

### Proposed ISRS 4400 (Revised)<sup>1</sup>—Issues and Recommendations

#### Objective of Agenda Item

The objective of this agenda item is to obtain the Board's views about how the draft of proposed ISRS 4400 (Revised) addresses professional judgment and ethical requirements.

#### 1. Introduction and Overview of Agenda Items

1. The Board last reviewed a working draft of proposed ISRS 4400 (Revised), *Agreed-Upon Procedures Engagements*, at its March 2018 meeting. The Agreed-Upon Procedures (AUP) Task Force ('the Task Force') is planning to present an Exposure Draft of proposed ISRS 4400 (Revised) in September 2018 for the Board's approval at that meeting.
2. To facilitate the approval of the Exposure Draft in September, the Task Force would like to obtain:
  - The Board's views on two issues that have garnered more lengthy discussions – Professional Judgment (see Section 2) and Ethical Requirements (see Section 3) at this August 2018 conference call; and
  - Offline comments on the draft of proposed ISRS 4400 (Revised) in **Supplements to Agenda Item 1**<sup>2</sup>. The Task Force believes that it has been able to accommodate the Board's previously expressed views on key issues in developing the proposals. The Task Force would welcome offline comments on the draft standard by August 9 end of day. The Task Force will consider the offline comments received for the draft of ISRS 4400 (Revised) that will be presented to the Board for its September 2018 meeting.
3. This paper discusses the Task Force's deliberations of professional judgment and ethical requirements in light of the generally supportive views expressed at previous meetings of the Board, the Consultative Advisory Group, the Small and Medium Practices Committee's IAASB Rapid Response Task Force and feedback from the widespread consultations on the AUP Working Group's Discussion Paper, [\*Exploring the Demand for Agreed-Upon Procedures Engagements and Other Services, and the Implications for the IAASB's International Standards\*](#), issued in November 2016 ("Discussion Paper").
4. An extract from the draft minutes of the March 2018 IAASB meeting related to AUP is included in the Appendix.

<sup>1</sup> Proposed ISRS 4400 (Revised), *Agreed-Upon Procedures Engagements*

<sup>2</sup> Supplement 1 – Requirements (Marked from March 2018); Supplement 2 – Application and Other Explanatory Material (Marked from March 2018); Supplement 3 – Requirements (Clean); Supplement 4 – Application and Other Explanatory Material (Clean)

## 2. Professional Judgment

5. An excerpt of the relevant paragraphs related to professional judgement can be found at the end of this section.

### Background

6. Extant ISRS 4400 is silent on what role professional judgment plays in an AUP engagement. The response to the Discussion Paper showed mixed views on whether there should be a requirement in ISRS 4400 (Revised) on professional judgment. However, a clear majority supported the need for material to describe the role professional judgment plays in an AUP engagement.
7. Originally, the Task Force replicated the requirement on professional judgment from ISRS 4410<sup>3</sup> on grounds that it created a viable precedent. The requirement in paragraph 22 of ISRS 4410 states: “The practitioner shall exercise professional judgment in conducting a compilation engagement.” The Board, however, felt that this requirement did not sufficiently recognize the inherent limitations of the concept when performing detailed procedures that have been previously specified and agreed on.

### The Application of Professional Judgment in an AUP Engagement

8. The Task Force deliberated the issue and concluded that a requirement in the standard for the practitioner to exercise professional judgment would be appropriate. Such a requirement would be consistent with paragraph 17 of the *Preface to the International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, which states that the nature of International Standards requires the professional accountant to exercise professional judgment in applying them. However, to more appropriately reflect the role of professional judgment in the context of an AUP engagement, the Task Force has proposed to:
  - Clarify that the practitioner takes into consideration the nature of the procedures performed in an AUP engagement when applying professional judgment (see paragraph 19 of proposed ISRS 4400 (Revised)); and
  - Include application and other explanatory material to explain how the practitioner takes into consideration the nature of the procedures in an AUP engagement (see paragraph A16 of proposed ISRS 4400 (Revised)).

