

## 2. THE NEED FOR ASSURANCE

Who are the users of assurance services? Which types of services provided by professional accountants best address their needs?



## 2. THE NEED FOR ASSURANCE

### 2.1 Introduction

Owners, management, investors, governments, regulators and other stakeholders need to rely on the successful conduct of business activities, sound internal processes and the production of credible information. These operational and reporting processes enable users to make decisions and develop policies. Confidence diminishes when there are uncertainties around the integrity of information or of underlying operational processes.

There is a range of subject matters over which these parties might require assurance which can be captured under three broad categories:

- data – extracted or calculated volumes, values or other items;
- processes and controls – a series of organised activities designed to meet defined objectives; and
- reporting – a whole or part of a written report which may contain a combination of data, design of processes and narrative, including any assertions the reporting organisation has made.

Where organisations or their stakeholders identify a particular need to build confidence in data, processes, or related information, involving an independent practitioner may play a valuable role. Assurance reporting is one such role: an independent practitioner with relevant experience expressing an assurance conclusion provides a strong signal of credibility.

This section provides an overview of the need for assurance and considers various types of services that practitioners may offer to help meet that need depending on circumstances.

### 2.2 Drivers: new technology, regulation, business change, changing expectations and demands

Over the last few years the demand for assurance has increased. Lenders and shareholders require assurance over the safe, profitable and sustainable growth of their businesses. Management seeks assurance on its own operations, increasingly in a consistent and measurable form, to monitor progress either in relation to an area of risk such as information security or on an area of performance. In the course of mergers and acquisitions, for example, assurance is sought over the acquired businesses. Management seeks assurance to ensure that it is meeting regulatory obligations that may be specific to the sector, such as oil and gas or financial services, or related to broader regulatory regimes. In the public and not-for-profit sectors management may want assurance to maintain the confidence of fund providers and the public as well as for management's own purposes. In other words, assurance is sought to inform management and other users and enable them to make sound judgements and decisions.

The wider supply chain of the organisation can also benefit from assurance. Service organisations seek to assure their customers that they have adopted and implemented appropriate processes and controls over the operations outsourced to them and major customers seek such assurance. Organisations seek assurance that their distribution partners are acting in line with contractual agreements and broader expectations. Suppliers to organisations are increasingly asked to provide assurance over the ability to service their customers' needs within a framework of control that covers a wide spectrum of areas such as anti-bribery, ethical trade and financial health.

Recent initiatives, such as the UK Stewardship Code from the Financial Reporting Council (FRC), encourage management to obtain assurance against a set of principles, rather than being required to simply tick boxes or be subjected to inspection. This approach aids management in interpreting good practice, embedding this in the organisation and developing the

capability to ensure that the organisation is achieving, or working towards, those standards. The assurance journey can take organisations from the early steps, assuring that information has been fairly presented, onto assurance over the suitability of design of processes and controls, to assuring the measurement and reporting of operational effectiveness.

## 2.3 Determining the organisation's needs and defining the service

'Assurance' is a term commonly used to refer to any type of work that provides confidence to the recipient. Much of what practitioners do for their clients constitutes 'assurance' of this kind in one form or another. For example, a Chief Finance Officer may initially want assurance over the internal controls in a key subsidiary. What the CFO is actually seeking may be objective evaluation by the practitioner of the controls as designed and operated. Practitioners can meet such a request in several different ways (see 2.4). It is therefore important that practitioners and their clients explore together the nature of the organisation's needs, because the language used may unnecessarily confuse the situation.

In many instances, an organisation's needs may be very specific. For example, management may be required by law or regulation to obtain an independent assurance report, relating to the organisation's compliance with a particular law or regulation. In other instances, the organisation's management may wish a practitioner to perform an assurance engagement on a particular aspect of the entity's activities which is not required by law or regulation. In the latter case, dialogue between the practitioner and management will be essential to understand management's needs and to identify which service offering is the most appropriate to address this need. An experienced professional will be able to translate the needs of the management into an appropriately structured assurance or other engagement from a technical perspective.

In order to provide the most appropriate service, the practitioner might ask questions such as:

- Is a formal report from a practitioner required? Would it be an assurance report or would another form of report be acceptable?
- Are there relevant legal or regulatory drivers for the assurance report?
- What issue or topic is management concerned about and why?
- How can professional involvement add to the credibility of information related to the matter?
- What is the subject matter? Does the issue relate to financial or non-financial matters?
- Does management report on the subject matter themselves?
- Who are the intended users of the practitioner's report and what are their expectations? Do they expect to be involved in setting the scope of the work?
- Is information prepared by management provided to external parties? If so, who would be looking at the report and for what purpose?

