

## Engagements to Review Historical Financial Statements— Issues and IAASB Task Force Proposals

**[Note to Readers: This Issues Paper contains cross-references to the relevant sections of the draft Standard presented in Agenda Item 7-D, where the issues discussed in this Paper arise in relation to the text of the draft ISRE.]**

**A. Scope of the Draft ISRE<sup>1</sup> [*Agenda Item 7-D, paragraphs 1-3*]**

1. The Task Force has developed the draft standard on review engagements, ISRE 2400<sup>2</sup> (see Agenda Item 7-D), addressing review of historical financial statements. The draft revised standard is constructed on the premise that the IESBA *Code of Ethics for Professional Accountants* (IESBA Code), or relevant ethical requirements of national standards that are at least as restrictive, and ISQC 1,<sup>3</sup> define the responsibilities of the practitioner, and the practitioner's firm, in such engagements together with the draft revised ISRE.
2. The draft ISRE is to be applied, adapted as necessary, to engagements to review other historical financial information. Limited assurance engagements performed on information other than historical financial information are preformed under ISAE 3000.<sup>4</sup>

*Presentation of the Draft Standard under the “Clarity” Drafting Conventions*

3. The Task Force has drafted the ISRE using the drafting conventions adopted for the clarified International Standards on Auditing (ISAs).
4. The Task Force was directed by the Board in June 2009 to draft the ISRE on a “stand-alone” basis, without reference to the ISAs, which address the audit of historical financial statements in the context of a suite of individual standards.
5. Reflecting the different nature of the review of historical financial statements, and specifically that it is a limited assurance engagement,<sup>5</sup> the Task Force's aim has been to draft the ISRE with a statement of the practitioner's objectives for the review, and setting out the key requirements to achieve those objectives when performing the review together with related introductory material, definitions and application and explanatory guidance as needed. In short, the draft standard represents a complete, self-standing assurance standard.
6. As a consequence, the draft standard is a significantly longer and more detailed standard than the extant ISRE.

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<sup>1</sup> International Standard on Review Engagements (ISRE).

<sup>2</sup> International Standard on Review Engagements (ISRE) 2400, “Engagements to Review Historical Financial Statements.”

<sup>3</sup> International Standard on Quality Control (ISQC) 1, “Quality Control for Firms That Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements.”

<sup>4</sup> International Standard on Assurance Engagements (ISAE) 3000, “Assurance Engagements Other Than Audits or Reviews of Historical Financial Information.”

<sup>5</sup> International Framework for Assurance Engagements, paragraph 11

**B. Scalability of the Draft ISRE**

7. The Task Force is mindful of the wider objectives that motivated the project to revise this ISRE, as described in the project proposal (March 2009) and the initial issues paper (June 2009). Those objectives included development of assurance (review) standards that can be used by practitioners to address financial reporting assurance needs of smaller entities. The Task Force has come to understand that reviews are currently and frequently performed for larger entities that have well-developed accounting systems and internal controls related to the preparation of financial information, including financial statements.
8. The draft revised standard has therefore been developed with the intent of being scalable to reviews of historical financial statements for entities of all sizes. This aim has influenced the drafting of the requirements as follows:
  - (a) The Task Force has drafted the standard primarily from the perspective of practitioners engaged to review financial statements of smaller entities. For example, there is limited reference to formal systems of internal control over financial reporting in the draft revised standard.
  - (b) The requirements are not as detailed as the ISA requirements. Requirements for practitioners are stated as principles rather than as a series of mandated procedures. This allows scope for practitioners to apply professional judgment and knowledge and understanding of the entity and its environment when performing the review. The requirements are supplemented by more comprehensive application guidance that explains how they may be fulfilled in different engagement circumstances.

**C. Nature of the Review as a Limited Assurance Engagement, the Statement of the Practitioner’s Objectives and the Form of the Practitioner’s Conclusion**

*Nature of a Review of Financial Statements*

**[Agenda Item 7-D, paragraphs 4; 12-13; 53-53; A2-A5]**

9. The Task Force has developed the draft standard as a form of limited assurance engagement with the overall purpose of an assurance engagement in mind. The practitioner’s conclusion expressed on the financial statements is intended to enhance users’ degree of confidence in the financial statements in the context of the applicable financial reporting framework.<sup>6</sup>
10. In a limited assurance engagement, the practitioner obtains assurance about the financial statements in a range that is between the “reasonable assurance” obtained in an audit and a level of assurance that is significantly lower than reasonable assurance, but that is still sufficient to be able to express a conclusion on a meaningful basis. In line with the *International Framework for Assurance Engagements* (International Framework), the “meaningful basis” for expressing the practitioner’s conclusion is the conceptual description of the lower threshold for expression of a conclusion on the financial

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<sup>6</sup> International Framework for Assurance Engagements, paragraph 7

statements<sup>7</sup>. If the practitioner does not reach that threshold the practitioner will not have a reasonable basis for expressing a conclusion on the financial statements.