### Examples of Areas When Professional Judgment May Be Applied

9. At its March 2018 meeting, the Board reviewed examples in the application material of areas where professional judgment may be applied in an AUP engagement. The Board generally supported the examples but asked the Task Force to further consider whether:
  - Some of the examples should be elevated to requirements. For example, whether the example of applying professional judgment in determining appropriate actions if the practitioner becomes aware of fraud or non-compliance should be elevated to a requirement for the practitioner to take appropriate action.
  - All the examples are truly examples of exercising professional judgment. In particular, some Board members asked the Task Force to consider the example referring to the extent of

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<sup>3</sup> ISRS 4410, *Compilation Engagements*

judgment involved in discussing and agreeing the nature, timing and extent of the procedures to be performed.

10. The Task Force considered whether some of the examples should be elevated to requirements and identified two examples that merited further consideration. In particular, further consideration was given to when the practitioner becomes aware of:
  - Matters that may indicate fraud or non-compliance with laws or regulations; and
  - Other matters that cast doubt on the subject matter relevant to the AUP engagement, or indicate in any other way that the information with which the practitioner is associated may be misleading.
11. The Task Force considered whether to elevate the examples relating to fraud or non-compliance with laws and regulations to requirements, and concluded that doing so is unnecessary. An AUP engagement requires the practitioner to comply with relevant ethical requirements<sup>4</sup>, which would require the practitioner to take appropriate actions when the practitioner becomes aware of such matters. In addition, the Task Force explored how ISA 250 (Revised)<sup>5</sup> addresses this issue. Taking a similar approach to paragraphs 9 and A8 of ISA 250 (Revised), the Task Force proposes to include an explanation that the practitioner may have additional responsibilities regarding an entity's non-compliance with laws and regulations in paragraphs 7 and A9 of proposed ISRS 4400 (Revised).
12. The Task Force also reconsidered, as requested by the IAASB, the examples of areas where professional judgment may be exercised. The Task Force removed the following example:

*Determining whether any of the procedures that the practitioner is being asked to agree to, including procedures that are modified over the course of the engagement, are clearly inappropriate for the purpose of the agreed-upon procedures engagement.*
13. In the Task Force's view, this example is covered by the condition that the practitioner is not aware of any indications suggesting that the procedures the practitioner is being asked to perform are inappropriate. In addition, it is also covered by the example in paragraph A17 that explains that the practitioner takes appropriate actions if the practitioner becomes aware of other matters that cast doubt on the information relevant to the AUP engagement or indicate in any other way that the information may be misleading.
14. The Task Force has retained the remaining examples. The examples were included in the Discussion Paper and a significant majority of respondents to the Discussion Paper agreed that the examples appropriately reflect the areas in which professional judgment is applied in an AUP engagement.
15. In addition, the Task Force repositioned an application and other explanatory paragraph dealing with the consideration of resources necessary to carry out the procedures as a further example in paragraph A17 to improve the clarity of the standard.

### **Considering Knowledge Acquired from Other Engagements**

16. Paragraph A18 of proposed ISRS 4400 (Revised) states that “the exercise of professional judgment is based on facts and circumstances that are known to the practitioner... including knowledge acquired from performance of other engagements undertaken for the entity...”

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<sup>4</sup> Relevant ethical requirements are discussed in further detail in the Section below.

<sup>5</sup> ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

17. One Board member questioned whether it is practicable for the practitioner to consider knowledge acquired from performance of other engagements undertaken for the entity. The Task Force is of the view that the consideration of knowledge acquired from performance of other engagements undertaken for the entity is not impracticable and notes that paragraph A24 of ISRS 4410 contains similar guidance. More importantly, the Task Force is of the view that the practitioner cannot ignore such knowledge. The Task Force has therefore retained paragraph A18.
18. The Task Force also added “*For example, an engagement to audit the entity’s financial statements*” to paragraph A18 in response to an offline request for an example of another engagement undertaken for the entity.

