

Date
15 December 2008

Le Président

Fédération
des Experts
Comptables
Européens
AISBL

Avenue d'Auderghem 22-28
1040 Bruxelles
Tél. 32 (0) 2 285 40 85
Fax: 32 (0) 2 231 11 12
E-mail: secretariat@fee.be



Mr. Jim Sylph
Executive Director Professional Standards
International Auditing and Assurance Standards Board (IAASB)
545 Fifth Avenue, 14th Floor
New York, New York 10017
USA

Edcomments@ifac.org

Dear Mr. Sylph,

Re: Consultation Paper – Matters to Consider in a Revision of International Standard on Review Engagements 2400, *Engagements to Review Financial Statements*

As the representative organisation of the European accountancy profession, FEE is pleased to comment on the Consultation Paper – Matters to Consider on a Revision of International Standard on Review Engagements (ISRE) 2400, Engagements to review Financial Statements (the Consultation Paper). In this context, we would like to point out that the FEE Issues Paper entitled Principles of Assurance: Fundamental Theoretical Issues with Respect to Assurance in Assurance Engagements¹ addresses theoretical issues concerning the concept of assurance which may be of relevance to the IAASB in its further considerations relating to the revision of ISRE 2400.

FEE supports a revision of ISRE 2400 by the IAASB. FEE also supports splitting ISRE 2400 and ISRE 2410 on “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” in the context of a review of interim financial statements undertaken by the auditor of an entity to make it clear that the auditor’s audit-based knowledge influences the auditor’s professional judgment applied to plan and perform the review. Therefore, our comments which follow are made exclusively in the context of ISRE 2400.

However, any revision of the review standards must take place at the same time as, and in a manner consistent with all other assurance and compilation standards. All such standards should be enhanced to allow users to perceive the value of the engagement and of the involvement of a professional accountant. This is vital where there is no statutory requirement that prevents unqualified 'accountants' from carrying out assurance engagements. If a revision and clarification of all other assurance and compilation standards is not feasible in the short term, all such standards should at least be clarified following the clarity conventions as soon as possible.

FEE is also of the opinion that the IAASB’s revision of the review engagement standard as well as of the other assurance and compilation standards is extremely urgent given the likelihood that certain standard setters having already started initiatives to develop standards for alternative assurance services will finalise their projects in the near future.

¹ http://www.fee.be/publications/default.asp?library_ref=4&content_ref=114

In this respect, FEE has launched a survey on the supply or provision of assurance services as an alternative to audit by the members of FEE (and IFAC) Member Bodies across Europe. Increasingly the provision of such services to smaller entities is being addressed by professional accountancy bodies, regulators, national and international standards setters and various European Institutions.

The following recent developments are driving this heightened focus on alternative assurance services:

- The increases in the audit exemption thresholds in various European Union (EU) Member States in 2007, 2008 and expected in the future which result in fewer smaller entities being submitted to a statutory audit, creating an opportunity to offer an alternative level of assurance to such smaller entities;
- Proposals and discussions in the European Institutions related to 'limited audit' (High Level 'Stoiber' Group), the creation of micro-entities (JURI and ECON Committees of the European Parliament), the creation of micro-entities and overhaul of the Fourth Accounting Directive (European Commission);
- Proposals for standard setters in a number of EU Member States introducing alternative assurance services for smaller entities.

FEE continues to be a strong supporter of the view point that 'An audit is an audit'. Consideration and possible proposals related to alternative assurance services leave the concept of 'An audit is an audit' intact as alternative assurance services are to be situated in-between an audit and a compilation engagement.

The results of the survey are expected to be available early in 2009. At that point, FEE will consider whether any further work on the provision of alternative assurance services is desirable.

Our main comments on the concepts addressed in the Consultation Paper are set out below, followed by our responses to the questions raised in the Consultation Paper.