The practitioner should help management determine what service options best suit their needs.

The thought process should help management become more specific about the expectations and the understanding of who the users of the assurance report are and why they will need it for.

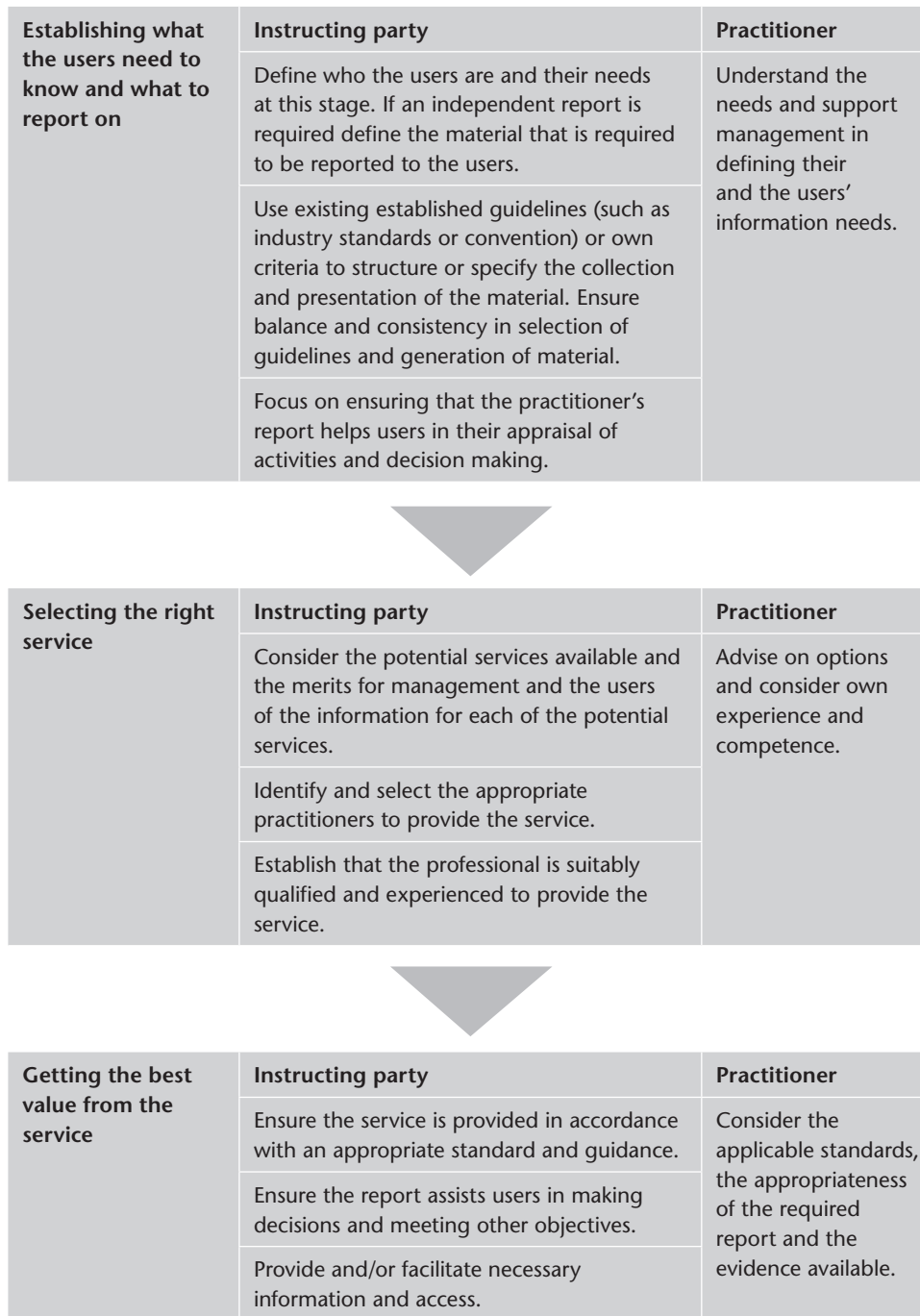
## 2.4 Types of services

In this sub-section, we review the nature and risk related to different types of services to help understand what would be the best type of service to perform to meet differing needs.

The following service categories are considered:

- assurance (see 2.4.1);
- agreed-upon procedures (AUP) (see 2.4.2);
- compilation (see 2.4.3);
- consultancy services (see 2.4.4); and
- other services (see 2.4.5).