11. The assurance obtained in a review will vary according to the review evidence obtained from the practitioner's work effort, which is in turn determined by the practitioner having regard to the engagement circumstances of individual engagements. As the level of limited assurance will vary and cannot be expressed as a static value, the Task Force believes it is not practicable to define limited assurance in the draft standard.
12. The interaction between the proposed statement of the practitioner's objectives and the definition of "review evidence" is pivotal in the standard. The Task Force has followed the direction provided by the Board at the September 2009 meeting, i.e. that the optimal approach is to describe "limited assurance" as the outcome achieved from following a "procedures-based" approach rather than attempting to define what the term means. Accordingly, limited assurance is achieved as the *outcome* of obtaining sufficient appropriate review evidence to be able to express a conclusion on the financial statements. The review evidence is obtained by performing review procedures (as defined) and any other additional procedures the practitioner considers are necessary for the review. The practitioner's evaluation of the results obtained from the procedures performed, in the context of the practitioner's knowledge and understanding of the entity and its environment and of the applicable financial reporting framework, provides the evidential basis for expression of the practitioner's conclusion.
13. The terms *review procedures* and *review evidence* are defined in the draft ISRE as follows:  
**[Agenda Item 7-D, paragraph 15(c) and (d)]**
  - *Review procedures*—primarily inquiries of management or those charged with governance, as appropriate, and others within the entity involved in financial and accounting matters, and analytical procedures performed by the practitioner.
  - *Review evidence*—the information used by the practitioner as the basis for forming the practitioner's conclusion on the financial statements.
14. In relation to the definition of review evidence, application guidance explains that "information used by the practitioner" is information obtained from evaluation of the results of procedures the practitioner performs in the context of the practitioner's knowledge and understanding of the entity and its environment, and of the applicable financial reporting framework (see discussion at paragraph 37). Consequently, review evidence includes both review procedures and other information obtained by the practitioner (including that obtained from other procedures) in the course of the engagement.

#### Describing the Basis for the Practitioner's Conclusion—the "Meaningful Basis" for the Conclusion

15. In the extant standard, the basis for the practitioner's conclusion is conveyed in the wording used by the practitioner to the effect that "nothing has come to our attention that

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<sup>7</sup> International Framework for Assurance Engagements, paragraph 48

causes us to believe that the accompanying financial statements are not prepared in all material respects ...” (i.e. a negatively-worded form of expression that contains a “double-negative”).

16. The Task Force is understanding of the advice provided by some IAASB Consultative Advisory Group (CAG) representatives at their March 2010 meeting that, to be accepted by both users and practitioners, the description of the review engagement should positively state what the review engagement is, and what is achieved in the engagement, rather than state what the engagement is not. The Task Force is also mindful of the Board’s overall view at the September 2009 and March 2010 meetings that a negative form of expression of the basis for the practitioner’s conclusion, and of the conclusion itself, most effectively expresses the limited assurance nature of the review engagement.
17. In line with the Task Force’s view, that the outcome of following the approach described in draft standard is that the practitioner obtains limited assurance on the financial statements as the basis for expressing the practitioner’s conclusion, the Task Force has considered how this outcome can best be expressed in a positive manner.
18. In addition, preliminary comments from some NSS participants in the IAASB-NSS liaison group suggest that it might be appropriate to provide an indication of a target range or level of limited assurance for a review of financial statements in the standard. These NSS participants argued that this would encourage greater consistency in performance of reviews (i.e. achieve a consistent target level of assurance). In the extant standard, the “meaningful basis” of the practitioner’s conclusion is implicit in the wording used, as set out in paragraph 15 above. Having explored this thought previously, the Task Force recognizes that if there were to be specification of any target level of assurance, it would need to be very clear to be well understood, and be capable of being applied in a diverse range of engagements.
19. As explained in paragraphs 12–13 above, the Task Force believes that consistency of performance can best be achieved through requirements that focus on performance of review procedures directed towards achieving limited assurance as the *outcome* of the review engagement. The practitioner is required to comply with the requirements of the ISRE for performing the review, apply professional judgment throughout, to obtain sufficient, appropriate review evidence as the basis for expressing a conclusion *on a meaningful basis*.
20. The Task Force’s view is that the words used to describe the “meaningful basis” for the practitioner’s conclusion do not represent or indicate a specific “target level of assurance” in performing the review; rather it represents a principles-based threshold that the practitioner must be satisfied has been reached when performing a review.
21. Throughout the draft ISRE, the Task Force has used the words “appears credible” to articulate this aspect of the review engagement, particularly in the expression of the practitioner’s objectives (see discussion in paragraph 29) and in the expression of the practitioner’s conclusion (see discussion in paragraph 32). For example, when forming a conclusion on the financial statements the practitioner considers whether, on the basis of the review evidence obtained, it “appears credible” (or using a similar term or phrase) that