Main Comments

The revision of ISRE 2400

Smaller entities, users of assurance reports, standard setters and regulators in many European jurisdictions have until now not widely availed of the possibility to use ISRE 2400 because there was no need for it due to regulatory structures and low statutory audit exemption thresholds and because of perceptions it is not relevant to their circumstances. Therefore, when revising ISRE 2400, the IAASB needs to ensure that standards for alternative assurance services are workable in the marketplace as well as technically adequate. Once standards for such service or services have been developed, IFAC (and FEE) Member Bodies should be able to promote the provision of such services by professional accountants as a commercially viable service. This is necessary to 'fill the gap' between the performance of an audit engagement, which may be perceived to be too costly for smaller entities not being mandated to have a statutory audit, and the performance of a compilation engagement, which provides no assurance on the financial statements of an entity.

As discussed above, FEE supports the urgent revision of the review engagement standard and the other assurance and compilation standards because parallel initiatives are currently being considered or developed by national standard setters, regulators and the European Institutions.

Clarity is needed about the "demand" for assurance" referred to in paragraph 5. In some EU jurisdictions, practitioners have the perception that neither clients (smaller entities) nor banks or other users will demand review engagements. Smaller clients appear to regard the audit as an administrative burden to be lifted; banks are considered to be concerned about personal

guarantees for lending with the *involvement of a reputable professional accountant* in the preparation of accounts but not necessarily assurance thereon.

Level of assurance and Reporting and Communication with Intended Users

Currently, ISRE 2400 states that the review engagement provides a *moderate* level of assurance that the information subject to review is free of material misstatement, with the report expressed in the form of “negative assurance”.

In this respect, FEE observes the following:

- The IAASB Glossary of Terms defines ‘limited assurance engagements’ and ‘review engagements’ expressing assurance in a negative form, but does not refer to or define ‘a moderate level of assurance’ in relation to these terms;
- The IAASB International Framework for Assurance Engagements also refers to ‘limited assurance engagements’ expressing assurance in a negative form, but does not refer to a moderate level of assurance;
- International Standard on Assurance Engagements (ISAE) 3000 also refers to ‘limited assurance engagements’ expressing assurance in a negative form, but does not refer to a moderate level of assurance.

As IAASB is still using the different terms of “moderate” and “limited” for what is seemingly one and the same level of assurance for a review engagement, the use of these terms varies from one European jurisdiction to another. In some jurisdictions the term limited assurance is used and preferred because of the limited scope and extent of procedures performed, in other jurisdictions the term moderate assurance is used and preferred because this term has a less negative connotation than limited assurance.

Consequently, the reporting and communication with intended users of the level of assurance related to review engagements also vary from one European jurisdiction to another. In some jurisdictions, the negative form of conclusion is widely used and accepted. In other jurisdictions, such reporting is poorly understood and certainly does not emphasise the value of the engagement.

However, the understanding of what these different terms mean appears to be broadly the same: moderate or limited assurance is situated in-between reasonable assurance related to an audit engagement which is higher, and no assurance related to a compilation engagement.

FEE recommends that the IAASB streamlines the terminology in relation to the level of assurance in respect of review engagements and defines the level of assurance and the form in which it is expressed. FEE invites the IAASB to explore if the informative value of the report from a reader’s perspective could be enhanced. I.e., the transparency of the level of assurance provided increased, the procedures performed explained and the limitations thereof clarified, while at the same time thought should be given to a straightforward, clear and cost effective approach for what should be a simple and cost effective service to clients. A standard and report which balance these different or even apparently opposing features is key to the successful use of such engagements.

In this respect, FEE notes that the communication of the level of assurance as well as the meaning of this level of assurance to users of assurance and review reports is of greater importance rather than the terminology used to express the level of assurance given. The IAASB should therefore specifically focus on the implementation of a revised review or assurance engagement as well as the education of users of review or assurance reports.

Evidence to support the review engagement report

As is the case with the terminology and definitions used for the level of assurance related to review engagements and the reporting and communication with intended users of the level of assurance related to review engagements, the scope and extent of the evidence to support the review engagement report also vary from one European jurisdiction to another. One of the reasons for this is that in different European jurisdictions, the approach to review engagements and the scope and extent of review engagements procedures differ significantly and cover a wide range of different services offered.