**Figure 1: Decision flow to determine the most appropriate service**



#### 2.4.1 Assurance

In an assurance engagement, the practitioner expresses a conclusion designed to enhance the degree of confidence of the user about the outcome of an evaluation of measurement of a particular item (known as a subject matter or subject matter information) against specified criteria. For example, have the financial statements (subject matter information) been prepared in accordance with the applicable financial reporting framework (criteria)?

The type of assurance conclusion required will affect the nature and scope of work that the practitioner carries out and the form of conclusion that the practitioner issues. The practitioner expresses either a reasonable assurance conclusion (equivalent to a financial statement audit level) opinion, or a limited assurance (equivalent to a review level, see Appendix 3 for further consideration) conclusion.

The practitioner's report and the conclusion therein are for the benefit of intended users, usually comprising third parties but which may also include management of the organisation. When the practitioner evaluates a subject matter against criteria that is designed for a specific purpose, the report usually includes a statement restricting the use of the assurance report for that purpose. In addition, the report may indicate that it is intended solely for specific users.

For example, where the criteria are based on the terms of contract between two business partners, they may not be relevant or appropriate for, or even known to, other parties, including potential business partners.

### Critical considerations

The subject matter of the assurance engagement, for example historical financial information or a regulatory compliance return, will determine the professional assurance standards and supporting guidance to be used.

The *International Framework for Assurance Engagements* (the Framework) published by the IAASB sets out principles that apply to all assurance engagements. Detailed assurance standards, general or subject matter specific, are compliant with the Framework (for further information on the Framework, see 3.2).

For assurance services, other than audits (ISAs) or reviews (ISREs) of historical financial information, such as assurance regarding internal controls and processes, contractual terms, pro forma financial information, sustainability reports and non-financial performance measures, the applicable standards are International Standards on Assurance Engagements (ISAEs).

All assurance engagements are subject to relevant ethical requirements, including those pertaining to independence, contained in Parts A and B of the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA). The fundamental ethical principles that apply to all services that professional accountants in public practice are: integrity, objectivity, professional competence and due care, confidentiality, professional behaviour and technical standards. Equally, the *International Standard on Quality Control 1* (ISQC1) will apply to all services that the practitioner provides.

As a result of either a client's request or the need to comply with legal and regulatory requirements, the practitioner may be required to provide an assurance report in accordance with specific requirements or use specific wording which may conflict with an assurance engagement standard such as ISAE 3000 *Assurance Engagement other than Audits or Reviews of Historical Financial Information*. Where in consequence the practitioner is unable to follow an assurance engagement standard in full, he should not refer to the assurance engagement as having been conducted in compliance with the standard. For many such engagements, however, the practitioner should make as much use of the ISAs or ISAEs and the Framework as is possible. This is because these assurance standards provide a clear set of principles for carrying out assurance engagements.

The following conditions are required to be met before accepting an assurance engagement:

- an expectation that relevant ethical requirements, such as independence and professional competence will be satisfied;
- an expectation that there is a rational purpose to the engagement;
- the engagement exhibits all of the following five elements:
  - a three-party relationship involving the practitioner, a responsible party, and intended users;
  - an appropriate subject matter;
  - suitable criteria exist and such criteria will be available to intended users;
  - the practitioner will have access to sufficient appropriate evidence to support the conclusion; and
  - a conclusion, in the form appropriate to the engagement, is to be contained in a written report.

An overview of these elements is provided below and they are considered further in Section 3.

Assurance engagements involve three separate parties: a practitioner, a responsible party and intended users of the assurance report. Engagements can only be accepted if the subject matter is the responsibility of a party (for example management of an organisation) other than the intended users or the practitioner. The responsible party is responsible for the information on which the practitioner is engaged to give a conclusion. Acknowledgement by the responsible party for its responsibilities is essential to ensure the appropriate relationship exists between the responsible party and the practitioner, and to establish a basis for a common understanding of the responsibility of each party.

Of particular importance are the relative roles and responsibilities of the parties in the assurance process. Practitioners generally perform assurance engagements for the benefit of intended users which will often include their client, ie, management of the responsible party.

The assurance services need not necessarily include an external user as assurance may be provided over the client's own operations for the client's own use. In such cases there will be two different parties within the organisation – those responsible for the operations under scrutiny (such as management) and those ultimately responsible for the organisation (the Board). We refer to this as a three-party relationship despite there being only one organisation other than the practitioner. The three-party relationship is considered further in 3.4.

The subject matter of an assurance engagement can take many forms. An appropriate subject matter is (a) identifiable, and capable of consistent evaluation or measurement against the identified criteria; and (b) such that the information about it can be subjected to procedures for gathering sufficient appropriate evidence to support a reasonable assurance or limited assurance conclusion, as appropriate. Further consideration on the subject matter is provided at 3.5.

