



AUDIT &
ASSURANCE
FACULTY

re:Assurance

Perspectives on assurance

ENGAGING
PRACTITIONERS



re:Assurance

An initiative from [the ICAEW Audit and Assurance Faculty](#)

All types of business, public and voluntary bodies, investors, governments, tax authorities, market regulators and their stakeholders need to be able to rely on credible information flows to make decisions. Confidence suffers when there is uncertainty about the integrity of information or its fitness for purpose.

The Institute of Chartered Accountants in England and Wales' (ICAEW) Audit and Assurance Faculty is a leading authority on external audit and other assurance services. It is recognised internationally by members, professional bodies and others as a source of expertise on issues related to audit and assurance.

Through the *re:Assurance* initiative, the ICAEW Audit and Assurance Faculty is promoting dialogue about external assurance: finding out where new assurance services could strengthen markets and enhance confidence by making information flows more credible; asking how the *International Framework for Assurance Engagements* can be applied and developed; and answering demands for practical guidance to meet emerging business needs.

Perspectives on assurance is a series of discussion papers within the *re:Assurance* initiative aimed at specific audiences; those with an interest in public policy, people in business and assurance practitioners. The aim of these papers is to stimulate dialogue.

Perspectives on assurance: Engaging policy makers explains the role of external assurance in society and considers public interest issues related to the provision and performance of assurance services.

Perspectives on assurance: Engaging business helps business and their stakeholders to understand the nature of external assurance, to identify business needs and expectations that could be met by external assurance and to solicit feedback based on practical experience.

Perspectives on assurance: Engaging practitioners aims to increase awareness amongst practitioners of the nature of external assurance and helps them to respond to opportunities for external assurance. It explains the key elements of the *International Framework for Assurance Engagements*, seeks feedback based on practical experience and identifies areas where there may be a need for new guidance.

Further information on the *re:Assurance* initiative, the current work programme and how to get involved is available at www.icaew.com/assurance or telephone Jo Iwasaki on + 44 (0)20 7920 8786.

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Perspectives on assurance
Engaging practitioners

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Share your views

This paper is written primarily for assurance practitioners. The Institute of Chartered Accountants in England and Wales' (ICAEW) Audit and Assurance Faculty is committed to raising awareness of the nature of external assurance and exploring opportunities for practitioners in new areas of external assurance and the practical application of the International Auditing and Assurance Standards Board *International Framework for Assurance Engagements* (the IAASB Framework).¹

We want to discuss the issues identified in this discussion paper with practitioners who have an interest in external assurance and the IAASB Framework. Comments can be emailed to us but if you would like to talk to us please call the number below or send your contact details to our email address. Comments are requested by 30 June 2008.

In the discussion paper we pose a series of questions, which are reproduced below. We are particularly interested in views on these questions.

The discussion paper also explores a number of issues which might benefit from further research. We are keen to hear about any research which is being or could be conducted in these areas.

Opportunities for practitioners

1. Other than audit, what, if any, types of service do you currently provide where you give an opinion? Please include examples of services whether or not they follow a formal framework or standard.
2. Are there any emerging issues that your clients are currently facing where they might need or benefit from some form of external assurance? Please give examples.
3. Can you identify any areas (whether related to assurance engagements in general or engagements on specific subjects) where the ICAEW could provide new guidance?

Definitions and objectives of assurance engagements

4. What are the difficulties, if any, in applying the IAASB Framework or International Standard on Assurance Engagements 3000, *Assurance engagements other than audits or reviews of historical financial information* (ISAE 3000) in practice to assurance engagements?
5. Do you think that users' needs can be met through two types of assurance engagement (i.e. reasonable or limited assurance), characterised by two different types of conclusion (i.e. positive or negative conclusion)? If not, are there other forms of assurance conclusion that you think could be given?

Structure of an assurance engagement

6. This paper explains the structure and key characteristics of an assurance engagement under the IAASB Framework. Are there any aspects of this structure that you think require further consideration? If so, please give reasons.
7. The paper raises the possibility that the identification of suitable criteria may inhibit the development of new types of assurance engagement. Do you believe this to be a valid concern and, if so, can you offer any solutions?
8. Do you think that external assurance reports that include the elements in ISAE 3000 could be made more useful? If so, please make suggestions.

¹ IAASB functions as an independent standard setting body under the auspices of the International Federation of Accountants (IFAC). The ICAEW is a member body of IFAC and is committed to supporting its work.

Contact details

Email: tdaf@icaew.com

Address: *Perspectives on assurance: Engaging practitioners*
ICAEW Audit and Assurance Faculty
Chartered Accountants' Hall
PO Box 433
Moorgate Place
London
EC2P 2BJ
United Kingdom

Telephone: + 44 (0)20 7920 8786

Website: www.icaew.com/assurance

1. Introduction

1.1 Background

Businesses² continually seek new opportunities to develop new business relationships, to enter new markets and to adopt new practices and technologies. They may, for example, enter into new partnerships or outsource operations to third parties. Credible information flows are essential for effective business relationships but how can you know if new partners are providing trustworthy information and whether the outsourced operations are being properly monitored? Businesses may turn to practising accountants for general business advice but is there anything more that practising accountants could be doing to help their clients in these areas?

Businesses, public and voluntary bodies, investors, governments, tax authorities, market regulators, policy makers, non-governmental organisations (NGOs) and other interest groups need to rely on credible information to make effective economic decisions and policy. Trust and integrity are important factors that underpin credible information flows. It is however, difficult to build trust in a complex and dynamic business world where there are new technology and business practices, changing expectations of stakeholders and demands for further information and a stream of new regulations which require increasing levels of expertise and experience.

