**Chapter 6**

**Assurance Engagements and Other Services**

Audit-related services may be assurance engagements or non-assurance engagements. A client would generally engage an auditor to undertake an audit-related engagement either because the client needs to make use of expertise that the auditor possesses but the client itself does not, or because it needs a relatively independent third party to provide assurance regarding some specific matter. For example, the client may lack the expertise to carry out a financial due diligence assignment on a potential acquisition, and may therefore engage the auditor to do this for it. Or it may be that the client needs to obtain new finance in the form of a bank loan, and engages the auditor to provide assurance over its prospective financial information because this will help strengthen its case with the bank.

There are many different types of audit-related services, which are summarised by the following diagram.

The types of standard which apply to each type of engagement are given in brackets.

Engagement

Limited Assurance

Eg Voluntary Audit

Reasonable Assurance

Eg Statutory Audit

Audit Related Service engagement

* Compilation Assignments.
* Agreed upon procedures.

Other Information

* Prospective Financial Information.
* Key Performance Indicators.
* Internal Controls.

Assurance Engagement

Assurance Engagement

Historical Financial Information

One important kind of engagement not included in this diagram is **due diligence**, as it could be placed within several of the above categories. It is covered later in this chapter.

This section focuses on reviews of historical financial information, which are limited assurance engagements. This includes several types of engagement:

* Review of financial statements
* Review of interim financial information by the entity's auditor

These are both types of review engagement:

**Review engagements.** The objective of a review engagement is to enable an auditor to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.

This is an exercise similar to an audit, except that in a review engagement the practitioner will rely more heavily on procedures such as **enquiry and analytical review** than on detailed substantive testing. The reasons for this are:

* He is seeking a **lower level of assurance than for an audit**, so these forms of evidence are sufficient due to risk being lower.
* Such techniques provide **indicators** that direct work to risk areas and from which to draw conclusions, and they are **quick** and, therefore, **cost-effective**.

You may be interested to note that International Standards on Review Engagements (ISREs) and International Standards on Assurance Engagements (ISAEs) use the term 'the practitioner', as opposed to 'the professional accountant' (used in the *Code of Ethics*) and of course 'the auditor' (ISAs). A 'practitioner' is defined as 'a professional accountant in public practice'.

Review of financial statements

A review of financial statements is a **limited assurance** engagement

The practitioner performs primarily **inquiry and analytical procedures** to obtain sufficient appropriate to review whether financial statement complies with reporting standards. Although inquiry and analytical procedures are the main sources of evidence, if the practitioner becomes aware of something that makes them think there may be a material misstatement, then further procedures may be necessary (such as substantive procedures). In addition:

* The practitioner shall **comply with relevant ethical requirements**, including those pertaining to independence.
* The practitioner shall plan and perform the engagement with **professional** recognizing that circumstances may exist that cause the financial statements to be materially misstated.
* The practitioner shall **exercise professional judgment** in conducting a review engagement.
* The practitioner must **not** accept an engagement if:
* There is not a **rational purpose** for the engagement, or a review is not appropriate to the
* Circumstances

The practitioner must not accept the review engagement if

* **Ethical requirements** will not be satisfied
* Information is likely to be **unavailable** or **unreliable**
* There is cause to doubt **management's integrity**
* The scope of the review has been limited such that a **disclaimer of opinion will be issued**
* **Preconditions** must be present, including:
* An **acceptable financial reporting framework**
* Management **acknowledges its responsibilities** for internal control, for the financial statements and for providing access to information

**When performing review engagement**

* The practitioner shall determine **materiality** for the financial statements as a whole, and apply this materiality in designing the procedures and in evaluating the results obtained from those procedures.( Materiality must also be **revised** as the engagement progresses (like an audit).)
* The practitioner shall **obtain an understanding** of the entity and its environment, and the applicable financial reporting framework

Procedures are then designed to address all material items and to focus on areas where material misstatements are more likely. The main procedures are **enquiry** and **analytical procedures**.

Procedures should be performed to address any specific issues, such as:

* **Related parties** (remain alert and if they are identified, inquire about them)
* **Fraud** and **non-compliance** with laws or regulations (if found, communicate and consider effect on conclusion)
* **Going concern**
* Use of **work performed by others** (take steps to ensure it is adequate for the purposes of the review)

It is a requirement to obtain evidence that the **financial statements agree to accounting records**. If a material misstatement is discovered then **additional procedures** are performed to enable a conclusion to be formed. Responsibilities in relation to **subsequent events** are similar to those on an audit.