Suitable criteria are necessary because they provide the frame of reference for a reasonably consistent evaluation or measurement of a subject matter. What constitutes suitable criteria will depend on the engagement circumstances – in some circumstances they may be identified by law or regulation, in others they may be specifically designed to meet the needs of specific intended users. Suitable criteria exhibit the following characteristics: relevance, completeness, reliability, neutrality and understandability. See 3.6 for further consideration.

#### 2.4.2 Agreed-upon procedures (AUP)<sup>1</sup>

In an agreed-upon procedures engagement the practitioner provides a report of the factual findings from the procedures and tests he has performed with professional skill. The procedures and tests should be sufficiently detailed so as to be clear and unambiguous, and discussed and agreed in advance with the engaging parties so that the factual findings are useful to them and, depending upon the engagement, others to whom the report is made available. The practitioner's report does not express a conclusion, and therefore it is not an assurance engagement in the technical sense. It does not provide recommendations based on the findings. The report is worded so as to restrict access and/or reliance on it to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures, may misinterpret the findings. The specified parties review the procedures and findings in the practitioner's report and use the information to draw their own conclusions.

The value of AUP comes from the practitioner objectively carrying out procedures and tests with relevant expertise thus saving the engaging party carrying out the procedures and tests themselves. AUP are most effective where the engaging parties are knowledgeable enough to identify the area or matter to focus on, discuss and agree the procedures to be performed, and interpret the findings in their own decision making.

AUP can also be a powerful tool where a client initially seeks a practitioner's support for assertions for which sufficient work cannot be performed or evidence obtained. For example, clients or users may ask the practitioner to issue a conclusion concerning such matters as the future performance of the client which the practitioner cannot support by any amount of work. Issuing such reports may give rise to misunderstandings such that the practitioner may potentially become the equivalent to insurers or guarantors of the client's obligation to third parties. Instead, the practitioner may effectively propose an AUP engagement testing relevant control procedures without concluding on how such procedures may affect the future performance. Informed users may find the AUP engagement useful to form their own conclusion based on the findings reported by the practitioner.

#### Critical considerations

When performing an agreed-upon procedures engagement on historical financial information, practitioners should, as a minimum, comply with International Standards on Related Services (ISRS) 4400 *Engagement to Perform Agreed-upon Procedures on Financial Information*. ISRS 4400 also provides useful guidance for engagements regarding non-financial information.

ISRS 4400 requires compliance with the applicable requirements of the Code of Ethics for Professional Accountants issued by the IESBA. The ethical principles that apply to agreed-upon procedures engagements are the professional responsibilities for integrity, objectivity, professional competence and due care, confidentiality, professional behaviour and technical standards. Independence is however not a requirement for agreed-upon procedures engagements. The specific terms of an engagement may however require the practitioner to refer to the independence requirements of IESBA's Code of Ethics for Professional Accountants. Equally, ISQC1 will apply to all services that the practitioner provides under ISRS 4400.

<sup>1</sup> Based on ISRS 4400.

As a result of either a client's request or the need to comply with legal and regulatory requirements, a practitioner may perform an agreed-upon procedures engagement in accordance with specific requirements or standards other than ISRS 4400. Where the practitioner is unable to follow ISRS 4400 in full for example because of a specific regulatory or other requirement, he should not refer to the engagement as having been conducted in compliance with the standard. For many such engagements, irrespective of whether the practitioner performs the agreed-upon procedures engagement in accordance with legal and regulatory requirements, the practitioner should make as much use of ISRS 4400 as is possible. This is because ISRS 4400 provides a clear set of principles for carrying out agreed-upon procedures engagements.

ISRS 4400 requires clear agreement of the following with the engaging parties:

- nature of the engagement including the fact that the procedures performed will not constitute an assurance engagement and that accordingly no assurance conclusion will be expressed;
- stated purpose for the engagement;
- identification of the information to which the agreed-upon procedures will be applied;
- nature, timing and extent of the specific procedures to be applied;
- anticipated form of the report of factual findings;
- limitations on the use and distribution of the report of factual findings.

It is important that users of the report take responsibility for the sufficiency and appropriateness of the procedures for their purposes.

### 2.4.3 Compilation

The objective of a compilation engagement is for the practitioner to carry out procedures such as collecting, classifying and summarising subject matter data and presenting it in accordance with the applicable reporting framework. The most common compilation engagement is one in which a practitioner receives financial data and information from a client and rearranges it into a set of financial statements. The procedures do not involve verifying the subject matter data, and the practitioner does not express a conclusion on the compiled information. As such, this type of engagement does not constitute an assurance engagement. However, as the practitioner uses expert knowledge of the subject matter and the reporting framework to compile the information, the client may be provided with some degree of comfort. The practitioner issues a compilation report to set out the nature of the compilation engagement and respective responsibilities to avoid expectation gaps arising among the readers of the report.