Business and their stakeholders need to find solutions to help them meet these concerns and address information needs. One of these might be an external assurance service provided by an independent expert, a practitioner (such as a chartered accountant). The statutory audit is one example of an external assurance service which helps to reinforce confidence in business reporting and information. There are, however, other areas where an external assurance service is being or could be provided, for example on information relating to internal controls, outsourced operations and compliance with contractual agreements.

1.2 Objectives and scope of this discussion paper

This discussion paper seeks to engage practitioners on the subject of external assurance and:

- increase awareness amongst practitioners of the nature of external assurance services;
- explain the International Auditing and Assurance Standards Board *International Framework for Assurance Engagements* (the IAASB Framework) in an accessible way;
- help practitioners to respond to opportunities with confidence and then provide feedback on their experience;
- prompt feedback on areas where practitioners perceive a need for new guidance or where external assurance services are already being provided; and
- stimulate discussion of potential risks and difficulties in providing external assurance services, applying the IAASB Framework and identifying matters for future consideration that can be fed into international standard setters.

This is one of the discussion papers in the *Perspectives on assurance* series, part of the Institute of Chartered Accountants in England and Wales' (ICAEW) Audit and Assurance Faculty's *re:Assurance* initiative which promotes dialogue on assurance with interested parties. Over the last two decades there have been other initiatives in the area of external assurance, some of which have focused on the identification and promotion of new

² The term 'businesses' is used in the broadest sense of the word to encompass activities carried out by both commercial and non-commercial entities and organisations.

assurance services.³ However, the opportunities for practitioners presented by external assurance services are dependent on the perceived benefits gained by business, their stakeholders, policy makers and society.

The other discussion papers in this series explore potential benefits so as to understand how external assurance can add value. The objective of these papers is to seek to engage with those who have an interest in reliable business information and, through discussion of the issues around the role of external assurance, to try to gain a broader understanding of the needs of business, their stakeholders and society at large.

³ For example, work carried out through the American Institute of Certified Public Accountants' (AICPA) Vision Project and Special Committee on Assurance Services, see www.cpavision.org.

2. Opportunities for practitioners

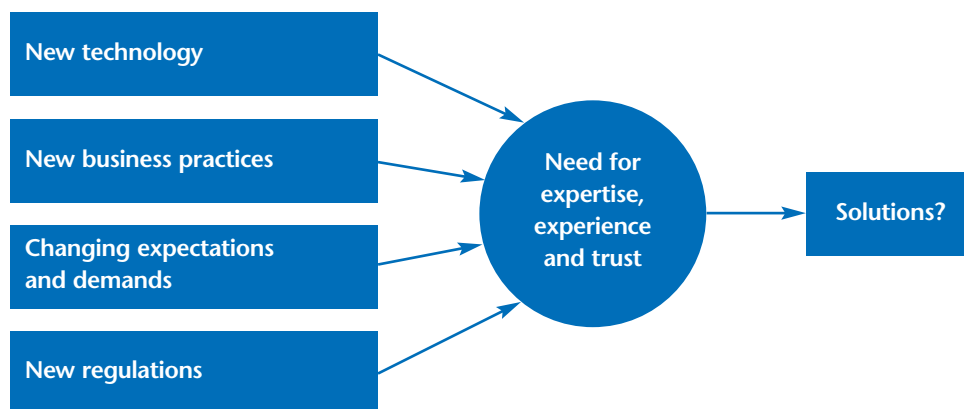
2.1 The need for credible information flows

Why might clients want external assurance services? Information is central to market activities; business and their stakeholders need reliable information to make sound economic decisions.

Trust and integrity are key characteristics of effective business relationships and underpin credible information flows. Where individual businesses identify a particular need to build confidence in information and reinforce relationships of trust, external assurance can play a valuable role. It can complement the important functions fulfilled by internal control and internal audit in creating confidence in corporate governance and reporting. An independent expert, a practitioner, expressing assurance on information provides a signal that information is trustworthy.

The business world is constantly changing with businesses facing new technology and business practices, changing expectations of stakeholders and demands for further information and a stream of new regulations. Businesses might have limited experience and expertise in unfamiliar and complex areas, which increases the risks to the business. Business and their stakeholders need to find suitable solutions to help them address their concerns in the face of uncertainty as highlighted in figure 2.1.

FIGURE 2.1: CHALLENGES TO CREDIBILITY



There are many ways that business and their stakeholders can build trust in the reliability of information, for example, through the establishment of an internal audit function or by stakeholder engagement. External assurance is another solution.

2.2 What is external assurance?

What do we mean by external assurance? 'A positive declaration intended to give confidence' is a dictionary definition of the word 'assurance'.⁴ When applied in the context of business information, external assurance may be described as the provision of an independent opinion by an expert practitioner (such as a chartered accountant) on information prepared by one party for the benefit of another party or parties. This opinion is intended to increase confidence in the reliability of information.

It is important to emphasise the point that the opinion comes from an independent source. Stakeholders want credible information that they can trust. Objectivity and independence are therefore essential characteristics of external assurance. Practitioners who perform

⁴ *Concise Oxford English Dictionary*, Oxford: Oxford University Press, 2004.

assurance engagements by applying the IAASB Framework are governed by a code of ethics which includes requirements regarding independence. This is explained in more detail in section 2.3.

Another important characteristic is that of professional judgement. Practitioners need to have the ability to make professional judgements that are ethical and apply relevant knowledge to specific situations. It is essential to have the ability to understand and assess the reliability of information and to have the strength of character to challenge management where concerns arise.

There is a wide range of information that could be subject to some form of external assurance. Areas where an external assurance service might be requested include:

- quantitative information, including financial information;
- corporate governance performance;
- human resource performance indicators;
- environmental statements;
- compliance with contractual agreements;
- outsourced operations/service organisations;
- narrative information; and
- internal controls.

Other examples are included in section 4.3.

2.3 The International Framework for Assurance Engagements

To ensure a consistent approach by practitioners to external assurance services and manage users' expectations, widely accepted models and frameworks can be helpful.

