



International Federation of Accountants

545 Fifth Avenue, 14th Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org

Agenda Item

14

Committee: IAASB
Meeting Location: Lima
Meeting Date: March 7-11, 2005

Review of Interim Financial Information Performed by the Auditor of the Entity

Objectives of Agenda Item

To review and discuss the proposed revised ISRE XXXX, *Review of Interim Financial Information Performed by the auditor of the Entity*.

Background

The comment period for the Exposure Draft ended on September 30, 2003. Twenty-nine comment letters were received.

A review of the significant issues was carried out at the April 2004 IAASB meeting in Toronto. The key issues raised in this paper are those where IAASB requested the Task Force to give more consideration. The minutes of the April 2004 IAASB meeting relating to each of these key issues are included (*in italics*) at the beginning of the discussion of each issue.

Activities Since Last IAASB Discussions

The Task Force met in January 2005 to discuss the comments received from the IAASB on the key issues raised at the April 2004 IAASB meeting in Toronto. In addition, the Task Force performed a review of the detailed comments and amended the document accordingly.

Key issues

NEED FOR A SEPARATE ISA ON REVIEW OF INTERIM FINANCIAL INFORMATION

The Task Force should continue to develop this ISA and, at the same time, use what it has learned from this project to comprehensively identify the issues (and tentative solutions) that are likely to arise in the revision of ISRE 2400. In arriving at this decision, the IAASB noted that issuing the proposed ISA without reviewing ISRE 2400 may lead to unreconciled differences between the two documents, and that issues with ISRE 2400 identified through this project would not be promptly addressed unless the review thereof was carried out as this project progressed. In addition, the report issued under the proposed ISA may not be sufficiently different from that issued under an ISRE 2400 engagement for the user to be aware of the different work effort required and the consequent difference in the nature of the assurance obtained by the practitioner. In this regard, the IAASB noted

the need to further consider whether the differences in the work effort should be reduced or eliminated or whether the difference in the reports should be reduced or eliminated. It was also noted that the differences between the proposed ISA and ISRE 2400 should be identified and analyzed and, depending upon the nature of the differences, it might be appropriate to merge the two documents, and that the regulatory environments in jurisdictions where reviews are common differ and the effect of this on both the proposed ISA and ISRE 2400 need to be addressed.

The fundamental distinction between the proposed standard and ISRE 2400 is that, in the proposed standard, the review is performed by the auditor of the entity who has an understanding of the entity and its environment, including its internal control, acquired through previous audits. This understanding is used to determine the inquiries to be made and the analytical procedures to be applied and to identify the particular events, transactions or assertions to which inquiries may be directed or analytical procedures applied.

There would be a public expectation that the auditor would use this cumulative knowledge in planning and performing a review of interim financial information. In contrast, a practitioner who is not the auditor of an entity would not be expected to have the same level of knowledge of the entity and its environment, nor is the practitioner expected to obtain an understanding of internal control.

ISRE 2400 may need to be updated at a future date to be aligned with the assurance framework. However, at the present time, it is proposed that we clarify the scope of ISRE 2400 to apply to engagements when a practitioner is not the auditor of the entity, as follows:

The purpose of this International Standard on Review Engagements (ISRE) is to establish standards and provide guidance on the practitioner's professional responsibilities when a practitioner, who is not the auditor of an entity, undertakes an engagement to review financial statements and on the form and content of the report that the practitioner issues in connection with such a review. A practitioner, who is the auditor of the entity, engaged to perform a review of interim financial information performs such a review in accordance with ISRE XXXX "Review of Interim Financial Information Performed by the Entity's Auditor".

In addition, all references to auditor in ISRE 2400 should be replaced by "practitioner".

ISRE 2400 paragraph 2 indicates that this ISRE is directed towards the review of financial statements but it to be applied to the extent practicable to engagements to review financial or other information.

The proposed standard has been revised to incorporate a black letter requirement and a cross-reference to ISRE 2400, as follows (paragraph 3):

An auditor of an entity who is engaged to perform a review of interim financial information should perform the review in accordance with this ISRE. Through performing the audit of the annual financial statements, the entity's auditor obtains an understanding of the entity and its environment, including its internal control. This understanding, which is updated through inquiries made in the course of the review of the interim financial information, assists the auditor in focusing the inquiries to be made and the analytical and other review procedures to be applied. A practitioner who is engaged to perform a review of interim financial information and who is not the auditor of the entity performs the review in accordance with ISRE 2400 "Engagements to Review Financial Statements".

The proposed standard applies when an auditor undertakes an engagement to review the interim financial information of an audit client. While it does not cover the situation when the auditor is asked to undertake a review of annual financial statements, a footnote has been added to indicate that the guidance in the proposed standard is to be adapted to such reviews.

The proposed ISA has also been repositioned as an ISRE, to address concerns that labeling this standard as an ISA caused confusion.

At the completion of this project, the Task Force proposes to provide comments to IAASB staff on the revision to ISRE 2400 to form the basis of a future project proposal.

CRITERIA DEFINING THE SCOPE OF THE PROPOSED STANDARD

The requirement that the entity is required or permitted to issue the interim financial information should be deleted.

The Task Force should reconsider the requirement that the annual financial statements be publicly available, particularly when the interims are: not condensed; not publicly available; prepared for a non-listed entity, and/or prepared in accordance with a recognized framework.

The auditors of non-listed entities should not be precluded from using the proposed standard. In addition, the Task Force should further consider whether the approach outlined in the agenda paper whereby ISRE 2400 is not to be used for a listed entity is appropriate, particularly when there is little distinction in the report under the proposed ISA compared to ISRE 2400.