#### Critical considerations

When compiling historical financial information, practitioners should follow the guidance provided in AAF 2/10 *Chartered accountants' reports on the compilation of financial statements of incorporated entities*, or AAF 3/10, *Chartered accountants' reports on historical financial information of unincorporated entities*.

The relevant international standard issued by the IAASB is International Standards on Related Services (ISRS) 4410 *Engagement to Compile Financial Statements*. ISRS 4410 also provides useful guidance for engagements regarding non-financial information.

As with assurance and AUP engagements, ISRS 4410 requires compliance with the applicable requirements of the Code of Ethics for Professional Accountants issued by the IESBA. The ethical principles apply to compilation engagements as for AUP engagements. Compliance with the Code of Ethics is an important aspect of compilation engagements. This is because the value of compilation by the practitioner is driven primarily by these ethical principles as the engagement does not involve any testing. Independence is not a requirement for compilation engagements; however, the specific terms of an engagement may require the practitioner to refer to the independence requirements of IESBA's Code of Ethics for Professional Accountants. Equally, ISQC1 will apply to all services that the practitioner provides under ISRS 4410.

As a result of either a client's request or the need to comply with legal and regulatory requirements, a practitioner may perform a compilation engagement in accordance with specific requirements or standards other than ISRS 4410. Where the practitioner is unable to follow ISRS 4410 in full because of a specific regulatory or other requirement, the practitioner should not refer to the engagement as having been conducted in compliance with the standard. For many such engagements, irrespective of whether the practitioner performs the compilation engagement



in accordance with national legal and regulatory requirements, the practitioner should make as much use of the ISRS as is possible. This is because the ISRS provides a clear set of principles for carrying out compilation engagements.

ISRS 4410 requires clear agreement of the following with the engaging parties:

- nature of the engagement including the fact that compilation will not constitute an audit or a review and that accordingly no assurance will be expressed;
- stated purpose for the engagement;
- identification of the reporting framework to be used;
- respective responsibilities of management and the practitioner, including management responsibility for the information compiled, applicability of the financial reporting framework that is acceptable in view of the intended users and the accuracy and completeness of underlying records;
- limitations on the use and distribution of the report.

#### 2.4.4 Consultancy services

Consultancy services, also often referred to as advisory services, utilise a practitioner's skills, observations, experiences, and knowledge of the advisory and consulting process.<sup>2</sup> Consultancy engagements typically relate to the design and development of new methods, approaches and strategies for an organisation and may include the implementation of new systems and processes. Consulting services encompass a wide range of consulting methodologies and approaches on subject matters such as strategy, operations, technology and people.

It is essential that the practitioner obtains a clear understanding of the purpose of the engagement from the client's perspective and their expectation of the focus and content of the deliverables. The consulting process is an analytical process that typically involves some combination of activities relating to:

- objective setting;
- fact finding and reporting;
- definition of problems or opportunities;
- evaluation of alternatives;
- development of recommendations including actions;
- communication of results;
- implementation and follow up; and
- independent 'views'.

Reports, if issued, are generally written in a narrative style. Generally the work performed is only for the use and benefit of the client. The nature and scope of work is determined by agreement between the practitioner and the client.

Reports tend to set out a practitioner's diagnosis of the issue, evaluation of solutions, and recommendations related to a subject matter such as a system, process or a situation and alternatives for the client's consideration. Other than the client, there is no other user of these reports.

There are currently no IAASB standards for consultancy or other types of services. As with other services, accountants comply with the applicable requirements of the Code of Ethics for Professional Accountants issued by the IESBA. Although not developed with consultancy and other such services in mind, the key elements of a system of quality control noted in ISQC1 such as provisions for leadership responsibilities, acceptance, human resources, engagement performance and monitoring may also be important in principle for consulting engagements.

#### Critical considerations

Consultancy services are subject to a practitioner's risk management policies relating primarily to engagement acceptance and independence. These vary depending on whether the advisory services are provided to audit clients or to non-audit clients. There are currently no international standards that specifically address advisory engagements.

<sup>2</sup> Footnote 7, International Framework for Assurance Engagements.



Additional risk considerations include:

- assigning individuals with the appropriate skills and experience – for certain engagements this may include meeting specific accreditation requirements;
- using appropriate methodologies;
- reviewing engagements in accordance with established firm policies;
- supporting any findings and recommendations with relevant evidence and analysis; and
- carefully wording the practitioner's report and including necessary disclaimers and restrictions on use and distribution.

