

Split of Section 290

Background

The existing Code contains one Section (290) that addresses independence requirements for all assurance engagements. The Section deals with both “Financial Statement Audit engagements” and all “Other Assurance engagements”, whether assertion-based or direct reporting. The Section contains differing independence requirements depending on the nature of the engagement. Section 290 currently defines “Financial Statements” as:

“The balance sheets, income statements or profit and loss accounts, statements of changes in financial position (...)notes and other statements and explanatory materials which are identified as part of the financial statements”.

It will be seen that this effectively means a complete set of financial statements.

The IESBA concluded that existing 290 should be split into two Sections. A primary reason for this was to provide greater focus and clarity on the requirements relating to the audit of financial statements. Further, because most assurance engagements are either audit or review engagements, the IESBA revised Section 290 to address all audit and certain review engagements.

As noted in the Explanatory Memorandum to ED –

“Audit engagements are assurance engagements in which a professional accountant expresses an opinion on whether historical financial information is prepared in all material respects with an identified financial reporting framework. Such engagements include audit engagements to report on:

- A complete set of general purpose financial statements;
- A complete set of financial statements prepared in accordance with a framework designed for a special purpose;
- A single financial statement; and
- One or more specific elements, accounts or items of a financial statement.”

In the ED the term “Financial Statements” was defined consistent with that of the IAASB (see Appendix 2).

The ED proposed that the independence requirements of Section 290 apply to more than the audit (or review) of “financial statements” (see final bullet above), and in doing so extended the requirements beyond that of the current Code.

The IESBA was, per the Explanatory Memorandum (EM), “of the view that all such engagements should be addressed in proposed revised Section 290. In all such engagements the professional accountant obtains reasonable assurance that the information is prepared in all material respects with the identified financial reporting framework. The IESBA is of the view that a reasonable and informed third party would expect that the same independence requirements had been met in an audit of a complete

set of financial statements as in an audit of a single financial statement or one or more specific accounts or elements of a financial statement.”

The IESBA was further of a view that certain review engagements should also be dealt with in Section 290. As further noted in the Explanatory Memorandum:

“A review engagement is a limited assurance engagement performed in accordance with International Standards on Review Engagements issued by the IAASB, or equivalent standards. The IESBA has concluded that such engagements should be addressed in proposed revised Section 290 together with audit engagements, rather than in proposed new Section 291 with “other assurance engagements”. In both audit and review engagements the accountant is expressing a conclusion on historical financial information and in many review engagements the accountant is expressing a conclusion on a complete set of financial statements. The subject matter and subject matter information of the engagement is the same as in an audit engagement; the difference is the level of assurance obtained.

The IESBA, therefore, is of the view that it is appropriate to address independence requirements for audit and review engagements in one section and to address independence requirements for other assurance engagements in a separate section”.

Discussion

Comments received

Commentators were, to the extent they commented thereon, in favour of a split of existing 290. Only [3] respondents (FRS, CAGNZ and ICANZ) were explicitly against a split. CAGNZ noted for example that “The principles do not vary with the nature of the engagement and, for this reason, it is preferable that the guidance on independence is contained within one section of the Code of Ethics”.

A few respondents expressed concern about the level of repetition and length caused by the split.

[16] commentators were expressly supportive of the proposed split. Many others provided no comment thereon, although it should be recognised that the Explanatory Memorandum did not specifically ask for comment on the split issue.

Comments were however received from [18] respondents as to “how” the split should be made. The comments vary in nature, but a summary of the key comments is provided in Appendix 1, by respondent.

Some expressed concern about the inclusion of reviews of historic financial information (either in totality or in part), as well as engagements relating to components of financial statements, in Section 290. These issues are dealt with separately below.

Detailed comments are contained in Agenda Paper 3-D.

