time.</u></p>	<p>2.2. This ISA applies to an engagement performed by an entity's auditor to review interim financial information that is issued by <u>an listed entity</u> entity in accordance with legislation or regulation, or equivalent authority, when all of the following criteria are met:</p> <p>(a) The interim financial information is prepared in accordance with an <u>identified applicable</u> financial reporting framework;</p> <p>(b) The entity is required or permitted under legislation, regulation, or equivalent authority to issue such interim financial information; and</p> <p>(be) The audited annual financial statements of the entity <u>are required to be filed with a regulatory authority, or equivalent, and are publicly available or will be within a specified period of time.</u></p>
<p>4.</p>	<p>4.3. The auditor of an entity that is not a listed entity may perform a review in accordance with this ISA when all of the criteria in paragraph 2 are</p>

Alternative I	Alternative II
	<u>met.</u>
<p>4.3.In some jurisdictions, legislation or regulation, or equivalent authority may require that a review of the interim financial information of the <u>listed</u> entity be performed by its auditor. In other jurisdictions, there may be no such review requirement, but those charged with governance may request that the auditor perform a review of the interim financial information.</p>	<p>4.4.In some jurisdictions, legislation or regulation, or equivalent authority may require that a review of the interim financial information of the <u>listed</u> entity be performed by its auditor. In other jurisdictions, there may be no such review requirement, but those charged with governance may request that the auditor perform a review of the interim financial information.</p>
<p>4.4.A review performed in accordance with this ISA may only performed by a practitioner who is the auditor of the <u>listed</u> entity. This differs from a review performed in accordance with ISA 910 “Engagements to Review Financial Statements” which may be performed by a practitioner who is not the auditor of the entity. Through performing the audit of the annual financial statements, the entity’s auditor has obtained an understanding of the entity and its environment, including its internal control. This understanding, which is updated through inquiries made in the course of the review of the interim financial information, assists the auditor to focus the inquiries to be made and the analytical procedures to be applied. A practitioner who has recently been appointed auditor of the entity obtains the understanding of the entity and its environment, including its internal control before performing a review of interim financial information in accordance with this ISA.</p> <p>3.</p>	<p>4.5.A review performed in accordance with this ISA may only performed by a practitioner who is the auditor of the entity. This differs from a review performed in accordance with ISA 910 “Engagements to Review Financial Statements” which may be performed by a practitioner who is not the auditor of the entity. Through performing the audit of the annual financial statements, the entity’s auditor has obtained an understanding of the entity and its environment, including its internal control. This understanding, which is updated through inquiries made in the course of the review of the interim financial information, assists the auditor to focus the inquiries to be made and the analytical procedures to be applied. A practitioner who has recently been appointed auditor of the entity obtains the understanding of the entity and its environment, including its internal control before performing a review of interim financial information in accordance with this ISA.</p> <p>3.</p>

Task Force recommendation

Alternative II should be adopted for the proposed ISA

The Task Force is of the view that the auditors of non-listed entities should not be precluded from using the proposed ISA as long as the criteria in paragraph 2 above are met.

ISSUE 2: “AUDIT BASED KNOWLEDGE”

Paragraph 13 of the ED states:

“The auditor should have a sufficient understanding of the entity and its environment, including its internal control, as it relates to the preparation of both annual and interim financial information, to plan and conduct the engagement so as to be able to:

- (a) Identify the types of potential material misstatement and consider the likelihood of their occurrence
- (b) Select the inquiries and analytical procedures that will provide the auditor with a basis for reporting whether the auditor is aware of any material modification that should be made to the financial information for it to conform with the identified financial reporting framework.”

This language was modeled on the US standard and while it is similar to the audit risk model it is not consistent with it. The Task Force believes that the level of understanding required to perform a review under the proposed ISA is the same as the level of understanding required by ISA 315. Accordingly, the Task Force recommends that paragraph 13 be changed to be consistent with ISA 315. It would read:

“The auditor should have an understanding of the entity and its environment, including its internal control, sufficient to:

- (a) Identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, and
- (b) Select the inquiries and analytical procedures that will provide the auditor with a basis for reporting whether the auditor is aware of any material modification that should be made to the financial information for it to conform with the applicable financial reporting framework.”

Task Force Recommendation:

The proposed ISA should require the same level of understanding of the entity as that required to perform an audit.

It should be noted that this proposed change will require a newly appointed auditor to obtain “audit based knowledge” before performing a review of interim information. The Task Force carefully considered this matter. The Task Force concluded that it is not possible to articulate a level of understanding that is less than that required to perform an audit.

ISSUE 3: REPORTING

The ED provided that different conclusions would be expressed depending on whether condensed or complete financial statements were prepared by the entity.

If the interim financial information is comprised of a condensed set of financial statements the report would be expressed in terms of whether the auditor is aware of any modification that

should be made to the information for it to be in accordance with the identified financial reporting framework.

If the information is comprised of a complete set of financial statements the report contains a statement about whether the auditor is aware of any material modification that should be made to information for it to give a true and fair view (or be presented fairly in all material respects) in accordance with the applicable financial reporting framework.

Four respondents (NIVRA, PwC, ICANZ and LSCA) agreed that the conclusion expressed should differ depending on whether a complete or condensed set of financial statements was issued. The following arguments to support this point were noted:

- “True and fair” opinions should be restricted to circumstances when financial statements fully comply with all of the requirements and disclosures of a financial reporting framework;
- As proposed in the Assurance Framework, the level of assurance influences whether the conclusion is expressed in positive or negative form but the words to express the conclusion should logically vary depending on the subject and the criteria.