#### 2.4.5 Other services (eg, investigation, due diligence)

There are many other types of service that practitioners can provide for their clients including a range of investigative services. These services often involve the practitioner proving or disproving a hypothesis, obtaining specified information or providing facts and information the practitioners have identified during their engagement. The report describes the objective and results of the work, may or may not have a conclusion, but also clearly states that the procedures do not constitute an assurance engagement and that the report conveys no assurance. Typical examples of such work might include:

- Forensic reports: engagements to testify or establish facts and evidence to be presented in legal proceedings regarding accounting, auditing, taxation or other related matters.
- Due Diligence: engagements to probe into the detail of financial results and sometimes of operational activities of a company that is, for example, a target for acquisition. The reports are factually based.

There are many other examples of investigative services a practitioner might deliver. While typically the deliverables from such engagements do not include an assurance conclusion as defined previously, it is possible that in certain circumstances an assurance conclusion may be sought on a specific piece of information. For example, a client may need assurance over the process of preparing management accounts in accordance with agreed guidelines, to be shared with a fund provider in the context of a funding arrangement. In such circumstances, it is important that the scope of the assurance engagement is clearly set out separately (see 2.4.1) and communicated in writing to minimise any expectation gap arising.

For the purposes of the table below we have termed engagements that we discussed under 2.4.4 and 2.4.5 as **other services**.

#### 2.4.6 Types of services

Table 1 below summarises different types of services that have been considered above, namely:

- assurance;
- agreed-upon procedures;
- compilation; and
- other services.

**Table 1: Types of services**

	Assurance	Agreed-upon procedures	Compilation	Other services
<b>Service offered and deliverables</b>	The practitioner examines information and expresses a conclusion on the outcome of that evaluation. The engagement can be a reasonable or limited assurance engagement.	The practitioner reports factual findings based on procedures agreed with the engaging parties in advance but imparts no assurance conclusion, views or recommendations.	The practitioner compiles information to assist management in accordance with an applicable reporting framework but imparts no assurance conclusion, views or recommendations.	The practitioner carries out various procedures with a view to providing a written report in the form of observations and comments and may also provide recommendations but imparts no assurance conclusion.

**Table 1: Types of services (continued)**

	Assurance	Agreed-upon procedures	Compilation	Other services
<b>Value of the service</b>	The primary user of the assurance report is a third party who is using or benefiting from the information prepared by the responsible party (eg, management) as an input in decision making. The assurance report enhances the user's confidence regarding the credibility of the information that varies with the nature of the conclusion in the report.	The users of the practitioner's factual findings are the party engaging the practitioner and any other specified parties who agree to the procedures to be performed by the practitioner. These parties are relying on the practitioner's expertise, experience and objectivity to perform the procedures and factually report findings that the parties may use to draw their own conclusion. The findings are an input in the users' decision-making process.	The primary beneficiary is management whom the practitioner assists, using his expertise and based on information provided by management, to prepare and present information in accordance with an applicable reporting framework.	The user of the practitioner's report is the engaging party who is relying on the practitioner's expertise, experience and objectivity. The practitioner's views or recommendations are inputs in the engaging party's decision-making process.
<b>Parties to the engagement</b>	Assurance engagements involve three parties – the responsible party, the practitioner and intended users. The engagement may be instructed either by the responsible party or intended users. The responsible party may benefit from the practitioner's report but is not the only intended user of the report.	Agreed-upon procedures engagements involve the practitioner and the parties who agree to the procedures.	Compilation engagements involve management (the engaging party) and the practitioner.	Advisory engagements involve the engaging party or parties and the practitioner.
<b>Critical considerations</b>	<p>Assurance engagements should only be accepted when, among other things:</p> <ul style="list-style-type: none"> <li>• There is an appropriate subject matter that is capable of consistent evaluation or measurement against identified criteria.</li> <li>• The engagement has a rational purpose.</li> <li>• Criteria are suitable.</li> <li>• The engagement team collectively has the appropriate competencies and capabilities. This includes knowledge and competence in assurance skills and techniques, as well as expertise in the subject matter.</li> </ul>	<p>Key features of an agreed-upon procedures engagement:</p> <ul style="list-style-type: none"> <li>• The engaging party and other third parties, if relevant, agree on the procedures to be performed by the practitioner.</li> <li>• The practitioner is required to perform the procedures and report factual findings. The practitioner's report includes only factual findings and it avoids either explicitly or implicitly expressing a conclusion.</li> <li>• Users of the practitioner's report assess for themselves the procedures and factual findings reported and draw their own conclusions.</li> <li>• Users of the report acknowledge their agreement to the procedures and their acceptance of the sufficiency and appropriateness of the procedures for their purposes.</li> </ul>	<p>Key considerations for compilation engagements include:</p> <ul style="list-style-type: none"> <li>• The need to clarify the scope of the engagement and respective responsibilities and communicate them to the users of the report.</li> <li>• Due to the practitioner's close involvement with the underlying data and the professional manner with which the information is prepared, there is a risk that those who received the compiled information may believe that procedures involved testing of the data. The wording of the compilation report is intended to help address this risk.</li> </ul>	<p>Key features of an advisory engagement include:</p> <ul style="list-style-type: none"> <li>• The practitioner employs technical skill, knowledge, experience and objectivity to carry out procedures with a view to providing observations and recommendations. The report may also include consideration of alternatives.</li> <li>• The engagement is performed by suitably skilled and experienced individuals. This may include: meeting specific accreditation requirements; involving specialists when considered necessary; and using appropriate methodologies.</li> <li>• Any views or recommendations provided should be supported by relevant evidence and analysis.</li> </ul>