the financial statements are prepared in accordance with the applicable financial reporting framework.

22. The Task Force is not especially committed to using the term “appears credible” in the draft ISRE, and has been seeking stakeholder views about whether its use in the draft ISRE is acceptable (the phrase was suggested in the context of the March 2010 IAASB CAG discussion of this project, as a possible alternative to other phrases that the Task Force considered in earlier stages of the project, such as “worthy of belief” or “plausible” to name some examples).
23. The Task Force has sought feedback from its correspondent members and from the NSS on the use of “appears credible” to describe the meaningful basis for the practitioner’s conclusion. Overwhelmingly the NSS’s reaction is that the phrase “appears credible” should not be used unless its meaning can be defined otherwise it would likely cause confusion, and may even raise users’ expectations about what is achieved in the review relative to what it actually delivers.
24. The Task Force is open to alternative suggestions for appropriate wording. While it is important to identify the right words for the ISRE, the Task Force believes that what is most important at the conceptual level, in drafting the ISRE, is that the words selected properly express or describe the idea that the work effort applied by the practitioner in the review provides a meaningful basis for the practitioner’s conclusion. The selected phrase or words should preferably be able to be expressed in a “plain-language” manner, and be capable of being translated into languages other than English.
25. In the absence of other options for wording that is perhaps better or clearer, the NSS have expressed a clear preference for the current “negatively-worded” characterization of the outcome of the review, i.e. the practitioner concludes whether *anything has come to the practitioner’s attention that leads the practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework*. This form of wording aligns with the International Framework. Notwithstanding the challenges that this form of wording poses, many countries have existing national review standards that require the negative form of the practitioner’s conclusion. This form of wording has also achieved certain market acceptance in countries where reviews are commonly performed. The IAASB has expressed support for continued use of this form of the conclusion in its discussion of the matter to date.
26. In listening to stakeholder views expressed to date, it is clear that the various terms suggested for expression of the practitioner’s objectives and the conclusion all have some supporters and some detractors; the Task Force can discern no consensus view. Suggested possible alternative positive descriptions of the practitioner’s objective in a review which appear to warrant further consideration are:

To obtain sufficient appropriate review evidence to enable the practitioner to...

...Express a conclusion on whether the amounts and disclosures in the financial statements are consistent with the practitioner’s knowledge and understanding of the entity and its environment, and the practitioner’s understanding of the applicable financial reporting framework used to prepare the financial statements.

Or,

... Express a conclusion on whether any material amendments are needed for the financial statements to be presented, in all material respects, in accordance with the applicable financial reporting framework.

27. The Task Force seeks the Board’s reaction to this debate. Given that the words used to articulate the meaningful basis for the practitioner’s conclusion in the draft ISRE would appear to be a critical issue in developing wider understanding and acceptance of reviews of financial statements – especially in those countries where use of reviews is being considered for the first time – the Task Force believes there is merit in obtaining wider views on this. Accordingly the term “appears credible” used by the Task Force should be viewed as a type of “placeholder” for words that are yet to be identified and that would reflect consensus among IAASB stakeholders.