Issue 1 - Reviews

A number of concerns were raised, including:

- The split does not recognise the differing level of assurance provided, users do not derive the same level of assurance from review engagements and user expectations of independence are not the same – 290 should deal only with positive assurance reports
- The level of public interest in review engagements is generally less
- The requirements may hinder the ability of small entities to obtain timely service or result in increased cost of reviews.
- Split does not reflect the market place in which smaller entities operate – review will often be appropriate for non ESPIs
- The reference to ISRE2400 does not provide sufficient clarity as to which “review” engagements would be covered by 290
- Review engagements vary in nature around the world, and including some in 290 and some in 291 will lead to inconsistent application of the requirements
- The majority of review engagements are not similar in nature to an audit of financial statements
- No research is presented on the number of review engagements to support specific focus on such engagements
- Only reviews with a public interest element should be included in Section 290.

The comment made by the ICAEW is illustrative of views on this:

“We do not believe that the scope of section 290 should automatically include review engagements as well as audit engagements. ‘Review engagements’ covers a much wider range of possible activities than the latter, however, meaning different things around the world and indeed within the same country. In some jurisdictions and some circumstances they can indeed refer to engagements with a clear public interest perspective such as auditor reviews of interim reports which are issued to the market. However, in other jurisdictions and circumstances a review opinion (often applied to a small entity that does not require an audit and frequently intended for restricted use) would not demonstrate a public interest perspective and the guidance in section 291 (which requires the same standard of independence but is more principles based in achieving that) would be more appropriate. We note that the proposed definition of ‘review engagement’ is one “...conducted in accordance with International Standards on Review Engagements or equivalent.” This indicates that IFAC does not intend section 290 to apply to all forms of engagement that might be called ‘review’ but as the International Standards on Review Engagements have not been adopted everywhere in the world we think there will be confusion. We also note that the terms ‘audit’ and ‘review’ are commonly used in place of ‘reasonable assurance

engagement’ and ‘limited assurance engagement’ by practitioners and their clients alike. Considering the complexities and general lack of understanding as to what types of ‘review’ engagements exist, the definition of types of engagements to be covered by section 290 should be considered carefully. We believe that IFAC should seek to apply section 290 only to engagements with a clear public interest perspective such as where there is reporting to capital markets: indeed it may be appropriate for national standard setters to decide on this, in line with the approach in respect of ESPIs”

A few respondents noted concerns about the definition of a review engagement; “A review engagement is a limited assurance engagement performed in accordance with International Standards on Review Engagements issued by the IAASB, or equivalent standards”

ISRE 2400 states that “This ISRE is directed towards the review of financial statements. However it is to be applied to the extent practicable to engagements to review financial or other information”.

The concern is that it will not always be clear whether Section 290 requirements should apply to certain review engagements that are not related to “financial statements”, leading to inconsistent application of independence requirements.

The Task force considered whether there were sufficient and persuasive arguments to endorse moving all review engagements to Section 291. The following arguments were put forward to support this approach:

- It would have the clarity and simplicity of focussing on the “audit of financial statements” in Section 290
- It would recognise that a threats and safeguards approach as adopted in Section 291 will often be appropriate for review engagements
- It is consistent with the way reviews are currently treated under the existing Code, which does not appear to have given rise to concern/issues
- It removes the complexity of dealing of some reviews in 290, and others in 291
- Removes unintended consequence of wrapping “review” of historical financial information into the term “audit”, as per ED paragraph 290.2 (e.g. thereby extending partner rotation to reviews of historical financial information and other engagements).
- It arguably better reflects user needs and market expectations

However recognising the level of direct and indirect support for the inclusion of reviews “performed in accordance with International Standards on Review Engagements issued by the IAASB, or equivalent standards” in Section 290, the Task Force is not persuaded by the arguments presented and recommends that such reviews are dealt with in Section 290. In particular the Task Force was not persuaded by a primary argument that because the level of assurance was less than in an audit that the independence requirements should also be less rigorous.

In coming to this view, the Task Force had particular concerns that if reviews of financial statements were moved to Section 291 that the important provisions in Section 290 relating to accounting and bookkeeping services might not be followed when the firm is conducting a review of financial statements. The Task Force believes that this is particularly important given the nature of the more limited procedures undertaken to form a review conclusion, but the same self review threat.

The Task Force considers that the provisions relating to accounting and bookkeeping services should be complied with in the case of a review of financial statements. The Task Force is not persuaded that the threats and safeguards approach in Section 291 would be sufficiently robust for reviews of financial statements.