However, there are the following common features of a review engagement in the majority of European jurisdictions:

- As a minimum, enquiry and analytical procedures are performed as part of a review engagement;
- A review engagement is not a risk-based engagement as in an ISA audit engagement;
- Instead, a review engagement is a procedures-based engagement whereby professional judgement is used, for instance to determine when and which additional procedures are to be performed.

The approach to general 'preconditions' of a review engagement, to internal control as a precondition to a review engagement, to risk assessment procedures, if any, to circumstances warranting performance of other review procedures, etc, differs considerably between European jurisdictions.

As already explained in our introductory remarks, the demand for alternative assurance services in-between an audit engagement and a compilation engagement is likely to increase. However, it is currently not entirely clear which type(s) of assurance engagement(s) is(are) needed by users and the market at large.

As already stated above, FEE strongly encourages the IAASB to develop such alternative assurance service or services urgently as national initiatives are currently being considered or developed.

Responses to Questions

Question 1: Is the concept of a 'moderate level of assurance' meaningful for practitioners?

Reference is made to our main comments on level of assurance and reporting and communication with intended users.

Question 2: How should a practitioner determine what constitutes a moderate level of assurance for a review of financial statements?

Reference is made to our main comments on level of assurance and reporting and communication with intended users.

A practitioner is expected to determine what constitutes moderate or limited assurance by reference to the nature, scope and extent of the procedures to be performed as detailed in the requirements and guidance in ISRE 2400, and especially through the use of professional judgement. The use of the term "negative assurance" is unlikely to be readily understood by the users of review reports and appears to only be used by the IAASB in the context of this Consultation Paper.

Question 3: Should ISRE 2400 contain requirements and guidance to assist practitioners' judgments at the pre-acceptance stage as to whether a request to undertake a review of an entity's financial statements is:

(a) Practicable; and

(b) Appropriate, in the sense of being likely to meet the needs and expectations of the engaging party and those parties who are intended users of the report?

As the IFAC Code of Ethics and ISQC 1 on "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements" include general requirements which cover the pre-acceptance stage, FEE is of the opinion that some material consistent with the International Framework for Assurance Engagements, the International Standard on Assurance Engagements (ISAE) 3000 and International Standards on Auditing (ISAs) would be helpful to assist practitioner's judgment for engagement acceptance. Such material should be practicable and appropriate but concise.

Discussion at the pre-acceptance stage, generally, can clarify the needs and expectations of the engaging party. However, the needs and more especially the expectations of intended users of the report will not necessarily be susceptible to a definitive determination. It would be helpful for the eventual Standard to acknowledge the practical difficulty in meeting the expectation of users where these are many, have different levels of understanding of financial reporting, with wide variations in the nature of their relationship to the reporting entity.

Question 4: Should ISRE 2400 explicitly describe the respective obligations of the entity's management and those charged with governance, and of the practitioner performing the review of the entity's financial statements?

Yes. The subject matter information i.e., the historical financial information prepared by management does not differ in terms of quality from financial statements information presented for audit and management assertions are also the same. Thus the practitioner needs to base the review on the same premises as applied in an ISA audit. A clear and concise description of the practitioner's responsibilities and procedures performed is essential to an understanding of the level of assurance the practitioner obtains in a review engagement.

Question 5: To achieve the objective of a review engagement, what factors influence the practitioner's assessment of the work effort required to provide a reasonable basis for reporting the practitioner's conclusion(s) on the financial statements? To what extent are the illustrative detailed procedures contained in Appendix 2 to ISRE 2400 used in practice?

The following factors drive the work effort:

- The nature of the client and the engagement;
- The requirements set-out in the applicable standard;
- The ongoing results of the procedures performed.

The list contained in Appendix 2 to ISRE 2400 is helpful, but should be viewed as application material not as required procedures.

Reference is also made to our main comments on the evidence to support the review engagement report.

Question 6: How should a practitioner performing a review of financial statements address engagement risk when performing the review?