Hereafter, this document primarily considers assurance engagements performed in accordance with the IAASB framework and ISAE 3000. Although the discussion herein should be consistent with the principles used for audits and reviews, these are excluded from the scope as there are specific standards for such engagements.

## CASE STUDIES: Background and need

We provide three case studies that appear throughout this document to illustrate how types of assurance engagement are developed and key considerations are applied. Appendix 4 contains the full table of the case studies while extracts are reproduced in the relevant sections throughout the *Assurance Sourcebook*.

The three case studies consist of:

### Performance metrics

A broadcaster that, in order to demonstrate its commitment to a public charter, publishes a set of objectives and wishes to obtain an assurance report to support its claim that it has met the objectives.

### Operational systems

A service organisation, which provides its customers with information processing infrastructure to manage and collect license fees. The reason for obtaining an assurance report is to demonstrate to its customers the quality of operational controls over the services it provides.

### Stewardship compliance

An asset manager who manages investment funds for the asset owners and is covered by the UK Stewardship Code. The asset manager hopes to obtain an assurance report on its compliance with the Code including independent verification.

	Performance metrics	Operational systems	UK Stewardship Code compliance
<b>Background and need</b>	<p>A broadcaster operates under a public charter that determines its objectives. Management wanted to demonstrate publicly how well they had performed against those objectives through a public report.</p> <p>One of the management team was charged with developing the report. This was to be based round a series of performance metrics designed to show how well the company had performed against each objective in the charter.</p> <p>A series of metrics were developed in relation to each objective to show a range of perspectives. The metrics made use of a combination of: data held by the company, information and data obtained from independent third parties such as the Broadcasters Audience Research Board (BARB) and data obtained from contractors' media access systems for web pages, programmes and similar data.</p>	<p>A service organisation runs operational systems for its customers to manage the collection of their license fees. That involves using the customers' database to analyse and evaluate information as well as managing and monitoring the resulting communications and information flows. Some of the processes involve further third parties contracted either with the customers or with the company.</p> <p>The company was aware that one of its key contracts was due for re-tender and wanted to demonstrate both its commitment to provide a high quality service through evidence of the quality of control in the systems being operated. However, the Board were not able to define how this might be achieved to best effect.</p>	<p>One of the UK's leading asset managers decides to report on its stewardship in line with the UK Stewardship Code, issued by the FRC with a view to enhancing the nature of engagement between asset managers acting on behalf of their asset owners and the boards of the companies they invest in. The asset manager is also covered by the 'comply or explain' requirement of the Code.</p> <p>The asset manager chose to demonstrate its commitment to the Code by way of complying with all the requirements and have decided to obtain an assurance report on its engagement and voting processes as suggested in the Code.</p> <p>The asset manager has been reporting on its internal controls and receiving an assurance report for the past few years, and therefore found the new requirements relatively familiar.</p>

## 2.5 Types of assurance

Where the client and the practitioner establish that an assurance service is being sought, ISAE 3000 provides two options; **reasonable** and **limited** assurance. For a **reasonable assurance engagement** the practitioner needs to reduce the assurance engagement risk (the risk that an inappropriate conclusion is expressed when the information on the subject matter is materially misstated) to an acceptably low level as the basis for a positive form of expression of the practitioner's conclusion. Such risk is never reduced to nil and therefore, there can never be absolute assurance. For a **limited assurance engagement** the practitioner collects less evidence than for a reasonable assurance engagement but sufficient for a negative form of expression of the practitioner's conclusion. The practitioner achieves this ordinarily by performing different or fewer tests than those required for reasonable assurance or using smaller sample sizes for the tests performed. Further discussion on the work effort for limited assurance is available from Appendix 3.