Written representations

Various written representations are required:

* To confirm that management has fulfilled its responsibilities as set out in the engagement letter
* To confirm that management has disclosed various matters to the practitioner, eg the identity of

any related parties, facts relating to any frauds.

Reporting

There are some important differences between a review report and an auditor's report

|  |  |
| --- | --- |
| Review Report | Auditor’s Report |
| Conclusion | Option |
| Limited Assurance | Reasonable Assurance |
| Negative form of words | Positive form of words |

An **unmodified conclusion** uses a negative form of words, such as:

'Based on our review, nothing has come to our attention that causes us to believe that the financial statements do not present fairly, in all material respects (or do not give a true and fair view), … in accordance with the applicable financial reporting framework. The term 'negative assurance' does not exist in the current ISRE. The correct term is 'limited assurance', which is logical: this is still positive assurance, but there is just less of it than when 'reasonable assurance' is provided. The only thing that **is** negative is the way the conclusion is worded.

**Modified conclusions** are expressed in the same terms as the auditor's report (the terminology used for assurance conclusions and reports is now aligned with the International Standards on Auditing (ISAs)). And just like the auditor's report, a modified conclusion paragraph must be preceded by a 'Basis for' modified conclusion paragraph. The type of modified conclusion given will depend on two things: the materiality of the issue, and the availability of evidence.

|  |  |  |
| --- | --- | --- |
| Nature of matter giving raise to modification | Practitioner's judgement about the pervasiveness of the effects or  possible effects on the subject matter information | |
| Material but not pervasive | Material and pervasive |
| Information is materially misstated | Qualified conclusion | Adverse conclusion |
| Inability to obtain sufficient appropriate planning | Qualified conclusion | Disclaimer of conclusion |

It is also possible to modify the assurance report without modifying the actual conclusion, by including an emphasis of Matter or an Other Matter paragraph. These are defined as follows.

* An **Emphasis of Matter** paragraph will] draw intended users' attention to a matter presented or disclosed in the financial statements that, in the practitioner's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.
* An **Other Matter** paragraph will] communicate a matter other than those that are presented or disclosed in the financial statements that, in the practitioner's judgment, is relevant to users' understanding of the review, the practitioner's responsibilities or the practitioner's report and this is not prohibited by law or regulation.

The key difference here is:

|  |  |
| --- | --- |
| Emphasis of Matter | Other matter |
| Matter **is** already presented or  disclosed in the subject matter  information. | Matter **is not** already presented  or disclosed in the subject matter  information. |

Review of interim financial information performed by the independent auditor of the entity

The auditor should comply with **ethical principles** relevant to the audit when carrying out an interim review and should apply **quality control procedures** applicable to the individual engagement. In addition, the auditor should plan and perform the engagement with an attitude of **professional scepticism**. The auditor should agree the terms of the engagement with the client (these will not be the same terms as for the audit, as the review will result in a lower level of assurance than the annual audit), with a view to providing negative assurance

Procedures

The procedures outlined below follow the same pattern as an audit, but, because this is a review not an audit, they are not as detailed as audit procedures. The auditor should possess sufficient understanding of the entity and its environment to understand the types of misstatement that might arise in interim financial information and to plan the relevant procedures (mainly enquiry and analytical review) to enable them to ensure that the financial information is prepared in accordance with the applicable financial reporting framework. This will usually include:

* Reading last year's audit and previous review files
* Considering any significant risks that were identified in the prior year audit
* Reading the most recent and comparable interim financial information
* Considering materiality
* Considering the nature of any corrected or uncorrected misstatements in last year's financial statements
* Considering significant financial accounting and reporting matters of ongoing importance
* Considering the results of any interim audit work for this year's audit
* Considering the work of internal audit
* Asking management what their assessment is of the risk that the interim financial statements might be affected by fraud
* Asking management whether there have been any significant changes in business activity, and if so, what effect they have had Asking management about any significant changes in internal controls and the potential effect on preparing the interim financial information
* Asking how the interim financial information has been prepared and the reliability of the underlying accounting records

A recently appointed auditor should obtain an understanding of the entity and its environment, as it relates to both the interim review and final audit.

