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Agenda Item
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Committee International Ethics Standards Board for Accountants

Meeting Location: JICPA, Tokyo, Japan

Meeting Date: October 19-20 2009

Review Engagements

Objectives of Agenda Item

1. To provide an update of the work of the IAASB on the revision of ISRE 2400 - Engagements to Review Financial Statements and ISRS 4410 - Engagements to Compile Financial Statements

Background

The IAASB has started a project to develop a revised standard on review engagements. The IAASB has identified issues that have to be dealt with by the task force. The issues include how communication can be used to promote practitioner and user awareness about alternatives to the audit, and about how combinations of services can be used to meet variety of needs.

The Task Force has also been asked to consider from the perspective of the public interest, whether there is need to further explore how the independence requirements of the *Code of Ethics for Professional Accountants* (Code) are applied in the context of reviews of financial statements. The IAASB extended an invitation to IESBA to appoint a correspondent member to the Task Force and Isabelle Sapet agreed to fill this role.

Discussion

At its July 2009 meeting, the Task Force received a presentation on the Code from Sylvie Soulier, and Isabelle Sapet participated by phone. The objective of the presentation was to explain the requirements of the revised Code for the Task Force to identify any areas where it felt there was a need for further discussion with the IESBA on the independence requirements for review.

It was noted that in the revised, and existing, Code the independence requirements for audit are essentially the same as for review. In both cases the accountant cannot assume a management responsibility and there are restrictions on bookkeeping services.

An issue that the Task Force discussed was whether, in the small- and medium-sized entity (SME) sector in particular, the public interest is best served by:

- Strict adherence to the independence principle and related guidance concerning provision of accounting services to these assurance clients (which aim to address the "self review" threat that arises when a practitioner providing an assurance service has certain types of involvement in the preparation of the client's accounting records and/or financial statements), or
- An approach that permits provision of such services under certain conditions so that threats to the practitioner's independence regarding performance of the assurance engagement are adequately disclosed, but at the same time permitting SME assurance clients to access the professional accountant's professional expertise regarding preparation of financial statements.

After discussion of the matter (and paragraph 290.162-171 in particular which are reproduced in an appendix to this paper), the consensus view of the Task Force was that, in the context of providing assurance on financial statements, the current provisions of the Code are appropriate, that is the application of the independence principle to audits and reviews of financial statements should not be different, for example because the reviews are limited assurance engagements and not reasonable assurance engagements.

The consensus view of the Task Force was also that the provisions of Section 290.171 of the IFAC Code concerning the practitioner's involvement in preparation of accounting records and financial statements of non-public interest entities provide adequate latitude for practitioners to respond appropriately to meet their clients' needs for assistance without impairing their independence in relation to the review of the financial statements.

However, the AICPA correspondent member on the Task Force strongly believes that practitioners should be permitted to perform a review engagement when independence is impaired because the performance of certain services is intended to assist the entity in preparing high-quality, reliable financial statements. Smaller entities that engage practitioners to perform review engagements often require assistance in order to prepare quality financial statements beyond the scope of what is envisaged in the provisions of Section 290.171. It is the position of the AICPA correspondent member that, as long as the report contains clear disclosure as to the services performed, and a statement that the performance of such services impaired the practitioner's independence, the practitioner should be able to express a review-level conclusion on the financial statements.

The SMP Committee provides comments on all IAASB projects. In commenting on this project, the SMP Committee noted:

> The first [concern] relates to the issue of independence, and whether the same degree of independence is required within a limited assurance framework. While the SMP Committee is not unanimous on this issue we are unanimous in thinking that further consultation be undertaken between the IAASB and IESBA to address the issue. Alternatives might include permitting a lack of independence with appropriate disclosure or identifying the report in a different way that would distinguish it from a conventional review (independence required). While we recognize that the IESBA believes the concern of independence for review

engagements has been addressed within paragraph 290.171 of their Code of Ethics we believe nevertheless that this particular provision does not fully address the issue.

At its September meeting, the IAASB agreed that, in the context of the objective of this project, the current provisions of the Code regarding the practitioner's involvement with an assurance client's accounting records and financial statements are appropriate in the case of review engagements. Therefore, IAASB does not believe that further consultation with the IESBA on this matter is necessary.