Given the comments received on this issue at the IAASB meeting, the Task Force has deleted the aforementioned criteria included in the Exposure Draft. The proposed standard would therefore apply when the interim financial information is prepared in accordance with an applicable financial reporting framework and is being reviewed by the auditor of the entity.

REPORTING

The Task Force was asked to further consider the use of “true and fair/present fairly,” taking into consideration: (a) whether interim financial information (whether a full set of financial statements or condensed) can be “true and fair/presented fairly” when, because of the timeframe in which they are prepared, the use of more estimation than annual financial statements is required; (b) whether there is any evidence of misunderstanding in those countries where legislation or practice requires use of “true and fair/presented fairly” for interims; and (c) the use of “true and fair/presented fairly” in existing ISRE 2400 and ISA 800.

In order to ensure that the readers of the report understand which standard is being followed by the auditor and the level of assurance being conveyed, it is desirable that the conclusion being expressed be consistent and independent of the subject matter being reviewed. The objective of the review is the same, irrespective of whether the information is a condensed or complete set of financial statements.

The Task Force is recommending that the conclusion expressed for all such review engagements be a conclusion about whether the auditor is aware of any material adjustment that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework.

The Task Force is also recommending that, if the interim financial information is comprised of a condensed set of financial statements, the auditor include in the review report a reference to the need for the interim financial information to be read in conjunction with the most recent annual financial statements.

OBJECTIVE OF A REVIEW OF INTERIM FINANCIAL INFORMATION

The Task Force was asked to consider whether both the alternatives identified (i.e. expanded description of procedures and guidance on the level of assurance obtained) should be implemented in the proposed standard, taking into consideration whether: (a) it might be confusing to describe the level of assurance in positive terms when a negative expression of conclusion is required in the report, and (b) the phrase “plausible in the circumstances” is appropriate given the difficulty experienced with this expression in drafting the Assurance Framework.

In their comment letter, IOSCO indicated that they believe that the objective of a review of interim financial information needs to be clearly and comprehensively described in the proposed standard.

The Task Force reviewed various alternatives and revised the paragraphs dealing with the objective of a review as follows (paragraphs 7-8):

~~The objective of an engagement to review interim financial information is to enable the auditor to conclude whether, on the basis of the analytical procedures applied and inquiries made, anything has come to the auditor’s attention that causes the auditor to believe that the interim financial information is not prepared in all material respects in accordance with an identified financial reporting framework.~~ The objective of an engagement to review interim financial information is to enable the auditor to express a conclusion whether the auditor is aware of any material adjustment that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework. The conclusion is expressed on the basis of inquiries made, analytical and other review procedures applied which do not provide all the evidence that would be required in an audit.

The objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with ISAs. A review of interim financial information does not provide a basis for expressing an opinion whether the financial information gives a true and fair view, or is presented fairly in all material respects, in accordance with an applicable identified financial reporting framework, ~~within the bounds of reasonable assurance~~. In a review of interim financial information the auditor reduces to a moderate level the risk of expressing an inappropriate conclusion when the interim financial information is materially misstated. The review provides the auditor with a basis to report whether the auditor is aware of any material adjustment ~~modification~~ to be made to the interim financial information for it to be in accordance with an applicable identified financial reporting framework. A review consists ~~primarily~~ of making inquiries of persons responsible for financial and accounting matters and applying analytical and other review procedures. A review may bring significant matters affecting the interim financial information to the auditor’s attention, but it does not ~~provide assurance that~~ enable the auditor to obtain assurance that the auditor will become aware of ~~any~~ or all significant matters that might be identified in an audit.

INABILITY TO COMPLETE A REVIEW

The Task Force was asked to reconsider the appropriateness of providing a qualified report on an incomplete review, particularly when a limitation is imposed by circumstances rather than by management.

The proposed standard states that an incomplete review is not an adequate basis for issuing a review report. This statement can also be found in both the US and Canadian standards on review of interim financial information performed by the auditor of an entity. This situation is not covered in ISAE 3000; however, the proposed standard can be more restrictive than ISAE 3000.

The fundamental issue is whether, as a result of a scope limitation, the auditor's inquiries and analytical procedures are sufficient to enable the auditor to state whether the auditor is aware of any material adjustment to be made to the interim financial information for it to be in accordance with an applicable financial reporting framework. In addition, it is unclear how the auditor can effectively communicate the scope limitation in the report without negating the assurance conveyed in the report. The position taken in the proposed standard is that the auditor needs access to all information relating to the subject matter in order to be able to effectively carry out the engagement and report.

Other issues

MATERIALITY

Guidance on the determination of materiality for interim periods was requested. This guidance has been added to paragraph 18 of the revised ISRE. Comments were also sought and received on this paragraph from the Materiality Task Force.

SAMPLE ENGAGEMENT LETTER

The task force was asked to prepare a sample engagement letter for inclusion in the ISRE. An example has been included in Appendix 1 to the revised ISRE.

Material Presented

Agenda Paper 14-A (Pages 593 – 622)	Draft ISRE – Review of Interim Financial Information Performed by the Auditor of the Entity (Clean copy)
Agenda Paper 14-B (Pages 623 – 656)	Draft ISRE – Review of Interim Financial Information Performed by the Auditor of the Entity (Mark up)

Action Requested

IAASB is asked to review the revised ISRE and to provide feedback to the Task Force in finalizing the Standard.

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