#### **Excerpt from Standard**

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#### **The Agreed-Upon Procedures Engagement**

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7. The practitioner may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, which may differ from or go beyond this ISRS, such as: (Ref: Para. A9)
  - (a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance, assessing the appropriateness of their response to non-compliance and determining whether further action is needed; and
  - (b) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.

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#### **Requirements**

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#### **Professional Judgment**

19. The practitioner shall apply professional judgment taking into consideration the nature of the procedures performed in an agreed-upon procedures engagement. (Ref: Para. A15-A18)

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#### **Application and Other Explanatory Material**

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#### **The Agreed-Upon Procedures Engagement (Ref: Para. 5, 7)**

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- A9. Law, regulation or relevant ethical requirements may require the practitioner to perform additional procedures and take further actions. For example, the IESBA Code requires the practitioner to take

steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed.

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**Professional Judgment (Ref: Para. 19)**

A15. Professional judgment is essential to the proper conduct of an agreed-upon procedures engagement. This is because interpretation of relevant ethical requirements and the requirements of this ISRS, and the need for informed decisions throughout the performance of an agreed-upon procedures engagement, require the application of relevant knowledge and experience to the facts and circumstances of the engagement.

A16. An agreed-upon procedures engagement is clearly distinguished from an assurance engagement because of the nature of the procedures in an agreed-upon procedures engagement. Agreed-upon procedures and the findings of the engagement need to be described objectively, in terms that are clear, not misleading, and not subject to varying interpretations. Consequently, performing the agreed-upon procedures (as opposed to the activities involved in accepting or continuing an AUP engagement, agreeing the procedures to be performed, or the reporting of findings) ordinarily requires little or no professional judgment from the practitioner. If a procedure requires professional judgment in performing it, the practitioner may need to consider whether the condition that the agreed-upon procedures and findings can be described objectively, in terms that are clear, not misleading, and not subject to varying interpretations is present.

A17. Professional judgment may be exercised in an AUP engagement in areas such as:

- Discussing and agreeing the nature, timing and extent of the procedures to be performed with the engaging party, and in some cases, the intended users or the responsible party (if these parties are not the engaging party) or the practitioner's expert.
- Describing the findings in an objective manner, taking into account the purpose of the engagement.
- Determining whether any of the terminology used to describe the procedures or findings is unclear, misleading, or subject to varying interpretations.
- Determining the resources necessary to carry out the procedures as agreed in the terms of the engagement.
- Determining appropriate actions if the practitioner becomes aware of:
  - Matters that may indicate fraud or non-compliance with laws or regulations.
  - Other matters that cast doubt on the information relevant to the agreed-upon procedures engagement, or indicate in any other way that the information may be misleading.

Appropriate actions may include, for example, discussing the matter with the engaging party or where appropriate, the responsible party or intended users, including a description of the matter in the agreed-upon procedures report, reporting to appropriate authorities, or withdrawing from the engagement.

A18. The exercise of professional judgment in individual engagements is based on the facts and circumstances known to the practitioner up to the date of the practitioner's report on the

engagement, including knowledge acquired from performance of other engagements undertaken for the entity, where applicable (for example, an engagement to audit the entity's financial statements).

#### **Matters for IAASB Consideration**

1. The Board is asked for its views on the matters as set out in paragraphs 7, 19, A9 and A15-A18 of proposed ISRS 4400 (Revised).