Five respondents (GT, KPMG, CICA, JICPA & APB) disagreed with differing conclusions. The following arguments to support this point were noted:

- The objective of the review is the same irrespective of whether the information is a condensed or complete set of financial statements and both conclusions are intended to convey the same level of assurance – two differing conclusions may cause confusion as to the objective of the procedures performed and the level of assurance conveyed;
- The terms “true and fair” or “presents fairly” should not be used because of the limited nature of the review procedures performed and the greater use by management of estimation procedures;
- The terms “true and fair” or “presents fairly” are generally understood as wording for an audit report – use of the terms in a review engagement might confuse users.

One respondent (IDW) stated that the use of “true and fair” or “presents fairly” should be dependent upon the requirements of the identified financial reporting framework and not dependent upon whether the interim set of financial statements are complete or condensed.

Task Force Recommendation:

The conclusion for a review of a complete or a condensed set of financial statements should be the same and should be expressed as follows:

“Based on our review, we are not aware of any material modification that needs to be made to the accompanying interim financial information for it to be in accordance with [applicable financial reporting framework (identified country of origin of the financial reporting framework when the framework used is not International Financial Reporting Standards)].”

The Task Force agrees with the views expressed that the use of two different conclusions can be confusing and that the conclusion should not be expressed in terms of “true and fair”. The Task

Force recognizes that in some jurisdictions (e.g. Australia) regulatory requirements may require that the conclusion be expressed in terms of “true and fair” or “fairly presents” and proposes to address this matter in a footnote.

ISSUE 4: INABILITY TO COMPLETE A REVIEW

The ED states that an incomplete review is not an adequate basis for issuing a review report. In circumstances when an auditor is unable to complete the review, the auditor should communicate that information to the appropriate level of management and to those charged with governance.

Three respondents (KPMG, PwC and AICPA) expressed support for prohibiting a scope limitation in the review report in situations where the auditor is unable to complete the review. One respondent (KPMG) noted that because of the auditor’s ongoing involvement with the entity, a scope limitation might have broader implications for the audit of the annual financial statements. Therefore such reporting should be prohibited.

Two respondents (IDW and FEE) expressed the view that the auditor should not be precluded from issuing a scope limitation. It was noted that both audit, ISA 910 and proposed ISAE 2000 provide for a scope limitation.

Task Force Recommendation:

Retain the position that an incomplete review is not an adequate basis to report

The Task Force believes that the position taken in the ED is appropriate. In the context of interim financial information, the Task Force believes that it would be inappropriate to allow reporting when the review is incomplete (“ Except for the fact that I have not done any work in this area, nothing has come to my attention...”)

The Task Force recognizes that this is not consistent with proposed ISAE 2000 or ISA 910. ISAE 2000 is an umbrella standard and as such, more detailed or restrictive guidance will be provided in specific subject matter standards. The Task Force believes that the position taken in ISA 910 is not conceptually sound and should be reconsidered when ISA 910 is updated.

ISSUE 5: ISA 910

Seven respondents (FAR, ACCA, APB, PwC, NIVRA, CNCC & KPMG) stated that ISA 910 be amended and restructured to be consistent with the proposed new standard.

Task Force recommendation:

When the proposed ISA is issued the IAASB should indicate its intention to update ISA 910.

The Task Force agrees that this is necessary and believes that the priority for updating ISA 910 should be considered.

Action Requested

IAASB is asked to review the issues presented and the recommendations of the Task Force in order to reach agreement on the resolution of these issues.

Appendix 1

Exposure Draft “Interim Financial Performed by the Auditor of the Entity ”

RESPONDENT SUMMARY

Member Bodies

1	Association of Chartered Certified Accountants	ACCA
2	American Institute of Certified Public Accountants	AICPA
3	Auditing Practices Board	APB
4	Australian Auditing and Assurance Standards Board	AuASB
5	Institute of Chartered Accountants in Ireland	ICAI
6	Canadian Institute of Chartered Accountants	CICA
7	Compagnie Nationale des Commissaires aux Comptes and the Conseil Supérieur de l'Ordre des Experts-Comptables (CNCC)	CNCC
8	FAR	FAR
9	Fédération des Experts Comptables Européens – European Federation of Accountants (FEE)	FEE
10	Foreningen af Statsautoriserede Revisorer	FSR
11	Institut Der Wirtschaftsprüfer	IDW
12	Institute of CA of New Zealand	ICANZ
13	Institute of Chartered Accountants of India	ICAI
14	Institute of Chartered Accountants of Pakistan	ICAP
15	Institute of Internal Auditors	IIA
16	Institut des Réviseurs d'Entreprises	IRE
17	The Japanese Institute of Certified Public Accountants	JICPA
18	London Society of Chartered Accountants	LSCA
19	Malaysian Institute of Chartered Accountants	MICA
20	Nederlands Instituut van RegisterAccountants	NIVRA
21	NY Society of CPAs	NYSCPA
22	South African Institute of Chartered Accountants	SAICA

Firms

23	Deloitte Touche Tohmatsu	D&T
24	Ernst & Young	E&Y
25	Grant Thornton	GT
26	KPMG	KPMG
27	PricewaterhouseCoopers	PwC

Others

28	Richard Regal	RR
29	Muddassar Mehmood	MM