The practitioner uses the same risk basis for planning their work and the same levels of materiality in evaluating the outcome of tests for reasonable and limited assurance engagements. Since the extent of evidence collected for a limited assurance engagement may be limited due to the reduced sample sizes and test coverage adopted, the level of risk of material misstatement remaining is potentially higher than in a reasonable assurance engagement. Hence, the practitioner is not in a position to express the same degree of confidence as in a reasonable assurance engagement. The conclusion in a limited assurance engagement is accordingly framed in a negative sense, 'based on the procedures performed, nothing came to our attention that the management assertion on XYZ is materially misstated....' in contrast with a reasonable assurance conclusion which would be formed in a positive sense, ie, 'based on the procedures performed, the management assertion on XYZ is reasonably stated...'

Practitioners may be familiar with the limited nature of the work performed in relation to a published review opinion for listed company half year financial statements. The half year review is an example of a limited assurance engagement that is conducted by the company's auditor under ISRE 2410. These reviews are ordinarily based on inquiry of management and analytical procedures. Analytical procedures typically involve the comparison of actual information against the expectations formed based on the prior year and industry average. The limited nature of the work is justified because the practitioner has a base of history with the client's previous financial statement audit and an understanding of the client's control environment which generally helps the practitioner to determine the reliability of the information produced by management.

While there are certain parallels between half year reviews and other limited assurance engagements conducted under ISAE 3000, there are also differences. The half year review is a defined concept in relation to a clearly defined subject matter, ie, the financial statements, and for which there is an expectation of a strongly defined internal control environment appropriate for the size and complexity of the client, structure through accounting practices, double entry book-keeping and other checks and balances as the organisation is a listed company. The company's auditor will have obtained a sound understanding of these matters and conducted recent tests of controls and substantive procedures as part of the annual audit. This background therefore reduces the need for detailed tests beyond inquiry, analytical review and other procedures of limited nature. In contrast, a limited assurance engagement may be tackling a subject matter which is less well defined and for which the control environment is far less mature and robust. For example, the calculation of a company's carbon footprint may have been performed by an individual and the results collected on a spreadsheet and supported by files of memorandum information. The practitioner may not have the equivalent understanding or knowledge of the past carbon footprint which is not based on double entry bookkeeping. Accordingly, in using a risk basis for the limited assurance engagement, the practitioner may not find it possible to solely adopt analytical review as a viable basis for the testing.

The International Framework for Assurance Engagements further differentiates assurance engagements into two types. The differentiation is based on who initially measures or evaluates the subject of interest (subject matter) and provides information about it.

In an **attestation** (also known as **assertion-based**) engagement, the responsible party, (usually management), carries out the measurement or evaluation of the subject matter and reports the information (the subject matter information) which contains the responsible party's assertion (eg, 'the subject matter information is fairly stated as of date/month/year...'). The work the practitioner performs is to give an assurance conclusion on this assertion.

Both the subject matter information including the responsible party's assertion and the practitioner's assurance report are made available together to the intended users. Attestation engagements are a familiar form of assurance engagement, as audits and reviews of financial statements have been structured as attestation engagements: management reports the financial performance and position in the annual accounts, asserts the information as being true and fair, and the practitioner gives a conclusion on the assertion.

The second type of engagement is a **direct (direct reporting)** engagement. The responsible party does not present the subject matter information in a report in a direct engagement. Instead the practitioner reports directly on the subject matter and provides the intended users with an assurance report containing the subject matter information. An example of a direct engagement would be a Sarbanes-Oxley engagement to report on the effective control over the financial reporting process. A direct assurance conclusion would be constructed as ' . . . In our opinion the company maintained, in all material respects, effective internal control over financial reporting as of date/month/year, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). . . '

Practitioners more commonly perform assertion-based engagements. This is because, ultimately, management (as the responsible party) are responsible for their business and, therefore, should be in a position to present relevant assertions in the subject matter information. They are also in a better position to understand who would use the information, what users want to see, in what format, and for what purpose.

**The decision as to the type of assurance needs to be agreed with the client by the practitioner when agreeing the terms of engagement.**

## 2.6 The breadth of subject matters

There is a wide range of information that could be subject to some form of external assurance. Examples of areas where an external assurance service might be requested are shown below.

- quantitative information, including financial information and performance measures such as KPIs;
- aspects of information technology such as information flows and security;
- management information flows;
- regulatory processes and compliance;
- compliance with contractual agreements;
- operations and projects, including where performed by third parties;
- governance, strategy and management processes;
- environmental information;
- internal controls and internal control environment;
- risk management systems and processes;
- ethics and behaviour;
- financial processes.