### **3. Ethical Requirements**

19. An excerpt of the relevant paragraphs related to ethical requirements can be found at the end of this section.

#### **Background**

20. The practitioner's objectivity and independence is an important public interest issue as it has an impact on the quality of the engagement.
21. Extant ISRS 4400 requires disclosure in the AUP report if the practitioner is not independent. At the March 2018 meeting, the Board agreed with this existing requirement. A majority of respondents to the Discussion Paper also agreed that the existing requirement strikes the right balance between acknowledging the value of independence and avoiding a requirement for the practitioner to be independent as it is unnecessarily restrictive.
22. The Board further supported the Task Force's collaboration with the International Ethics Standards Board for Accountants (IESBA) to develop criteria for determining whether the practitioner is independent. In addition, the Board provided several suggestions for enhancing this aspect.

#### **Referencing the Restructured Code of Ethics**

23. The recently issued IESBA's restructured *International Code of Ethics for Professional Accountants (Including the International Independence Standards)* (restructured IESBA Code) will be effective as of June 15, 2019. As the restructured IESBA Code will be effective before the expected effective date of ISRS 4400 (Revised), references to relevant ethical requirements in proposed ISRS 4400 (Revised) are to the restructured IESBA Code. To this end, the Task Force has included a definition of relevant ethical requirements that is consistent with the restructured Code in paragraph 14(i) of proposed ISRS 4400 (Revised).

#### **Criteria for Determining Whether the Practitioner Is Independent**

24. While extant ISRS 4400 requires the practitioner to disclose non-independence, it does not provide guidance for determining whether the practitioner is independent. When developing ISRS 4400 (Revised), the Task Force identified such guidance as being useful for helping practitioners to operationalize an existing requirement.
25. In January 2018, a conference call was held with the IESBA member responsible for coordination with the IAASB, Ms. Sylvie Soulie, to discuss possible criteria for determining whether the practitioner is independent, including:

- Part 4A<sup>6</sup> of the restructured IESBA Code; and
  - Part 4B<sup>7</sup> of the restructured IESBA Code.
26. Ms. Soulier and the Task Force tentatively agreed that Part 4B of the restructured IESBA Code, adapted as necessary for AUP engagements, may be an appropriate criterion for determining whether the practitioner is independent (for the purpose of determining whether disclosure in the AUP report is necessary). Part 4A of the IESBA Code is more restrictive than Part 4B. Ms. Soulier and the Task Force agreed that the criterion for determining whether a practitioner is independent for an AUP engagement should not be more restrictive than the criterion used for determining whether a practitioner is independent for an assurance engagement. The Task Force also considered Section 310 of the restructured IESBA Code, *Conflict of Interests*, as another possible criterion. However, the Task Force concluded that Section 310 is not as relevant as Part 4B of the restructured IESBA Code for determining whether the practitioner is independent as Section 310 focuses on circumstances when the interests of two clients conflict or the interest of the practitioner conflicts with that of the client.
27. The Task Force further considered the fact that, in many jurisdictions, practitioners are often subject to ethical requirements other than the IESBA Code. Therefore, the criterion for determining whether the practitioner is independent must be sufficiently flexible to address such circumstances. Accordingly, the Task Force added application material in paragraph A14 to provide guidance that the practitioner may consider ethical requirements such as Part 4B of the IESBA Code, adapted as necessary for agreed-upon procedures engagements, or other professional, legal or regulatory requirements that are at least as demanding.

#### **Other Improvements to Ethical Requirements Section**

28. In response to comments received at the March 2018 IAASB meeting and comments provided off-line, the Task Force has made changes to clarify that:
- The IESBA Code requires the practitioner to be objective but does not require the practitioner to be independent when performing AUP engagements. [Paragraph A11 of proposed ISRS 4400 (Revised)]
  - Notwithstanding that the IESBA Code does not require the practitioner to be independent, national ethical codes, laws or regulations, the firm's policies and procedures or terms of engagement may specify disclosure or other requirements pertaining to independence. [Paragraph A12 of proposed ISRS 4400 (Revised)]
  - If the practitioner is not independent, the practitioner is required to disclose this fact in the AUP report to enhance transparency. [Paragraph A13 and 29(f) of proposed ISRS 4400 (Revised)]
  - Ethical requirements that the practitioner may consider in determining whether the practitioner is independent include Part 4B of the IESBA Code, adapted as necessary for AUP engagements, or other professional, legal or regulatory requirements that are at least as demanding. [Paragraph A14 of proposed ISRS 4400 (Revised)]