Dealing with engagement risk pervades assurance engagements. But this does not mean that reducing it to an acceptable level is achieved the same way for different types of assurance engagements. In order for review engagements to be clearly distinguished from audit engagements, and cost-effective, the distinction between assessing engagement risk in an audit and considering risk in a review engagement needs to be clear. If it is not, the standard will not be taken up either by the market or by regulators, and “expectation gaps” will be created.

Addressing engagement risk for an audit emphasises a full, detailed and documented risk assessment, including an assessment of internal control. This is followed by detailed testing of controls and obtaining corroborative audit evidence as part of substantive procedures. The reduction of audit risk to an acceptable level is the consequence of the aforementioned sequence; it happens as a result of the work performed.

In a review, by contrast, the consideration of risk takes place as part of enquiry and analytical procedures. Enquiry and analytical procedures are not 'mere procedures'. They do not take place in a vacuum and cannot be performed adequately without an appropriate “understanding” of the business; albeit an “understanding” that is appropriate for a review engagement but not as in-depth as that needed in an audit. Accordingly such “understanding” of the business involves consideration of the risk of material misstatement associated with the financial statements. In the absence of any form of consideration of risk, it would be quite impossible for reviewers to make the predictions that are an essential element of analytical procedures (albeit often on occasion imperfectly performed), or for the reviewer to know what to enquire about.

The description of extant ISRE 2400 as a 'procedural standard' as opposed to a risk based engagement is, therefore, somewhat misleading. The distinction is not clear cut because risk consideration is already an integral and essential part of enquiry and analytical procedures and indeed drives further review procedures.

We would expect to see *greater emphasis* in the revised ISRE 2400 on a proper treatment of the consideration of risk, *in the context of enquiry and analytical procedures*. The approach to engagement risk needs to be sufficiently distinguishable from that taken in an audit engagement, as otherwise there is likely to be an “expectations gap” which is in neither in the public interest, nor that of the profession.

The greater emphasis referred to above might be encapsulated as follows:

An integral part of enquiry and analytical procedures is an awareness of the business and expectations as to risk of material misstatement. In the context of a review engagement, instead of the “understanding” of the entity and its environment, including internal controls as required by ISA 315, the practitioner needs to have an “awareness” (or similar wording) of the entity and its environment, including internal controls; rather than of “identifying and assessing” the risks as required by ISA 315 the practitioner should form an “expectation” (or similar wording) based on his “awareness”. This expectation would drive the scope and extent of review procedures in so far as inquiries and analytical procedures could be directed at, or focused on, particular items in the historical financial information. (In other words the practitioner has to respond to his or her risk expectations by asking the “right” or appropriate questions and performing specific analytical procedures).

Reference is also made to our main comments on the evidence to support the review engagement report.

Question 7: Would the nature, timing and extent of review engagement procedures be significantly different between a review engagement based on performance of procedures without an explicit assessment of risk of misstatement in the financial statements, and a review engagement where a risk-based approach is applied to assess and respond to those risks? Would the costs of the engagement differ significantly?

Reference is made to our main comments on the evidence to support the review engagement report.

On the basis of the analysis above, we note that question 7 makes an artificial and simplified distinction between procedures based and risk based engagements.

In this respect, we would encourage the IAASB to address situations in which it is economical to accept a review engagement but not an audit engagement, which will be important in practice. The issue is one of internal controls; there will be a great number of borderline cases in which there will be just enough controls to make the performance of a review cost-effective, but the performance of an audit not cost-effective. FEE believes that further guidance in respect of these situations would be of great help to practitioners.

Question 8: In general terms, what procedures are needed to obtain an understanding of the entity's internal control over financial reporting for purposes of performing a review of financial statement?

Reference is made to our main comments on the level of assurance and reporting and communication with intended users and to our responses to questions 6 and 7.

Question 9: If the entity does not have internal controls that would prevent or detect occurrence of misstatements in the entity's financial statements, what are the implications for the practitioner regarding the entity's internal controls for the purpose of the review

Although the question might imply such situation, we are of the opinion that practitioners should not accept to perform a review engagement on financial statements of an entity in which the weaknesses in internal controls related to financial reporting are so pervasive that the practitioner may not be able to complete the review engagement.