In 2004, the IAASB published its *International Framework for Assurance Engagements* and an assurance standard, ISAE 3000. These set out high-level principles applicable to various types of assurance engagement.

The IAASB Framework is important because it applies to all assurance engagements. The IAASB Framework sets out the key elements of an assurance engagement and applies to all financial or non-financial and historical or prospective information. For instance, all International Standards on Auditing (ISAs) published after 1 January 2004 are consistent with the IAASB Framework. ISAE 3000 provides basic principles, procedures and generic guidance on the performance of assurance engagements including guidance on planning the engagement and obtaining evidence.

Whilst defining and describing the objectives of an assurance engagement, the IAASB Framework also explains that the International Federation of Accountants (IFAC) *Code of Ethics for Professional Accountants* (the IFAC Code of Ethics)⁵ governs practitioners who perform assurance engagements. Part A sets out the fundamental ethical principles for professional accountants (integrity, objectivity, professional competence and due care, confidentiality and professional behaviour). Part B includes a conceptual approach to independence. Section 290 of the Code requires members of assurance teams, firms and, when applicable, network firms to be independent of assurance clients. These provisions are included in the ICAEW *Code of Ethics*, the latest version of which took effect from 1 September 2006 and practitioners performing assurance engagements must comply with the Code.

⁵ *Code of Ethics for Professional Accountants*, New York: IFAC, 2005.

2.4 Issues

Carrying out an external assurance service other than an audit of historical financial statements might seem a little daunting. As a practitioner you might already be performing engagements that are similar to an assurance engagement without following a particular framework or standard and your clients may be very happy with the service being provided. You might think that the IAASB Framework is too difficult to apply, limiting in scope, or perhaps too heavy handed by setting too high a barrier to providing external assurance services. However, using the IAASB Framework might help you to respond more easily to clients' requests. There are likely to be new areas of work that practitioners come across and the principles in the IAASB Framework can help practitioners to shape and perform assurance engagements, thereby helping clients to do business with confidence. This paper is designed to help practitioners to understand the IAASB Framework.

Perhaps another issue practitioners may face is that the IAASB Framework is too high level and that they would benefit from more detailed additional guidance on performing specific types of assurance engagements. This does not invalidate the IAASB Framework but places greater onus on standard setters and professional bodies to pick up areas where further guidance may be necessary.

As a practitioner you may be used to providing external assurance reports on financial information contained in financial statements, i.e. through the statutory audit, but not sure how you should deal with requests for external assurance on non-financial information, such as information on environmental performance, where there is a need for expertise in a number of different areas that may be quite complex and unfamiliar. This might require a shift away from the traditional model whereby one person, the engagement partner, who is responsible for the engagement, is not only an expert on assurance but also on the information to which an assurance report is attached. We may need to countenance situations where accountants co-ordinate multi-disciplinary teams with the relevant expertise and some form of joint assurance engagement is performed.

The IAASB Framework does not specifically deal with managing the commercial risks faced by practitioners. Whilst external assurance has an important role to play in reinforcing trust and confidence in the reliability of information, practitioners must also assess and manage their own risks when carrying out an external assurance service. Professional accountants are bound by ethical rules which require them to provide a competent professional service to clients. However, expectations held by business and their stakeholders also need to be managed. The faculty has issued guidance, Technical Release AAF 04/06, *Assurance engagements: management of risk and liability* to assist accountants in managing their risk when undertaking assurance engagements. This should be read in conjunction with other ICAEW and faculty guidance on risk and liability and assurance engagements generally.

Practitioners who perform assurance engagements need to be independent of their clients. The provision of other services to clients might, however, impact on the ability of the practitioner to perform an external assurance engagement. Practitioners will need to apply the ethical guidance in the IFAC Code of Ethics to judge whether they have addressed the threats to independence.

QUESTIONS FOR DISCUSSION

1. Other than audit, what, if any, types of service do you currently provide where you give an opinion? Please include examples of services whether or not they follow a formal framework or standard.
2. Are there any emerging issues that your clients are currently facing where they might need or benefit from some form of external assurance? Please give examples.
3. Can you identify any areas (whether related to assurance engagements in general or engagements on specific subjects) where the ICAEW could provide new guidance?

3. Definition and objectives of assurance engagements

3.1 A definition

The IAASB Framework defines an assurance engagement as:

‘an engagement in which a **practitioner** expresses a conclusion designed to enhance the degree of confidence of the **intended users** other than the **responsible party** about the outcome of the evaluation or measurement of a **subject matter** against **criteria**.’
(Paragraph 7 of the IAASB Framework)

A number of terms used in this definition, which we have highlighted in bold, are defined below:

Practitioners – those parties who are providing the assurance service (e.g. a chartered accountant).

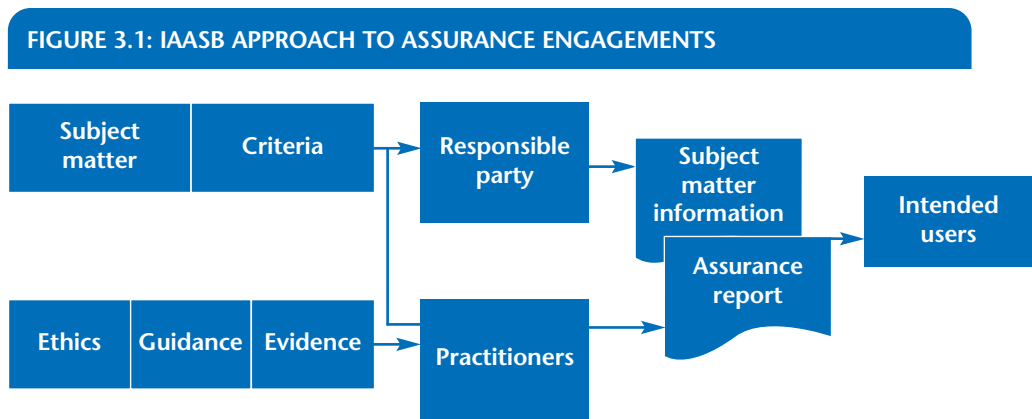
Intended users – those parties for whom the assurance report is prepared. This can include the responsible party although the responsible party cannot be the sole user of the report.