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<sup>6</sup> Part 4A – *Independence for Audit and Review Engagements*

<sup>7</sup> Part 4B – *Independence for Assurance Engagements Other Than Audit and Review Engagements*

- When agreeing the terms of the engagement, the anticipated form of the AUP report included in the terms of engagement would include a statement that the practitioner is not independent, if applicable. [Paragraph A32 of proposed ISRS 4400 (Revised)]
29. In the Task Force's view, the clarified approach to objectivity and independence reflects an appropriate balance between the need for:
- The AUP engagement to be performed by a practitioner who is objective (that is, the practitioner's professional or business judgment is not compromised);
  - Flexibility to address circumstances when the engaging party does not require the practitioner to be independent or the practitioner is required to perform the engagement despite not being independent; and
  - Transparency in circumstances when the practitioner is not independent.

#### Excerpt from Standard

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#### Definitions

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- 14(i) Relevant ethical requirements – Principles of professional ethics and ethical requirements to which the engagement team is subject when undertaking an agreed-upon procedures engagement, which ordinarily comprise the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (Including International Independence Standards)* (IESBA Code) related to related services engagements, together with national requirements that are more restrictive.

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#### Requirements

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#### Ethical Requirements

18. The practitioner shall comply with relevant ethical requirements. (Ref: Para. A11-A14)

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#### The Practitioner's Report

- 29(f) If applicable, a statement that the practitioner is not independent.

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#### Application and Other Explanatory Material

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#### Ethical Requirements (Ref: Para. 18)



- A11. The IESBA Code requires practitioners to comply with the fundamental principle of objectivity, which requires practitioners not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others. Independence facilitates the application of objectivity and comprises both independence of mind and independence of appearance. The IESBA Code does not require the practitioner to be independent when performing an agreed-upon procedures engagement.
- A12. Notwithstanding that the IESBA Code does not require the practitioner to be independent when performing an agreed-upon procedures engagement, national ethical codes, laws or regulations, the firm's policies and procedures, or the terms of engagement may specify disclosure or other requirements pertaining to independence.
- A13. To enhance transparency in circumstances when the practitioner is not independent, paragraph 29(f) requires disclosure of this fact.
- A14. In determining whether the requirement for disclosure in paragraph 29(f) is applicable because the practitioner is not independent, the practitioner may consider ethical requirements such as Part 4B of the IESBA Code, *Independence for Assurance Engagements Other Than Audit or Review Engagements*, adapted as necessary for agreed-upon procedures engagements, or other professional, legal or regulatory requirements that are at least as demanding.

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*Agreeing the Terms of the Engagement* (Ref: Para. 22-24)

- A32. In the circumstance when the practitioner is not independent, the anticipated form of the agreed-upon procedures report would include, as required by paragraph 29(f), a statement that the practitioner is not independent.

**Matters for IAASB Consideration**

2. The Board is asked for its views on how proposed ISRS 4400 (Revised) addresses ethical requirements, in particular:
- (a) Not requiring the practitioner to be independent; and
  - (b) Other clarifications as reflected in paragraphs 14(i), 18, 29(f), A11-A14 and A32 of proposed ISRS 4400 (Revised).