The key elements of the review will be:

* **Enquiries** of accounting and finance staff
* **Analytical procedures**

Ordinarily procedures would include:

* Reading the minutes of meetings of shareholders, those charged with governance and other appropriate committees
* Considering the effect of matters giving rise to a modification of the audit or review report, accounting adjustments or unadjusted misstatements from previous audits
* If relevant, communicating with other auditors auditing different components of the business
* Analytical procedures designed to identify relationships and unusual items that may reflect a material misstatement
* Reading the interim financial information and considering whether anything has come to the auditors' attention indicating that it is not prepared in accordance with the applicable financial reporting framework
* Agreeing the interim financial information to the underlying accounting records

The auditor should make enquiries of members of management responsible for financial and accounting matters about:

* Whether the interim financial information has been prepared and presented in accordance with the applicable financial reporting framework
* Whether there have been changes in accounting policies
* Whether new transactions have required changes in accounting policies
* Whether there are any known uncorrected misstatements
* Whether there have been unusual or complex transactions, eg disposal of a business segment
* Significant assumptions relevant to fair values
* Whether related party transactions have been accounted for and disclosed correctly
* Significant changes in commitments and contractual obligations
* Significant changes in contingent liabilities including litigation or claims
* Compliance with debt covenants
* Matters about which questions have arisen in the course of applying the review procedures
* Significant transactions occurring in the last days of the interim period or the first days of the next
* Knowledge or suspicion of any fraud
* Knowledge of any allegations of fraud
* Knowledge of any actual or possible non-compliance with laws and regulations that could have a material effect on the interim financial information
* Whether all events up to the date of the review report that might result in adjustment in the interim financial information have been identified
* Whether management has changed its assessment of the entity being a going concern

The auditor should evaluate discovered misstatements individually and in aggregate to see if they are material. The auditor should obtain **written representations** from management that it acknowledges its responsibility for the design and implementation of internal control, that the interim financial information is prepared and presented in accordance with the applicable financial reporting framework and that the effect of uncorrected misstatements are immaterial (a summary of these should be attached to the representations). The auditor should also obtain representations that all **significant facts** relating to **frauds or non-compliance with law and regulations**, and all **significant subsequent events**, have been disclosed to the auditor.

The auditor should read the other information accompanying the interim financial information to ensure that it is not inconsistent with it.

If the auditors believe a matter should be adjusted in the financial information, they should **inform management** as soon as possible. If management does not respond within a reasonable time, then the auditors should inform those charged with governance. If they do not respond, then the auditor should consider whether to modify the report or to withdraw from the engagement and the final audit if necessary. If the auditors uncover fraud or non-compliance with laws and regulations, they should communicate that promptly with the **appropriate level of management**. The auditors should communicate matters of interest arising to those charged with governance.

Agreed-upon procedures

**Agreed-upon procedures assignment.** In an engagement to perform agreed-upon procedures, an auditor is engaged to carry out those procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings. The recipients of the report must form their own conclusions from the report by the auditor. The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures, may misinterpret the results.

Accepting appointment

The auditor should ensure with representatives of the entity, and ordinarily, other specified parties who will receive copies of the report of factual findings, that there is a clear understanding regarding the agreed procedures and the conditions of the engagement.

Assurance engagements

Elements of an assurance engagement

**Assurance engagement.** An engagement in which a practitioner aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the subject matter information (that is, the outcome of the measurement or evaluation of an underlying subject matter against criteria).

Engagement type

Assurance engagement

Attestation engagement

Direct engagement

**Attestation engagement.** An assurance engagement in which a party other than the practitioner assures or evaluates the underlying subject matter against the criteria. A party other than the practitioner also often presents the resulting subject matter information in a report or statement. In some cases, however, the subject matter information may be presented by the practitioner in the assurance report. In an attestation engagement, the practitioner's conclusion addresses whether the subject matter information is free from material misstatement.

**Direct engagement.** An assurance engagement in which the practitioner measures or evaluates the underlying subject matter against the applicable criteria and the practitioner presents the resulting subject matter information as part of, or accompanying, the assurance report. In a direct engagement, the practitioner's conclusion addresses the reported outcome of the measurement or evaluation of the underlying subject matter against the criteria

Assurance provided

Assurance engagement

Assurance engagement

Assurance engagement

**Reasonable assurance engagement.** An assurance engagement in which the practitioner reduces engagement **risk** to an acceptably low level in the circumstances of the engagement as the basis for the practitioner's conclusion. The practitioner's conclusion is expressed in a form that conveys the practitioner's opinion on the outcome of the measurement or evaluation of the underlying subject matter against criteria.

**Limited assurance engagement.** An assurance engagement in which the practitioner reduces engagement risk to a level that is acceptable in the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement as the basis for expressing a conclusion in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the practitioner's attention to cause the practitioner to believe the subject matter information is materially misstated.

The nature, timing and extent of procedures performed in a limited assurance engagement is limited compared with that necessary in a reasonable assurance engagement but is planned to obtain a level of assurance that is, in the practitioner's professional judgement, meaningful. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the subject matter information to a degree that is clearly more than inconsequential