#### **Matters for IAASB’s Consideration**

The IAASB is asked:

- Whether it agrees with the description of the engagement to review financial statements in paragraphs 9–14 above.
- For its views on how best to convey the idea that the practitioner has achieved a “meaningful basis” for expressing the conclusion. Does the Board believe that this is best achieved:
  - in an implicit way, using the negatively-worded description of the basis of the conclusion (nothing has come to our attention), as is the case in the extant standard?
  - in an explicit way, using positive language to describe the meaningful basis achieved (e.g. using “appears credible” or similar language). If so, what is the best wording to use?
- For its views on how best to proceed regarding the draft ISRE. Which of the two “versions” should be used in the Exposure Draft? Is it better to show both possibilities, as is done in Agenda Item 7-D, to illustrate the effects for readers either way?

28. The discussion of the nature of the review engagement above influences the way the draft revised ISRE describes the practitioner’s objectives and the form of the practitioner’s conclusion.

#### *Form of Expression of the Practitioner’s Objectives in a Review of Financial Statements* **[Agenda Item 7-D, paragraphs 12-13]**

29. In view of the above discussion, the Task Force would like to obtain the Board’s reaction to the following alternative statements of the practitioner’s objectives for a review in the draft ISRE, shown in the wording labeled as [A.] and [B.] below:

In conducting a review of financial statements, the practitioner’s objectives are to

- (a) Obtain sufficient, appropriate review evidence to enable the practitioner to express a conclusion on whether [A.] Anything has come to the practitioner’s attention that causes the practitioner to believe the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework

[OR, B. It appears credible that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework;]

and to

- (b) Report the practitioner's conclusion on the financial statements in accordance with the practitioner's findings.

- 30. In drafting the ISRE, the Task Force has taken the step of showing how a possible positive expression of the nature of a review engagement and the objective (using the term “appears credible” for that purpose) can be articulated in the draft ISRE. The Task Force welcomes the Board's views about whether or not, on a “trial” basis, this approach is feasible in view of the nature of the review engagement and its associated limitations.
- 31. As is noted in paragraph 22, the Task Force appreciates that form [B] is but one possible form of a positively expressed of the objective in a review.

*Form of Expression of the Practitioner's Conclusion in a Review of Financial Statements*  
**[Agenda Item 7-D, paragraphs 54-60 and Appendix 2]**

- 32. The form of the statement of the practitioner's objectives must be tied to the form of the expression of the practitioner's conclusion. Taking the same approach of using alternative possible forms of the practitioner's conclusion in the draft standard, the Task Force would like the Board's view on whether either of the following alternative forms of expression of the practitioner's unmodified conclusion is preferable:

The practitioner shall express an unmodified conclusion in the practitioner's report on the financial statements when the practitioner concludes, based on the review obtained, that [A.] nothing has come to the practitioner's attention that causes the practitioner to believe:

- (a) If the financial statements are prepared using a compliance framework, that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework.
- (b) If the financial statements are prepared using a fair presentation framework that the financial statements are not fairly presented in all material respects, in accordance with the applicable financial reporting framework, or do not give a true and fair view of the matters to which those financial statements relate.

[Or B. ...based on the review, *it appears credible*:

- (a) If the financial statements are prepared using a compliance framework, that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
- (b) If the financial statements are prepared using a fair presentation framework, that the financial statements are fairly presented in all material respects, in accordance with the applicable financial reporting framework, or give a true and fair view of the matters to which those financial statements relate.]

Again, as explained in paragraph 22, the Task Force appreciates that alternative [B.] is but one possible form of a positively-expressed review conclusion.

- 33. Despite the apparent preference to retain the current negatively-worded expression of the conclusion, i.e. the form that appears in [A.] above, the Task Force understands the reservations that some stakeholders have expressed about the communicative effectiveness of

that form of wording. The “double-negative” that characterizes the negatively-expressed wording also poses a significant translation challenge.

*Combining a Positive Description of the Nature of a Review Engagement with a Negative Expression of the Practitioner’s Conclusion*

34. The Task Force understands the benefits of being able to positively describe the nature of a review engagement. The Task Force also appreciates the critical importance of there being clear differentiation between a limited assurance engagements and reasonable assurance engagements performed on financial statements. A satisfactory solution might lie in the combination of a clear, positive expression of what the review engagement is, and use of the generally preferred negatively-worded conclusion.
35. To address user perspectives, the Task Force has developed the draft ISRE by including a positive statement of what the review engagement is, as follows:

- (a) In the introductory section of the draft ISRE (paragraph 3), see alternative [B.] below:

*The Nature of the Review of Financial statements*

A review of financial statements is a limited assurance engagement undertaken for the purpose of expressing a conclusion on the financial statements of an entity that is designed to enhance users’ confidence in the financial statements regarding their preparation in accordance with an applicable financial reporting framework. This purpose is achieved in the context of a limited assurance engagement<sup>8</sup> where the evidence the practitioner obtains as the basis for the conclusion enables expression of the practitioner’s conclusion on the financial statements in the engagement report in terms of whether [A.] 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 [or B. it appears credible that the financial statements of the entity are prepared, in all material respects, in accordance with the applicable financial reporting framework].