However, as practitioners might not be aware of a lack of internal controls in relation to the financial reporting of the entity under review until the review engagement work is actually underway, we believe that in practice practitioners might effectively be faced with an entity which lacks internal control in one or a few isolated areas of financial reporting like sales and accounts receivable, purchases and accounts payable, etc.

In situations where an entity lacks internal controls related to financial reporting in one or a limited number of areas, the practitioners might or might not be able to compensate this lack of internal controls with other procedures. The practitioners will need to use his professional judgement to determine how to deal with such a situation:

- In some cases, the lack of such internal controls will be so pervasive that the practitioner will not be able to continue or complete the review engagement;
- In other situations, the lack of internal controls will necessitate that the practitioner performs additional procedures which might result in the need to report one or more material misstatements in the financial statements in the practitioner's review report;
- Finally, in some instances, the satisfactory performance of other procedures on the area of the financial statements lacking internal controls might not necessitate a mention in the practitioner's review report.

Reference is also made to our main comments on the evidence to support the review engagement report.

Question 10: Does ISRE 2400 place appropriate emphasis on the use of enquiry as a source of evidence in a review engagement? To what extent, if at all, do you think use of enquiry in an engagement to review financial statements should differ from its use in an audit?

In our opinion, the emphasis needs to be strengthened. When properly used, inquiry is a powerful procedure for obtaining evidence in the context of a review. Indeed, asking the right questions and observing the responses given critically can be most effective when practitioners have an appropriate degree of professional scepticism and remain alert to the possibility of misstatements.

The essential difference between inquiry in a review and in an audit is that in the second instance, the auditor does not limit the evidence available and will ordinarily seek to corroborate responses to inquiry, especially where, for whatever reason, they have doubt as to the validity of the response.

In a review, it is the fact that inquiry has been made that is important on its own. The practitioner is expected to be an expert and to possess sufficient professional scepticism, whatever the purpose of the inquiry to make asking the question actually worthwhile. So long as users of the report understand that the practitioner needs only be prima-facie satisfied with the responses, then that is sufficient given the nature of the engagement.

Reference is also made to our main comments on the evidence to support the review engagement report.

Question 11: Does ISRE 2400 provide sufficient guidance on how to apply analytical review procedures effectively in an engagement to review financial statements? If not, what additional guidance might be provided to assist practitioners?

We believe that the appropriate parts of the guidance in ISA 520 on Analytical Procedures which are essential and relevant to a review engagement should be included in ISRE 2400.

Reference is also made to our main comments on the evidence to support the review engagement report.

Question 12: To what extent, if at all, do you think use of analytical review procedures in a review engagement should differ from that in an audit engagement?

Reference is made to our response to question 11.

Question 13: What situations might require a practitioner performing a review to consider, based on the results of procedures performed to obtain evidence for the conclusion on the financial statements, whether performance of additional procedures is necessary to ensure that the engagement risk is reduced to an acceptable level?

We assume that this question is confined to circumstances where a response to an inquiry or a finding in an analytical procedure alerts a practitioner to a matter that is relevant to his conclusion.

In performing review procedures the practitioner seeks to gain adequate review evidence for this purpose. In our opinion, the practitioner will only need to perform further procedures when review procedures already performed indicate that the financial information subject to review is more

likely than not materially misstated. The extent and scope of the procedures to be performed beyond inquiry and analysis in order to obtain additional evidence will vary, depending upon the results of those procedures and the results of these additional procedures performed. In other words, when in performing inquiries and analytical procedures the reviewer becomes aware of a matter which more likely than not results in a material misstatement of the financial statements, he will extend procedures to “investigate” the specific matter further.

Reference is also made to our main comments on the evidence to support the review engagement report.

Question 14: What factors should the practitioner consider to determine the nature and extent of further procedures required to reduce the engagement risk sufficiently to be able to express the conclusion on the financial statements?

Reference is made to our main comments on the evidence to support the review engagement report and to our response to question 13.

Question 15: How, if at all, should a review of financial statements performed by a practitioner who is the entity’s auditor differ from a review of financial statements performed by a practitioner who is not the entity’s auditor?

Reference is made to our main comments on the evidence to support the review engagement report and to our response to question 6 in relation to engagement risk.

Additionally, as pointed out in our introductory remarks, FEE supports splitting ISRE 2400 and ISRE 2410 on “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” in the context of a review of interim financial statements undertaken by the auditor of an entity to make it clear that the wider extent of an auditor’s audit-based knowledge influences the auditor’s professional judgment applied to plan and perform the review.

Question 16: How, if at all, should the nature, scope and extent of the work carried out for an engagement to review financial statements differ depending on whether or not the report issued for the review engagement will be made public, or be published together with the financial statements reviewed?

Theoretically, the nature, scope and extent of the work should be the same whether the review report is for public or private use.

Reference is also made to our main comments on the evidence to support the review engagement report.

Question 17: What are the key matters a practitioner performing a review of historical financial statements should be required to communicate with those charged with governance of the entity?

The communication with ‘those charged with governance’ in relation to review engagements should be situated in-between the requirements for such communication in an audit engagement and a compilation engagement.

In case of material deficiencies or weaknesses in internal control and other matters which result in the reporting of material misstatements in the financial statements in the practitioner’s review report, such matters need to be communicated to ‘those charged with governance of the entity’. It is clear that the review standard should not prevent practitioners from communicating additional matters with ‘those charged with governance’.

However, practitioners should use their professional judgement to determine which such additional matters should be communicated to ‘those charged with governance’, we do not believe that the review standard should include a list of such key matters to be communicated to them.

Additionally, we would like to point out that in the majority of review engagements, it will often be equally important to communicate with owners and managers of the entity as they are often those charged with governance of the entity.

Question 18: How can a practitioner effectively communicate the concept of a level of assurance that is less than high, as obtained in a review engagement, to the intended readers or users of a review report, so that they will be able to properly estimate the level of confidence they can associate with the review conclusion?

Reference is made to our main comments on Level of Assurance and Reporting and Communication with Intended Users.

Question 19: Can the term ‘moderate level of assurance’ usefully be restated as a ‘plain language’ term in order to assist users of review reports to better understand the underlying message conveyed by the conclusion expressed in a review report?

Reference is made to our main comments on Level of Assurance and Reporting and Communication with Intended Users.

Question 20: What form of expression of the conclusion on the financial statements in the review report might increase the perceived usefulness of a review as an alternative form of assurance engagement? Would a different expression of the practitioner’s conclusion other than in negative terms increase readers’ or users’ understanding of the level of assurance conveyed and, if so, how should the practitioner’s conclusion be expressed?

Reference is made to our main comments on Level of Assurance and Reporting and Communication with Intended Users.

Question 21: Given the limited work effort ordinarily undertaken for a review engagement (i.e. enquiry and analytical review procedures), what level of detail is appropriate to properly inform readers or users of the review report about the scope of the review engagement and the work undertaken for the engagement? Should practitioners be permitted to use a flexible format for their review reports to communicate the nature of the work undertaken?

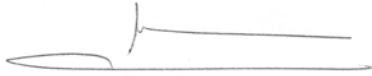
Reference is made to our main comments on Level of Assurance and Reporting and Communication with Intended Users.

Question 22: Do the review engagement standards need to be complete in themselves so that they ‘stand alone’ as standards separate from the ISAs? If so, which aspects of the ISAs should be incorporated into the review engagement standards?

Review engagement standards should stand-alone. Separate review engagement standards need to be established with differing levels of reporting attached to them. The initial distinction to be drawn is between engagements to review financial statements and engagements to review interim financial statements.

If you have any further questions about our views on these matters, please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in black ink, consisting of a series of connected loops and a long horizontal stroke at the end.

Jacques Potdevin
President

Ref.:AUD/JP/HB-SH