Responsible party – the party that is responsible for preparing and providing the information or the assertion, for example, the management of a company.

Subject matter (and subject matter information) – what practitioners are reporting on. Subject matter refers to underlying matter of interest to intended users and subject matter information is information that results from evaluating or measuring the subject matter.

Criteria – the benchmarks against which to measure the subject matter.

Practitioners perform the engagement on the basis of what has been agreed with the client, which may be the responsible party. In an assurance engagement, practitioners would perform work to obtain evidence to gain comfort over the information provided to the intended users. This comfort is then expressed in their assurance report as a conclusion, which is designed to enhance the confidence of the users about the information provided. Figure 3.1 illustrates the IAASB approach to assurance engagements.



EXAMPLE 3.1: APPLYING THE IAASB FRAMEWORK TO THE STATUTORY AUDIT

Taking a practical example of a statutory audit of IFRS financial statements:

- the responsible party is the board of directors of the company;
- practitioners are the statutory auditors;
- intended users are the shareholders;
- the subject matter is the financial position of the company;
- criteria is the applicable financial reporting framework;
- ethics represents the *IFAC Code of Ethics for Professional Accountants*;
- guidance represents International Standards on Auditing;
- the evidence is documented in audit working papers;
- the subject matter information is the financial statements; and
- the assurance report is the auditor's report.

An assurance engagement is different from an agreed-upon procedures engagement. An agreed-upon procedures engagement involves performing certain specified procedures on information and reporting factual findings without giving any form of opinion on the implications of the work performed.

3.2 Types of assurance engagement

According to the IAASB Framework, practitioners can perform two types of assurance engagement. These are:

1. a **reasonable** assurance engagement; and
2. a **limited** assurance engagement.

The difference between these types of assurance is reflected in the nature of the work performed, the level of engagement risk, and the type of conclusion provided. Put simply, limited assurance conveys less assurance than reasonable assurance.

Practitioners aiming to obtain reasonable assurance must obtain sufficient evidence in order that they may give a positive conclusion. To do this they must reduce the assurance engagement risk (see section 3.4) to an acceptably low level. The audit opinion as currently expressed in audit reports in the UK reflects a reasonable assurance conclusion.

In a limited assurance engagement, the assurance engagement risk is greater than for a reasonable assurance engagement and hence, a negative conclusion is provided. An interim review of the financial statements of listed companies is an example of a limited assurance engagement.

The types of conclusions expressed are discussed in more detail later in this paper.

3.3 Extent of work performed

The two types of assurance engagements are separated by the extent of work performed. In reasonable assurance engagements practitioners would do all that they need to do to support a positive opinion. However, this does not mean that absolutely all evidence is gathered or examined because there are time and cost factors to consider relative to the specific engagement. The gathering of evidence in limited assurance engagements is deliberately limited in comparison to a reasonable assurance engagement. Practitioners need to use their professional judgement in determining how much evidence is needed for limited assurance engagements. The sufficiency of evidence is affected by the risk of the specific engagement and the quality of evidence.

In some areas standards or guidance already exist on the nature, timing and extent of work procedures. For example:

- ISAs (UK and Ireland) provide detailed requirements for an audit (an example of a reasonable assurance engagement);
- the ICAEW Interim Technical Release AAF 03/06, *The ICAEW assurance service on unaudited financial statements* (an example of a limited assurance engagement);
- the ICAEW Technical Release AAF 01/06, *Assurance reports on internal controls of service organisations made available to third parties*; and
- International Standard on Review Engagements (ISRE) (UK and Ireland) 2410, *Review of interim financial information performed by the independent auditor of the entity* issued by the Auditing Practices Board (APB) which provides guidance on procedures appropriate for a specific limited assurance engagement.

Where there are no specific standards or guidance, it is ultimately the practitioners performing the assurance engagement who will need to decide the amount and nature of evidence needed in order to be able to express a suitable form of conclusion.

3.4 Assurance engagement risk

Assurance engagement risk represents the risk that practitioners provide an inappropriate conclusion because the information being reported on is materially misstated. There are ordinarily three components of assurance engagement risk for practitioners to think about when planning and performing an assurance engagement:

- inherent risk – the susceptibility of the information to a material misstatement (e.g. where there have been complex transactions);
- control risk – the risk that a material misstatement will not be prevented or detected on a timely basis by internal controls; and
- detection risk – the risk that the practitioners will not detect a material misstatement that exists.

When assessing these risks, practitioners will need to understand the type of engagement and nature of information being reported on.

3.5 Conclusion provided

The types of assurance are distinctly expressed in the report wording. Practitioners provide a positive form of conclusion for a reasonable assurance engagement, for example, 'In our opinion the internal controls are effective, in all material respects, based on XYZ criteria'.

In a limited assurance engagement, practitioners express a conclusion in a negative form, such as, 'Based on our work described in this report, nothing has come to our attention that causes us to believe that the internal controls are not effective, in all material respects, based on XYZ criteria'.

3.6 Direct and assertion-based reporting engagements

According to the IAASB Framework, there are two types of assurance engagement: direct or assertion-based reporting engagements.

An example of a direct reporting engagement is where practitioners directly perform the evaluation or measurement of the subject matter and the resulting information is provided to the intended users in the assurance report. Assertion-based engagements arise where the responsible party (the preparer of the information) has already evaluated (or measured)

the information and this evaluation will be made available to the intended users and the responsible party provides some form of assertion based on this. Practitioners generally prefer to perform assertion-based engagements and these are illustrated in the example below.