- (b) In the description of the review engagement in the draft practitioner’s report (paragraph 71, and illustrative review reports) in the draft ISRE, see alternative [B.] below.

A review of financial statements consists primarily of making inquiries, mainly of management and others within the entity involved in financial and accounting matters, and applying analytical procedures in relation to the financial statements. These procedures are performed to enable us to conclude whether [A.] anything has come to our attention that causes us to believe that the financial statements are not presented fairly, in all material respects, in accordance with International Financial Reporting Standards.

[OR, B. A review of financial statements consists primarily of making inquiries, mainly of management and others within the entity involved in financial and accounting matters, and applying analytical procedures in relation to the financial statements. These procedures are performed to enable us to conclude whether it appears credible that the financial statements are presented fairly, in all material respects, in accordance with International Financial Reporting Standards.]

36. To be consistent the Task Force has developed the alternative positive wording shown in the alternative labeled [B.] in paragraph 35(a) also using the phrase “appears credible”. As explained in paragraph 22 however, the Task Force appreciates that, while there is no clear

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<sup>8</sup> International Framework for Assurance Engagements, paragraph 11



consensus, there may be other possible forms of expression that warrant consideration. If in the Board's view the drawbacks of using this form of wording in the draft standard are overwhelming, but the Board considers that use of positive wording is workable if an appropriate "expression" can be identified, the Task Force will continue trying to identify what those alternatives might be.

#### **Matters for IAASB's Consideration**

The IAASB is asked:

- Whether it supports the statement of the practitioner's objectives set out in paragraph 29 in the form labeled [A.], or [B.].
- Whether it supports the form of expression of the practitioner's unmodified conclusion in a review of historical financial statements set out in paragraph 32 in the form labeled [A.], or [B.].
- For its views on whether the use of a positively expressed description of the review engagement, combined with a negative form of the practitioner's conclusion for the review, is a feasible way of addressing user perceptions concerning the review of historical financial statements, and what it represents as a limited assurance engagement (paragraphs 34-36 above)?

#### **D. The Approach to Performing a Review of Financial Statements**

##### *Level of the Practitioner's Knowledge and Understanding [Agenda Item 7-D, paragraph 30]*

37. The draft standard recognizes that the practitioner needs knowledge and understanding of the entity and its environment, and an understanding of the applicable financial reporting framework, sufficient to design appropriate review procedures and obtain the review evidence the practitioner will use to form the conclusion. The extent of the knowledge and understanding that is required, and how it is obtained, has been strongly debated by the Task Force, specifically with reference to the practitioner's ethical obligation to perform the engagement with professional competence and due care.
38. The Task Force's explicit intention is that the required knowledge will differ depending on the type of entity and its business, and on the degree of complexity of the applicable financial reporting framework. The Task Force strongly believes that this area needs to be scalable for different types of engagements, and the IAASB supported this approach at the September 2009 meeting.
39. A strong consensus view emerged in the earlier stages of the project that a key distinguishing factor between audits and reviews is that the review lacks the formal comprehensive risk assessment required to perform an audit. This does not mean the practitioner does not take into account the risk of material misstatements occurring in the financial statements. Rather, the review procedures are performed with an awareness of the risk of material misstatement. Under this approach, the types of procedures performed for the review are selected and executed on the basis of the practitioner's knowledge and understanding of the entity and its environment, and understanding of how the applicable financial framework is applied in the entity's industry.

40. Accordingly the practitioner focuses review procedures on the areas where, based on the practitioner’s knowledge and understanding, it is likely that risk of material misstatement exists. The level of the practitioner’s knowledge and understanding should therefore be sufficient to enable the practitioner to identify key areas where risk of material misstatement is likely to exist in the financial statements. The draft Standard does not follow a detailed or specific approach to the specification of relevant requirements, but leaves the question of the nature and extent of the “knowledge and understanding” that is appropriate to be decided by the practitioner applying professional judgment.