However, the Task Force believes that the Board should be responsive to concerns raised about the reference to ISRE2400. The Task Force recommends that Section 290 should specifically include only reviews of “financial statements”. This would have the advantage of clarity and consistent application, removing any confusion as to whether “other” reviews should be addressed under Section 290, and further by consistent with the proposal below re audits. The definition would need amending accordingly.

Action requested

Members are asked to consider the recommendation of the Task Force and provide feedback to the Task Force.

Issue 2 - One or more specific elements, accounts or items of a financial statement.

A few respondents expressed concern about the inclusion of the audit and review of “*One or more specific elements, accounts or items of a financial statement*” in Section 290.

Extracts from the response from the CICA are illustrative of the concern:

Our second main concern relates to the IESBA proposals that would require the same Independence standards for each of audits and reviews of general purpose financial statements plus single financial statements or discrete financial numbers. The existing approach would treat these latter items as other assurance services, which would be covered by the new Section 291. This change would result in broader independence requirements for those services, in terms of application to the firm and network, partners of the firm, and members of firm management.

We believe that this would create significant practical issues and is not necessary from a public interest perspective. There are several types of service that would be affected, including:

- reports on operating cost statements for rental buildings, where the statements are used for the charge of common area and related costs to tenants. In such cases, the property manager and the property owner are often not the same party, and obtaining the consent of all of the tenants is not something that could reasonably be done. The auditor of these statements is often the auditor for the property manager;
- reports on store sales for purposes of percentage rent calculations. Generally, the auditor is the auditor of the store's financial statements, but may or may not be the auditor of the entire chain that consolidates the results;
- reports on working capital or other financial statement items in connection with purchase and sale agreements for assets, divisions, or entire entities;
- reports on costs incurred for determination of various Crown royalties or other royalties that are payable under statute or an agreement;
- reports on costs which qualify for various assistance programs; and
- reports on expenditures incurred, or distributions made, as required by trust deeds or similar agreements.

In these cases, the user community is not generally of wide public interest. The subject matter is generally related to specific matters over which small (and generally identifiable) groups have any relevant interest. Defining the "audit client" broadly to include the entire entity is unnecessarily restrictive (and this assumes that it can be agreed in each case which in the group is the audit client). It is also difficult to see the benefit in restricting a broad range of individuals.

We do not believe that the "restricted use" provisions solve the problem in every instance. Those provisions require some agreement or understanding with the users as to the independence standards that have been applied. As noted in the example above, this is not always possible or practical in many of these cases.

The practical effect of the proposal is that frequently the corporation's financial statement auditor will be the only logical choice to conduct these audits, given that the ability for all firms to become "independent" may be next to impossible. That will result in a significant change in allocation of audit work within the firm which itself is probably not in the public interest. Moreover, in some cases, other auditors from the same firm or network firm may be better equipped, due to office locations or resources, to do these audits which are often in varied or remote locations away from the normal corporate offices.

We would therefore recommend that the two levels of Independence standards should be as currently exists – one level in Section 290 for audits (and reviews) of complete sets of general purpose financial statements, and a second level in Section 291 for all other "assurance services".

Whilst not all the examples above would seem to fall within the scope of “One or more specific elements, accounts or items of a financial statement”, a number clearly would and the Task Force believes that the provisions of Section 291 are appropriate for such engagements. The Task Force recommends that Section 290 does not deal with such engagements, and that Section 290 addresses only the audit and review of “financial statements”. This would have the following advantages:

- Having the clarity and simplicity of focussing on the audit and review of “financial statements”, as consistently defined with that of the IAASB
- It recognises that in some situations (e.g. an audit of royalties due) the application of the threats and safeguards approach in 291, based on the nature of subject matter information, will be appropriate
- It minimises the relevance of the difficult concepts in 291 regarding the definition of an assurance engagement (e.g. where there are, for example, multiple parties or direct reporting engagements)

Action requested

Members are asked to consider the recommendation of the Task Force and provide feedback to the Task Force.