EXAMPLE 3.2: LIMITED ASSURANCE ENGAGEMENT – EFFECTIVENESS OF INTERNAL CONTROLS OVER EXISTENCE OF FIXED ASSETS

- Nothing has come to our attention that causes us to believe that the internal controls over the existence of fixed assets are not effective, in all material respects, based on XYZ criteria; or
- nothing has come to our attention that causes us to believe that the directors' assertion in ...(e.g. the directors' report) on the effectiveness of internal controls over the existence of fixed assets is not fairly stated.

3.7 Non-assurance engagements

There are some engagements undertaken by practitioners, such as agreed-upon procedures engagements, that are not assurance engagements. They are, therefore, expressly excluded from the IAASB Framework. These are explained in paragraphs 12-14 of the IAASB Framework and set out in Appendix 1 to this paper.

QUESTIONS FOR DISCUSSION

4. What are the difficulties, if any, in applying the IAASB Framework or International Standard on Assurance Engagements 3000, *Assurance engagements other than audits or reviews of historical financial information* (ISAE 3000) in practice to assurance engagements?
5. Do you think that users' needs can be met through two types of assurance engagement (i.e. reasonable or limited assurance), characterised by two different types of conclusion (i.e. positive or negative conclusion)? If not, are there other forms of assurance conclusion that you think could be given?

4. Structure of an assurance engagement

4.1 Essential components

Paragraph 20 of the IAASB Framework sets out key characteristics of an assurance engagement. These are:

- a three-party relationship;
- appropriate subject matter;
- suitable criteria;
- sufficient appropriate evidence; and
- a written assurance report.

Some of these terms have already been briefly discussed but are explained in more detail below. Appendix 2 provides a decision tree to show how practitioners can use these characteristics to decide whether they can perform an assurance engagement and highlights how these characteristics fit together. The decision tree does not address risk management issues. As explained earlier, the Audit and Assurance Faculty has issued guidance (Technical Release AAF 04/06, *Assurance engagements: management of risk and liability*) to assist accountants in managing their risk and liability when undertaking assurance engagements.

4.2 Three-party relationship

According to the IAASB Framework, there are three separate parties involved in an assurance engagement: the party responsible for the subject matter and/or the reported information (responsible party), practitioners and the intended users. The responsible party and the intended users can either be from different entities or from the same entity. Practitioners are required to be independent of both the responsible party and the intended users.

In the case of a UK statutory audit, the separation of parties is easily recognised and defined: the responsible party is the board of directors, the users are the body of shareholders, and the practitioners are the auditors. However, the differentiation of three parties is not always straightforward, and issues may arise with the three-party relationship. For example, even in an audit, the fact that auditors work closely with the directors can lead to concerns about auditors' independence and responsibilities to the shareholders.

The requirement for a three-party relationship can also be less straightforward for non-audit situations. For instance, the management of a group company may engage practitioners to assess the operation of internal controls of its subsidiaries. In this case, the two parties are within the same group, and in fact the management is ultimately responsible for the subsidiary. The IAASB Framework adopts a pragmatic approach to this type of situation: where an organisation has a layered management structure, the board is unlikely to be involved in the controls of its subsidiaries on a day-to-day basis. In such cases, the management may benefit from the practitioners' independent assessment of the subsidiary's operations. The separation of the responsible party from the users is however often far less clear if the client is a smaller organisation.

Interim Technical Release AAF 03/06, *The ICAEW assurance service on unaudited financial statements* and Technical Release AAF 01/06, *Assurance reports on internal controls of service organisations made available to third parties* provide examples of how this might work in practice. Technical Release AAF 04/06, *Assurance engagements: management of risk and liability* provides some practical guidance on dealing with risk management issues, including agreeing contractual terms with clients and, where relevant, third parties.

4.3 Appropriate subject matter

The information that is being reported on can take many forms and can be quantitative or qualitative, subjective or objective or historical or prospective. These different forms will impact on the practitioners' ability to evaluate them and the types of evidence they use. For example, it is easier to source reliable evidence for historical financial information than for prospective financial information as the information is more capable of objective testing and evaluation.

Some examples of subject matters reported on in assurance engagements are set out in the table below:

| FIGURE 4.1: SUBJECT MATTER EXAMPLES | |
|--------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Type of information (paragraph 31 of the IAASB Framework) | Examples |
| Financial performance or conditions | <p>Historical Statutory financial statements</p> <p>Non-historical Prospective financial information</p> |
| Non-financial performance or conditions | Environmental performance or corporate social responsibility reports, key performance indicators which show the efficiency of the business in a particular area |
| Physical characteristics | Existence of mineral reserves or production capacity of machinery |
| Systems and processes | Internal controls and outsourced activities (which could include payroll, IT and custodial services), process of preparing information (as discussed in the ICAEW guidance, <i>Prospective Financial Information: Guidance for UK Directors</i>) |
| Behaviour | Corporate governance, human resources practices, compliance with law and regulation, labour policies |

The important consideration for practitioners is whether the information on which they are reporting is appropriate for an assurance engagement, in particular:

- Is the information capable of evaluation/measurement?
- Is evidence available?

If the subject matter is not capable of consistent measurement or the evidence available to practitioners is limited they are unlikely to be able to support their conclusion.

4.4 Suitable criteria

The IAASB Framework (paragraph 36) explains the characteristics of suitable criteria. Suitable criteria must be:

- relevant to the purpose of the assurance engagement (relevant criteria contribute to conclusions that assist decision-making by the intended users);
- complete including, where relevant, benchmarks for presentation and disclosure;
- reliable to allow a consistent evaluation of the information;
- neutral (i.e. free from bias); and
- understandable to contribute to clear conclusions that are not subject to significantly different interpretations.

EXAMPLE 4.1: SUITABLE CRITERIA FOR ASSURANCE ENGAGEMENTS

1. For a statutory audit in the UK, suitable criteria would include:
 - the provisions dealing with accounts and disclosures in the Companies Act;
 - applicable financial reporting standards (whether they are International Financial Reporting Standards as adopted by the EU or Financial Reporting Standards issued by the UK Accounting Standards Board); and
 - other standards or guidance issued, e.g. Urgent Issues Task Force Abstracts, rules issued by regulators such as the FSA or standards or guidance from professional bodies.
2. In terms of internal controls of service organisations, the ICAEW has issued Technical Release AAF 01/06, *Assurance reports on internal controls of service organisations made available to third parties* for assurance engagements concerning internal controls of financial service organisations. In considering suitable criteria, the guidance sets out a series of control objectives for financial service activities including custody, investment management and pension administration.
3. Suitable criteria for performing an ICAEW Assurance Service engagement on the accounts of audit-exempt companies are accounting policies selected by the directors within the framework of UK GAAP (see Interim Technical Release 03/06, *The ICAEW assurance service on unaudited financial statements*).
4. The ICAEW's publication *Prospective Financial Information: Guidance for UK Directors* provides objective criteria (including separate process criteria) to help directors prepare prospective financial information and to give investors confidence in its quality. These criteria might be used in an assurance engagement which assesses the process by which such information was prepared. The UK and Ireland Standards for Investment Reporting 3000, *Investment reporting standards applicable to public reporting engagements on profit forecasts* contains basic principles and essential procedures with which a reporting accountant is required to comply in the conduct of an engagement to report on a profit forecast included within an investment circular.

Whilst criteria must be relevant to the particular engagement, there may also be different criteria which could potentially be used for the same subject matter. It is therefore important that the criteria of any evaluation are clearly communicated to the users. By communicating why and how the conclusion is reached, practitioners are providing support for the basis of their conclusion. If such a basis is missing or unclear to users, there is a risk that the conclusion may be misunderstood or even considered to be misleading. Criteria

may be made publicly available, included in the information reported on or in the assurance report itself. If, however, criteria are only available to specific users, the assurance report is restricted to these users.

Criteria do not have to be established in the sense of being embodied in law or regulations. When accepting an engagement, practitioners discuss with their client what could be suitable criteria for a specific engagement and consider whether established criteria are suitable. Practitioners and their clients may agree that established criteria are not suitable for the engagement or require amendments for specific purposes. Where practitioners and clients develop criteria for a specific engagement or amend established criteria, they need to ensure that the criteria are suitable and are communicated to the users. Accordingly, the assurance report includes the criteria in a clear and concise manner, or provides a reference where users can find them, such as within the information to which the assurance engagement is related.

Without suitable criteria to measure or evaluate a subject matter, practitioners are unable to perform an assurance engagement. Criteria are therefore an important element of assurance engagements.

However, the ability to identify suitable criteria can sometimes act as a barrier to performing assurance engagements under the IAASB Framework. Identifying suitable criteria might be difficult in circumstances where practitioners are carrying out new types of assurance engagements where there may be no established criteria. This issue may need further consideration. For example, rather than referring to a set of standards, could criteria be based on norms of business behaviour or developed through experience? Alternatively, is there scope for criteria to be quite high level, with a greater focus on practitioners using professional judgement in such situations?

4.5 Sufficient appropriate evidence

To express a conclusion on subject matter, practitioners need sufficient appropriate evidence to obtain assurance that the information is free of material misstatement. In planning the work, practitioners will exercise professional judgement and consider what constitutes sufficient evidence and will use professional scepticism to question the validity of the evidence obtained. When determining the extent and nature of procedures needed practitioners consider materiality, assurance engagement risk and the quantity and quality of available evidence.

The term 'sufficient and appropriate' is used in auditing standards. Sufficiency represents the quantity of evidence obtained, for example, in checking the completeness of the debtors' provision – it means looking at a sufficient number of older debts to come to a conclusion about the amount to be provided for. Appropriateness is the measure of the quality of the evidence, its relevance and reliability.

The reliability of evidence is influenced by its source and by its nature. Paragraph 43 of the IAASB Framework provides some general guidance about the reliability of evidence although it notes that there may be exceptions:

- evidence from independent sources outside the entity is generally more reliable than from internal sources;
- evidence generated internally is generally more reliable where the related controls are effective;
- evidence is generally more reliable if obtained directly by practitioners rather than indirectly or by inference;
- evidence is generally more reliable when it exists in written form, i.e. paper, electronic or other media rather than an oral representation; and
- original documents are generally more reliable than copies.

4.6 Considering materiality

Materiality helps practitioners determine the nature, timing, and extent of work procedures needed to arrive at a conclusion about the information being reported on but deciding materiality can be a challenge when performing an assurance engagement. How should materiality be defined for various types of information that might be unfamiliar to practitioners?

In terms of historical financial information, the International Accounting Standards Board (IASB) defines materiality as follows:

‘Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.’ (IASB’s Framework for the Preparation of Financial Statements)

In other words, materiality should be assessed based on what factors might influence the decisions of the users. Suitable criteria tend to be agreed through consultation with the responsible party whereas the decision on materiality ultimately depends on practitioners’ professional judgement, based on an assessment of risk and an understanding of intended users’ needs.

4.7 Written assurance reports

The product of an assurance engagement is an assurance report. This communicates to users the conclusion reached by practitioners. The conclusion needs to be in writing and should not be substituted by an oral report.

An assurance report includes certain basic elements. Paragraph 49 of ISAE 3000 provides a list of such elements for assurance engagements. Practitioners need to:

- make clear that the report is an independent assurance report;
- identify to whom the report is addressed;
- identify and describe the subject matter;
- set out the criteria used;
- where applicable, provide a description of any significant inherent limitation associated with the evaluation/measurement of the subject matter against the criteria;
- where relevant, restrict the use of the assurance report to specific users or a specific purpose;
- identify the responsible party and explain the respective responsibilities of the responsible party and practitioners;
- refer to relevant International Standards on Assurance Engagements;
- provide a summary of the work performed;
- include the practitioner’s conclusion;
- provide the assurance report date; and
- include details of the practitioner (the name of the firm/practitioner and the location of the office performing the engagement).

Examples of report formats can be found in APB Bulletin 2006/6, *Auditor's reports on the financial statements in the United Kingdom*, Technical Release AAF 01/06, *Assurance reports on internal controls of service organisations made available to third parties*, Interim Technical Release AAF 03/06, *The ICAEW assurance service on unaudited financial statements*, Technical Release ITF 01/07, *Assurance report on the outsourced provision of information services and information processing services* and in ISRE (UK and Ireland) 2410, *Review of interim financial information performed by the independent auditor of the entity*.

4.8 Assurance conclusions

The type of conclusion differs depending on the type of assurance engagement. It is important to agree on the type of assurance engagement upfront with the client because once practitioners have accepted an assurance engagement, paragraph 19 of the IAASB Framework highlights that they should not change the type of assurance from reasonable to limited or from an assurance engagement to a non-assurance engagement without reasonable justification. A change in circumstances that affects the users' requirements or a misunderstanding over the nature of the engagement ordinarily may be considered reasonable justification. However, even if such a change is made, practitioners cannot disregard evidence that was obtained prior to the change.

In a reasonable assurance engagement practitioners express their conclusion in a positive form.

EXAMPLE 4.2: REASONABLE ASSURANCE THROUGH THE AUDIT REPORT

In a statutory audit where auditors give a positive opinion whether the accounts 'give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of affairs of company's affairs as at ... and of its profit [loss] for the year then ended.'

A reasonable assurance conclusion might therefore include the following wording:

- XYZ is true and fair in all material respects or XYZ presents fairly;⁶
- XYZ is effective in all material respects;
- the responsible party's assertion that ... in all material respects ... is fairly stated;
- XYZ is properly prepared; and
- XYZ is consistent with...

In a limited assurance engagement, practitioners express the conclusion in a negative form.

⁶ Such wording would only be used where it is clearly placed in context or made under a specific financial reporting framework.

EXAMPLE 4.3: LIMITED ASSURANCE THROUGH THE INTERIM REVIEW REPORT

An example of limited assurance engagements in the UK is found in ISRE (UK and Ireland) 2410, *Review of interim financial information performed by the independent auditor of the entity*: ‘... nothing has come to our attention that causes us to believe that...is not prepared, in all material respects, in accordance with ...’. Another example is found in Interim Technical Release AAF 03/06, *The ICAEW assurance service on unaudited financial statements* which says that ‘...nothing has come to our attention to refute the directors’ confirmation that in accordance with the Companies Act 1985 the financial statements give a true and fair view of ... and have been properly prepared in accordance with ...’.

Example wording in a limited assurance conclusion might include:

Nothing has come to our attention that causes us to believe that:

- XYZ is not effective;
- the responsible party’s assertion that... is not fairly stated;
- XYZ is not properly prepared; and
- XYZ is not consistent with ...

In certain circumstances practitioners may not be able to express an unqualified conclusion, for example, there may have been a limitation of scope of the practitioners’ work. According to paragraph 60 of the IAASB Framework practitioners may have to consider issuing a qualified, adverse or disclaimer of conclusion or possibly resigning from the engagement.