**Matters for IAASB’s Consideration**

The IAASB is asked:

- Whether it agrees with the way the Task Force has drafted the requirements concerning the required level of the practitioner’s knowledge and understanding of the entity and its environment, and the practitioner’s understanding of the applicable financial reporting framework.

*Specificity of Requirements Concerning Performance of Review Procedures*  
**[Agenda Item 7-D, paragraphs 13; 31 – 32; 45; A6-A7; A23; A70-87]**

41. The proposed definition of the term “review procedures” (see paragraph 13 above) describes review procedures as primarily inquiry and analytical procedures, but does not limit them only to those types of procedures. By defining review procedures in broader terms – the draft standard explains that review procedures are performed in context of achieving sufficient appropriate review evidence, supplemented by other procedures as required in the ISRE or as necessary in the practitioner’s judgment – under the draft standard the practitioner should consider what procedures are necessary in the circumstances of each engagement, with inquiry and analytical review being the primary procedures but not necessarily the only one used.
42. The Task Force believes that using a high-level, principles-based approach that establishes a framework for the practitioner’s decision-making about how to obtain sufficient, appropriate evidence most efficiently and effectively in the review, is preferable to specifying actual types of procedures to be performed for every engagement.
43. The draft revised standard specifies relatively few “minimum” procedures and avoids preempting the practitioner’s ability to apply professional judgment to reach the appropriate evidential basis in individual engagement circumstances. While this approach may be viewed as holding a significant challenge for practitioners, the Task Force believes it is preferable to the alternative of specifying numerous detailed procedures. Specifying detailed procedures could result in practitioners mistakenly believing that a single set of procedures will always achieve the objective of a review. Application material discusses the application of inquiry and analytical procedures and explains how the practitioner should evaluate the results of those procedures, and, where necessary, assess the need to extend procedures, or perform other types of procedures. Furthermore, the wide range of circumstances and different kinds of financial statements encountered by practitioners in practice means that the approach of prescribing procedures is not practicable as the procedures may not be relevant for many review engagements. Also, prescribing procedures that are not likely to be required on all, or most,

review engagements, would contradict the “think small first” objective of the standard.

44. The Task Force believes the approach described above will accomplish the aim of establishing a “baseline” evidential basis for obtaining limited assurance in the context of a review of financial statements and leave scope for the evidential basis to be tailored to the level that the practitioner considers appropriate for each engagement. The practitioner’s professional judgment and professional skepticism influence the practitioner’s development of review evidence. Consultation with NSS and other stakeholders prior to the project commencement clearly indicated this as the preferred approach.
45. The draft revised standard also makes it clear also that performance of procedures other than inquiry and analytical review does not turn a review into an audit. It expressly recognizes that the practitioner may need to perform other, additional procedures to obtain the evidential basis needed to express a meaningful conclusion on the financial statements.
46. Preliminary comments from the NSS show a fairly good level of consensus that this approach is workable provided the standard also includes illustrative examples of procedures applied in a review. The Task Force believes that provision of examples is important to promote understanding about the interaction between review procedures and review evidence. The extant standard accomplishes this to some extent by providing examples of procedures in a separate Appendix. The Task Force has considering whether such an Appendix might be needed in the draft standard. On a preliminary basis, it thinks it might be beneficial for practitioners but still has this under consideration.

#### **Matters for IAASB’s Consideration**

The IAASB is asked:

- Whether it supports the Task Force’s approach to describing how the practitioner performs review procedures as described above.
- Whether the Task Force should provide further application material concerning performance of review procedures to assist practitioners in performing reviews?

#### *Obtaining Sufficient Appropriate Evidence to Support Expression of the Practitioner’s Conclusion*

##### **Modified Conclusions [Agenda Item 7-D, paragraphs 55-60]**

47. The Task Force has focused on a number of questions relevant to modified conclusions:
  - (a) If the practitioner intends to modify the conclusion due to departures from the applicable financial reporting framework, what level of evidence is required to do that, bearing in mind the overall limited assurance nature of the engagement?
  - (b) In the case of scope limitations, in what circumstances is it appropriate to qualify the conclusion as opposed to disclaiming a conclusion?

Conclusions Modified in Respect of Material Misstatements in the Financial Statements  
**[Agenda Item 7-D, paragraphs 52-60]**

48. The Task Force’s view regarding 47(a) is that the practitioner’s conclusion is expressed on the financial statements as a whole. The practitioner therefore obtains sufficient appropriate evidence about the financial statements as a whole. If there are particular items that give the practitioner cause to qualify the conclusion, there are two views about what the practitioner should do to be able to express a conclusion:

- (a) Obtain sufficient appropriate evidence to be able to conclude that those items are misstated;
- (b) Obtain sufficient appropriate evidence to be able to conclude that regarding those particular items, “something has come to the practitioner’s attention that causes the practitioner to believe that the financial statements are materially misstated.”

The modified conclusion “Except for the matter(s) described in the Basis for Modified Conclusion paragraph, nothing has come to our attention that causes us to believe that ...” is valid for the approach under either 48(a) or 48(b) above.

49. The Task Force had previously asked for the Board’s views on the issue described in paragraph 48, and the Board’s previous discussions appeared to reflect support for the view in 48(a).
50. The Task Force recognizes that in some countries where reviews are performed, national standards implicitly follow the approach in 48(b). In view of that, if the draft revised ISRE requires the approach in 48(a) this would pose a significant change to current practice for performance of reviews. In considering the implications of the approach in 48(a) for the work effort undertaken where a modified conclusion is to be given, the Task Force notes that in some cases it will be relatively straightforward to conclude that an item is materially misstated, whereas in other cases significant work effort might be required to conclude about the existence of a material misstatement and its effects on the financial statements as a whole.
51. The Task Force has also considered how this issue is addressed in ISRE 2410,<sup>9</sup> but notes that ISRE 2410 does not explicitly address the question – it states the following in paragraph 22:

If the practitioner has reason to believe that the information subject to review may be materially misstated, the practitioner should carry out additional or more extensive procedures as are necessary to be able to express negative assurance or to confirm that a modified report is required.

Use of the word “confirm” would appear to imply that the practitioner is required to confirm that the items that are the subject of the modification of the practitioner’s conclusion are materially misstated, which seems to be more in line with the view in paragraph 48(a) above.

52. At this point, the draft revised ISRE reflects in the approach in paragraph 48(a). The Task Force is still considering how best to explain the associated work effort required to reflect that approach. The question that arises is that, in keeping with the overall limited assurance objective of the review, does the fact of the modification of the conclusion imply that the practitioner is positively stating that the financial statements are materially misstated (i.e. giving a high level of assurance on that component of the practitioner’s conclusion on the

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<sup>9</sup> ISRE 2410, “Review of Interim Financial Information Performed by the Independent Auditor of the Entity.”

financial statements)? In contrast, under the approach in paragraph 48(b), the practitioner will only have obtained sufficient evidence to be able to conclude, regarding the particular items that have caused the modification, that “...something has come to our attention...” (i.e., the limited assurance nature of the review engagement also applies to the work effort for modifications of the conclusion).

53. Review standards used in different countries where reviews are performed address these issues differently, regarding the form of expression of the practitioner’s conclusion and the work effort required from the practitioner.<sup>10</sup> The Task Force will continue to consider different approaches to resolving these questions.

**Adverse Conclusions [Agenda Item 7-D, paragraph 60]**

54. If a material misstatement the practitioner has identified has a pervasive effect on the financial statements and the practitioner’s conclusion on the financial statement is adverse, i.e., “...based on our review we conclude that these financial statements are not fairly presented, or do not give a true and fair view (or are not in accordance with the applicable financial reporting framework if a compliance framework is used) ...”, the Task Force is divided on the question of how much work effort is required to be able to express the adverse conclusion. If the practitioner has to obtain sufficient evidence to positively state that the financial statements as a whole are materially misstated, does that make the review conclusion similar to the adverse opinion in an audit?
55. As the Task Force needs more time to deliberate on the matters in paragraphs 48–54, at present the draft revised standard reflects the view described in paragraph 48(b). The Task Force would like to better understand the reasoning underlying the view in 48(a) and the implications for the practitioner’s work effort in the engagement.

**Matters for IAASB’s Consideration**

The IAASB is asked:

- Whether it believes the approach to performing the review in the case of modifications due to material misstatements in the financial statements should be as described in paragraph 48(a) or 48(b) above.
- What the practitioner’s appropriate work effort should be in relation to the modification of the conclusion in either case. In the approach described in paragraph 48(a), does the practitioner obtain sufficient, appropriate evidence to support a positive statement that the particular item is materially misstated? Or is it reasonable to obtain sufficient, appropriate evidence to be able to conclude that “something has come to the practitioner’s attention that causes the practitioner to believe” that the particular item is materially misstated (i.e. lesser work effort)?
- What is the appropriate work effort to support expression of an adverse conclusion on the

<sup>10</sup> For example: Financial statement reviews performed under the standards issued by the AICPA require expression of the practitioner’s conclusion in the following form: “... nothing has come to our attention that causes us to believe that material modifications are required for the financial statements to be prepared, in all material respects, in accordance with the applicable financial reporting framework.”

financial statements as a whole?

Conclusions Modified in Respect of Scope Limitations (Other Than a Limitation Imposed by Management) [*Agenda Item 7-D, paragraph 61*]

56. Regarding the question of scope limitations in paragraph 47(b), the Task Force is conscious of the approach followed in ISRE 2410 which explains that “a limitation on scope ordinarily prevents the auditor from completing the review.”<sup>11</sup> In the case of a limitation on scope due to circumstances other than a limitation imposed by management, ISRE 2410 states:

“In such circumstances the auditor is ordinarily unable to complete the review and express a conclusion ... there may be, however, some *rare* circumstances where the limitation on the scope of the auditor’s work is clearly confined to one or more specific matters that, while material, are not in the auditor’s judgment pervasive to the interim financial information. In such circumstances the auditor modifies the review report by ... qualifying the conclusion.”<sup>12</sup> (Emphasis added).

57. The Task Force has drafted the draft ISRE on the basis that a limitation on scope (other than one imposed by management) that warrants qualification of the conclusion (rather than disclaiming a conclusion) may not be rare in the review of financial statements. Examples cited by the Task Force include a limitation on scope arising from the failure to perform a year-end inventory count, and from the situation where an entity’s financial statements are prepared based on accounting records that are incomplete in some significant respect.

**Matters for IAASB’s Consideration**

The IAASB is asked:

- For its views on whether it is possible that there would be scope limitations in a review (other than ones that are imposed by management) that affect the practitioner’s ability to form a conclusion with regard to specific items in the financial statements, but that do not affect the practitioner’s ability to express an unmodified conclusion on the financial statements as a whole. In other words do such scope limitations always warrant that the practitioner would disclaim a conclusion, on the basis of being unable to complete the review?

**E. Reviews Performed by an Auditor under ISRE 2410**

58. The Task Force noted at the June and September 2009 Board meetings that the need to explain how the ISRE 2410 review relates to the ISRE 2400 review is frequently brought to the Task Force’s attention.
59. While the Board made it clear in September that both engagements should continue to be characterized as reviews, some commentators view the two engagements as being very different types of review engagements. This is mainly due to the different environments in which they are performed. (Typically, ISRE 2410 engagements are reviews of interim financial statements performed for public entities, therefore larger entities, performed on

<sup>11</sup> ISRE 2410, paragraph 48.

<sup>12</sup> ISRE 2410, paragraph 53.

the basis of the practitioner’s audit-based knowledge acquired from auditing the entity. For this reason some commentators perceive such reviews rather as extensions of the audit than as a review.

60. In developing ISRE 2400 for engagements performed by practitioners other than the auditor of an entity’s financial statements, the Task Force has attempted to identify the key characteristics of each of these two types of review engagement that differentiate the “ISRE 2400” review from the “ISRE 2410” review. In addition to the “environmental” factor noted in paragraph 59, the key differentiating factor is that an ISRE 2410 engagement is performed with audit-based knowledge that a practitioner performing an ISRE 2400 review would not ordinarily have. The practitioner performing the latter engagement does not acquire audit-level knowledge to perform the review, but designs the review to achieve the same outcome, i.e., expression of a conclusion based on having obtained limited assurance. Whether the level of assurance obtained in an “ordinary” review is higher or lower is a moot point. Some consider that the work effort applied certainly is higher, or should be higher, i.e. practitioner performs greater work effort in the absence of having audit-based knowledge. Whether or not this would translate to a higher level of assurance is a question for future debate.
61. Notwithstanding the question regarding the interrelationship with ISRE 2410 reviews, the Task Force’s aim is to draft ISRE 2400 as a complete and self-standing assurance standard without reference to either the ISAs or ISRE 2410.