**Next Steps**

30. The Task Force plans to present the following agenda papers for the September meeting:
- (a) An issues paper summarizing the Task Force's deliberations and conclusions, including the Task Force's proposed disposition of comments raised by Board members at the March 2018 Board meeting and August 2018 teleconference.
  - (b) Draft of ISRS 4400 (Revised) (Requirements and Application and Other Explanatory Material):

- (i) For requirements and application and other explanatory material paragraphs relating to professional judgment and ethical requirements – Marked from the draft submitted for the August 2018 conference call; and
    - (ii) For all other requirements and application and other explanatory material paragraphs – Marked from the draft presented at the IAASB March 2018 meeting.
  - (c) Clean versions of (b).
  - (d) Mapping of proposed ISRS 4400 (Revised) to extant ISRS 4400 for reference purposes.
31. The Task Force will post the papers approximately 3 weeks before the September 2018 IAASB meeting to give Board members sufficient time to familiarize themselves with the papers.
32. Marking the proposed ISRS 4400 (Revised) to extant ISRS 4400 will result in a draft that is difficult to read. This is because the extant ISRS does not reflect the clarity convention and significant changes have been made to the extant in developing proposed ISRS 4400 (Revised). The mapping approach will show what has been retained and what is new.
33. Board members' comments on submitted drafts ahead of meetings have been very helpful with other projects. Therefore, the Task Force welcomes comments on the submitted draft of proposed ISRS 4400 (Revised) ahead of the September 2018 IAASB meeting.

## Appendix

### Minutes of the March 2018 Board Meeting

#### Agreed-Upon Procedures Engagement

The Board discussed the matters set out in (**Agenda Item 5** and the accompanying Working Draft of ISRS 4400 <sup>8</sup> (**Agenda Item 5-A**). The IAASB generally supported the AUP Task Force's proposals. Key views expressed included:

- Support for the use of the term 'findings' instead of 'factual findings,' but the board asked that the AUP Task Force consider further clarifications where possible.
- Support for the AUP Task Force's collaboration with the International Ethics Standards Board of Accountants (IESBA) to develop criteria for determining whether the practitioner is independent.
- While agreeing that the AUP standard should be sufficiently flexible to address various circumstances when an AUP engagement is performed, the Board directed the AUP Task Force to consider whether it is appropriate to elevate some of the application material to requirements; for example, actions to be taken if the practitioner becomes aware of fraud.
- That ISRS 4400, when revised, should reflect the circumstances where the practitioner may reach a preliminary agreement with the engaging party on procedures to be performed at the start of the engagement, and subsequently confirm the procedures that were actually performed at the end of the engagement.
- Other matters for the AUP Task Force's consideration, such as:
  - Further clarity for the phrase "findings are described objectively," as it is unclear whether the phrase means that the practitioner who describes the findings is objective;
  - Clarifying whether the phrase "subject matter" is intended to convey the same meaning as the phrase that is used in ISAE 3000 (Revised);<sup>9</sup>
  - Aligning the documentation requirements with those in ISAE 3000;
  - Clarifying the requirement for the date of the AUP report; and
  - Providing examples of inappropriate terminology, which may be more useful than examples of appropriate terminology.

#### IAASB CAG CHAIR'S REMARKS

Mr. Dalkin noted the CAG's support for moving forward with the AUP project. On the issue of the use of the term 'finding,' Mr. Dalkin supported the use of the term "finding" as "finding" is inherently factual. He also suggested further consideration of the relationships between professional judgment, independence and objective reporting.

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<sup>8</sup> International Standard on Related Services (ISRS) 4400, *Engagements to Perform Agreed-Upon Procedures Regarding Financial Information*

<sup>9</sup> International Standards on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

#### PIOB OBSERVER REMARKS

Ms. Stothers indicated that the PIOB is particularly interested in the issue of whether a practitioner performing an AUP engagement is required to be independent. This issue has potential public interest implications on the credibility of the practitioner and the quality of the engagement.

#### WAY FORWARD

The AUP Task Force will further consider changes to the Working Draft of ISRS 4400, as well as actively monitor developments relating to ISQC 1<sup>10</sup> and the new revised IESBA *International Code of Ethics for Professional Accountants (including International Independence Standards)* so that any changes in the draft of ISRS 4400 (Revised) align.

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<sup>10</sup> International Standards on Quality Control (ISQC) 1, *Quality Control for Firms that Performs Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*