Material Presented

Agenda Paper 6	This Agenda Paper

Action Requested

1. IESBA members are asked to receive the update.

Appendix

Management Responsibilities

290.162 Management of an entity performs many activities in managing the entity in the best interests of stakeholders of the entity. It is not possible to specify every activity that is a management responsibility. However, management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment and control of human, financial, physical and intangible resources.

290.163 Whether an activity is a management responsibility depends on the circumstances and requires the exercise of judgment. Examples of activities that would generally be considered a management responsibility include:

- Setting policies and strategic direction;
- Directing and taking responsibility for the actions of the entity's employees;
- Authorizing transactions;
- Deciding which recommendations of the firm or other third parties to implement;
- Taking responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; and
- Taking responsibility for designing, implementing and maintaining internal control.

290.164 Activities that are routine and administrative, or involve matters that are insignificant, generally are deemed not to be a management responsibility. For example, executing an insignificant transaction that has been authorized by management or monitoring the dates for filing statutory returns and advising an audit client of those dates is deemed not to be a management responsibility. Further, providing advice and recommendations to assist management in discharging its responsibilities is not assuming a management responsibility.

290.165 If a firm were to assume a management responsibility for an audit client, the threats created would be so significant that no safeguards could reduce the threats to an acceptable level. For example, deciding which recommendations of the firm to implement will create self-review and self-interest threats. Further, assuming a management responsibility creates a familiarity threat because the firm becomes too closely aligned with the views and interests of management. Therefore, the firm shall not assume a management responsibility for an audit client.

290.166 To avoid the risk of assuming a management responsibility when providing non-assurance services to an audit client, the firm shall be satisfied that a member of management is responsible for making the significant judgments and decisions that are the proper responsibility of management, evaluating the results of the service and accepting responsibility for the actions to be taken arising from the results of the service. This reduces the risk of the firm inadvertently making any significant judgments or decisions on behalf of management. The risk is further reduced when the firm gives the client the opportunity to make judgments and decisions based on an objective and transparent analysis and presentation of the issues.

Preparing Accounting Records and Financial Statements

GENERAL PROVISIONS

290.167 Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework. These responsibilities include:

- Originating or changing journal entries, or determining the account classifications of transactions; and
- Preparing or changing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction (for example, purchase orders, payroll time records, and customer orders).

290.168 Providing an audit client with accounting and bookkeeping services, such as preparing accounting records or financial statements, creates a self-review threat when the firm subsequently audits the financial statements.

290.169 The audit process, however, necessitates dialogue between the firm and management of the audit client, which may involve (a) the application of accounting standards or policies and financial statement disclosure requirements, (b) the appropriateness of financial and accounting control and the methods used in determining the stated amounts of assets and liabilities, or (c) proposing adjusting journal entries. These activities are considered to be a normal part of the audit process and do not, generally, create threats to independence.

290.170 Similarly, the client may request technical assistance from the firm on matters such as resolving account reconciliation problems or analyzing and accumulating information for regulatory reporting. In addition, the client may request technical advice on accounting issues such as the conversion of existing financial statements from one financial reporting framework to another (for example, to comply with group accounting policies or to transition to a different financial reporting framework such as International Financial Reporting Standards). Such services do not, generally, create threats to independence provided the firm does not assume a management responsibility for the client.

AUDIT CLIENTS THAT ARE NOT PUBLIC INTEREST ENTITIES

290.171 The firm may provide services related to the preparation of accounting records and financial statements to an audit client that is not a public interest entity where the services are of a routine or mechanical nature, so long as any self-review threat created is reduced to an acceptable level. Examples of such services include:

- Providing payroll services based on client-originated data;
- Recording transactions for which the client has determined or approved the appropriate account classification;
- Posting transactions coded by the client to the general ledger;
- Posting client-approved entries to the trial balance; and
- Preparing financial statements based on information in the trial balance.

In all cases, the significance of any threat created shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Arranging for such services to be performed by an individual who is not a member of the audit team; or
- If such services are performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to review the work performed.