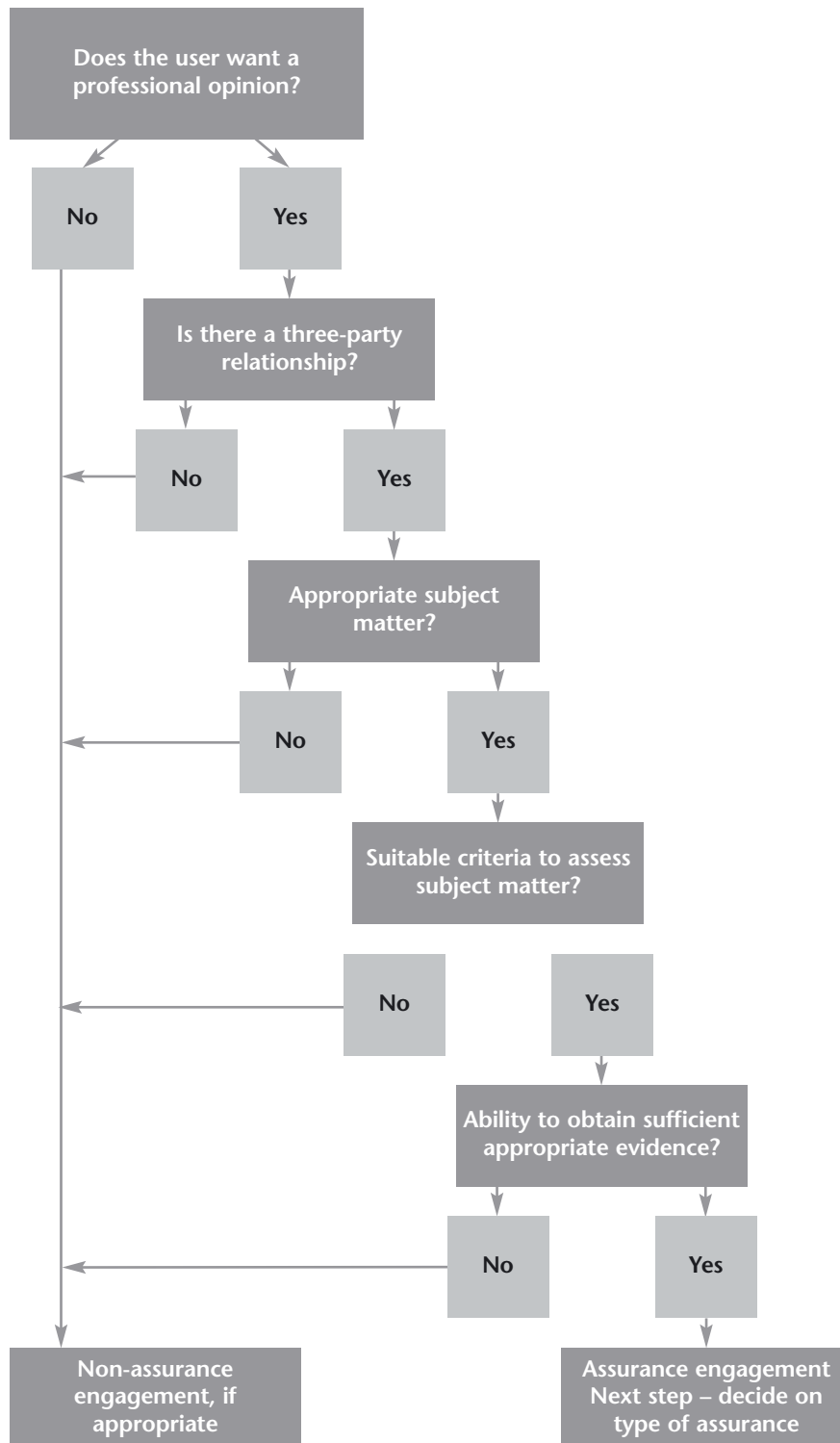
QUESTIONS FOR DISCUSSION

6. This paper explains the structure and key characteristics of an assurance engagement under the IAASB Framework. Are there any aspects of this structure that you think require further consideration? If so, please give reasons.
7. The paper raises the possibility that the identification of suitable criteria may inhibit the development of new types of assurance engagement. Do you believe this to be a valid concern and, if so, can you offer any solutions?
8. Do you think that external assurance reports that include the elements in ISAE 3000 could be made more useful? If so, please make suggestions.

Appendix 1 – Non-assurance engagements

| Types of engagement (grouped by key characteristics) | Key characteristics |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> • Engagements covered by International Standards for Related Services, such as agreed upon procedures engagements and compilation engagements • Preparation of tax returns • Consulting engagements | <ul style="list-style-type: none"> – No opinion conveying assurance is expressed in a report – No specific requirement to be independent under ICAEW <i>Code of Ethics</i> covering assurance engagements or APB's Ethical Standards for Auditors – Assurance is not the purpose of the engagement – For consulting engagements, work is often performed for benefit of client only (not external users for whom independence is required) |
| <ul style="list-style-type: none"> • Engagements to testify in legal proceedings regarding accounting, auditing, taxation or other matters | <ul style="list-style-type: none"> – No opinion conveying assurance is expressed in a report – No specific requirement to be independent under the independence requirements of the ICAEW <i>Code of Ethics</i> – Assurance is not the purpose of the engagement |
| <ul style="list-style-type: none"> • Engagements including professional opinions, views or wording from which a user may derive some assurance, but where all the key characteristics opposite apply: | <ul style="list-style-type: none"> – the opinions are merely incidental to the overall engagement; and – the written report expressly restricts the users for whom it is intended; and – there is a written agreement with the users that the engagement is not intended to be an assurance engagement; and – the engagement is not represented as an assurance engagement in the report. |

Appendix 2 – Decision tree for performing assurance engagements under the IAASB Framework⁷



⁷ The decision tree is designed to help accountants consider whether they can perform an assurance engagement under the IAASB Framework. These considerations are dealt with in sections 4.2 to 4.5 of this paper. It is important to agree the type of engagement upfront with the client (see section 4.8 for further information). This decision tree does not take account of risk management issues and practitioners should therefore also refer to the guidance in AAF 04/06, *Assurance engagements: management of risk and liability*.

Appendix 3 – References

Auditing Practices Board

APB Bulletin 2006/6, *Auditor's reports on the financial statements in the United Kingdom*, 2006
www.frc.org.uk/apb/publications

APB Ethical Standards, 2004
www.frc.org.uk/apb/publications

ISRE (UK and Ireland) 2410, *Review of interim financial information performed by the independent auditor of the entity*, 2007
www.frc.org.uk/apb/publications

Standards for Investment Reporting 3000, *Investment reporting standards applicable to public reporting engagements on profit forecasts*
www.frc.org.uk/apb/publications

Institute of Chartered Accountants in England and Wales

ICAEW *Code of Ethics*, 2006
www.icaew.com/ethics

Interim Technical Release AAF 03/06, *The ICAEW assurance service on unaudited financial statements*, 2006
www.icaew.com/aaf

Prospective Financial Information: Guidance for UK Directors, 2003
www.icaew.com/bettermarkets

Technical Release AAF 04/06, *Assurance engagements: management of risk and liability*, 2006
www.icaew.com/aaf

Technical Release AAF 01/06, *Assurance reports on internal controls of service organisations made available to third parties*, 2006
www.icaew.com/aaf

Technical Release ITF 01/07, *Assurance report on the outsourced provision of information services and information processing services*, 2007
www.icaew.com/itfac

International Auditing and Assurance Standards Board

International Framework for Assurance Engagements, 2004
www.ifac.org/Guidance

International Standard for Assurance Engagements 3000, *Assurance engagements other than audit or reviews of historical financial information*, 2004
www.ifac.org/Guidance

International Federation of Accountants

Code of Ethics for Professional Accountants, 2005
www.ifac.org

Audit and Assurance Faculty
PO Box 433 Moorgate Place
London EC2P 2BJ
T +44 (0)20 7920 8493 F +44 (0)20 7920 8754
E tdaf@icaew.com DX 877 London/City
www.icaew.com/assurance
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