Restricted Use

To the extent they commented thereon, respondents were generally supportive of the proposals regarding Restricted Use reports, although a number made suggestions which would help to improve the clarity of the provisions and the Task Force will address these. Restricted use reports are not specifically addressed in this paper, pending further consideration, but the Task Force would like to draw the Board’s attention to one particular matter.

A number of respondents (CSOEC, NIVRA, WpK, BDO, ACCA, FEE) expressed a view that where the criteria are met and the provision of paragraphs 290.500-514 are applied, that in such cases the terms, including the fact that the firm has applied modified independence requirements to the engagement, should be mentioned in the report.

The content and form of assurance reports are the authority of the IAASB, which is in the process of finalising ISA 800 on “special purpose” reports. The latest draft includes a requirement to indicate that the report is for restricted use (and distribution). It does not currently include any reference to the independence requirements.

Detailed comments are contained in Agenda Paper 3-E.

Action requested

Members are asked to consider whether it is appropriate and necessary for the report to include reference to the independence requirements that have been applied (e.g, “the modified provisions relating to restricted use reports in accordance with Section 290 of the IFAC Code of Ethics”). If the Board is of this view, the IESBA will need to refer the matter to the IAASB, with a recommendation, for their further consideration.

Appendix 1

Summary of comments received

Comment	Member Bodies	Firms	Regulators	Others
Not supportive of any split	FSR, NCICA			CAGNZ
Support the split (without further comment) or explicitly support the proposed split with 290 dealing with audits and reviews	CIMA, DnR, CNCC, SAICA, ICAS, IDW, IBR-IRE, CICA	E&Y, Mazars, DT		APESB, AC, FAP, APB
No comments were made on the split by -	AICPA, CMA, FAR SRS, HKICPA, ICAIndia, ICAP, ICJCE, ICPAI, ICPAS, JICPA, KICPA, Australia, NRF, CSOEC,		EC, BASEL	ACAG, CAPCA, CGA-ALBERTA, CGA-CANADA, CSCPA, INDIVIDUALS, EFAA, GAO, KyCPA, MACPA, NASBA, OCPA, SCAA, WOLF,
Section 290 should deal only with “audits” and review engagements should be dealt with in Section 291	ACCA, NIVRA	GT, BDO		SMP, IRBA
Expressed other concerns about the split such as <ul style="list-style-type: none"> - including all reviews in 290 - lack of clarity on split, especially re reviews - standards for assurance engagements 	WpK, ICAEW,	KPMG, PwC	CEBS	FEE, CARB, CCAB, PAOC, APB, CGA CANADA

<p>should distinguish between public reporting and private reporting</p> <ul style="list-style-type: none"> - review engagements should be dealt with in Section 291, except where a clear public interest element or “result in public reports that are relied on by external shareholders” - “subject matter” should not necessarily drive the independence requirements <p><i>Note- some of these issues relate to S.291</i></p>				
Exclude audit and review of components, single line items and special purpose FS from 290	ICAEW, CICA	PwC		
The term “general purpose financial statements” as defined by the IAASB appears to differ from the context used in the ED. Use of the report, not the framework, is key.		PwC, KPMG		APB
Proposed split does not wholly remove the complexities of the definition of an assurance engagement, as dealt with in 291, from 290		PwC, KPMG		

Appendix 2

Definitions in the ED

Audit

A reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether historical financial information is prepared in all material respects in accordance with an identified financial reporting framework, such as an engagement conducted in accordance with International Standards on Auditing. This includes a Statutory Audit, which is an audit required by legislation or other regulation.

Review Engagement

An assurance engagement in which a professional accountant in public practice expresses a conclusion on whether, on the basis of the procedures which do not provide all the evidence that would be required in an audit, anything has come to the accountant's attention that causes the accountant to believe that the historical financial information is not prepared in all material respects, in accordance with an applicable financial reporting framework, which is an engagement conducted in accordance with International Standards on Review Engagements or equivalent.

Financial Statements

A structured representation of historical financial information, which ordinarily includes explanatory notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term can relate to a complete set of financial statements, but it can also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes.