



Agenda Item 2

Proposed Revisions to AR-C sections 60 and 90 for Convergence With ISRE 2400 (Revised)

Objective of Agenda Item

To discuss draft proposed revisions to AR-C sections 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services* and 90, *Review of Financial Statements*, to more closely converge with International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*.

Background

At its meeting in November 2017, the ARSC discussed the accountant's response in a review engagement when identified misstatements are material and pervasive. As part of that discussion, the ARSC questioned whether the prohibition in AR-C section 90 on the accountant modifying the standard report to include a statement that the financial statements are not in accordance with the applicable financial reporting framework (i.e., an adverse conclusion) remains appropriate. ISRE 2400 (Revised) permits the issuance of an adverse conclusion.

The ARSC considered the situation in which an accountant is engaged to perform a review in accordance with both SSARs and ISRE 2400 (Revised) and has identified a misstatement that is material and pervasive to the financial statements. While SSARs prohibit the issuance of an adverse conclusion, ISRE 2400 (Revised) would require the issuance of such a conclusion. As such, the accountant would not be able to adhere to both sets of standards. The ARSC concluded that the issue merits the committee considering permitting the issuance of an adverse conclusion when the accountant is aware that the financial statements are materially and pervasively misstated – if for no other reason than not putting accountants in a position where they cannot adhere simultaneously to both sets of standards when engaged to perform the review in accordance with both sets of standards.

The ARSC concluded that a closer convergence between AR-C section 90 and ISRE 2400 (Revised) – which would include the consideration of requiring an adverse conclusion when a misstatement is material and pervasive should be considered.

Issues For Discussion With ARSC

Definition of Limited Assurance

This discussion is related to a discussion with respect to agenda item #1 – Revisions to AT-C sections 105, 210, and 215.

ISRE 2400 (Revised) includes the following definition of *limited assurance*:

Limited assurance—The level of assurance obtained where engagement risk is reduced to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for expressing a conclusion in accordance with this ISRE. ***The combination of the nature, timing and extent of evidence gathering procedures is at least sufficient for the practitioner to obtain a meaningful level of assurance. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the financial statements.***

To provide additional guidance, ISRE 2400 (Revised) includes the following application guidance:

A13. Sufficient appropriate evidence is required to obtain limited assurance to support the practitioner's conclusion. Evidence is cumulative in nature and is primarily obtained from the procedures performed during the course of the review.

The current Attestation Standards Task Force considered a similar definition from International Statement on Assurance Engagements 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*. However, that Task Force had concerns about the ***bold italicized*** sentences in the definition as several members of the Task Force believe that the phrase *meaningful level of assurance* implies that there is a range of levels of limited assurance. Those members would suggest that the ***bold italicized*** sentences be deleted. If those sentences were deleted, the Task Force believes the standard would not be considered ISRE minus because the work effort and reporting requirements would be consistent between the SSARs and ISRE 2400 (Revised).

Other members of the Task Force believe that ***bold italicized*** sentences should be included in the definition because they support the idea that the level of assurance obtained does need to be more than inconsequential and the evidence obtained must be sufficient and appropriate for the conclusion expressed. Some of the members see the accountant's consideration of whether he or she has obtained a meaningful level of assurance as part of a "stand-back" in which the accountant considers whether sufficient work was performed to enable the accountant to conclude that "nothing came to my attention to indicate the financial statements are materially misstated."

The definition of *limited assurance* in the draft revised AR-C section 90 is consistent with the ISRE 2400 (Revised) definition.

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Action Requested of ARSC

The ARSC is asked to consider whether the definition of *limited assurance* in proposed revised AR-C section 90 (which has been converged with the ISRE 2400 (Revised) definition) should retain the last two sentences. If retained, the ARSC is asked to consider whether any additional application guidance should be added.

Professional Skepticism in a Review Engagement

Traditionally, AR-C section 90 has not included an explicit requirement for the accountant to plan and perform the review with professional skepticism. The ARSC had concluded that the exercise of professional skepticism was a dividing line between limited assurance and the reasonable level of assurance obtained in an audit of financial statements. However, in recent deliberations, the ARSC has had a change of mind and believes that the accountant's procedures are effective only if the accountant plans and performs such procedures consistent with the concept of professional skepticism.

It is proposed that, consistent with ISRE 2400 (Revised) that the following requirement and associated application guidance be included in AR-C section 90:

12. The accountant should plan and perform the review with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: par. .A12 - .A15)

.A12 Professional skepticism is necessary for the critical assessment of evidence in a review. This includes questioning inconsistencies and investigating contradictory evidence, and questioning the reliability of responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of evidence obtained in the light of the engagement circumstances.

.A13 Professional skepticism includes being alert to, for example:

- Evidence that is inconsistent with other evidence obtained.
- Information that calls into question the reliability of documents and responses to inquiries to be used as evidence.
- Conditions that may indicate possible fraud.
- Any other circumstances that suggest the need for additional procedures.

.A14 Maintaining professional skepticism throughout the review is necessary if the practitioner is to reduce the risks of:

- Overlooking unusual circumstances.
- Over-generalizing when drawing conclusions from evidence obtained.
- Using inappropriate assumptions in determining the nature, timing, and extent of the procedures performed in the review, and evaluating the results thereof.

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.A15 The practitioner cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the practitioner of the need to maintain professional skepticism or allow the practitioner to be satisfied with evidence that is inadequate for the purpose of the review.

Action Requested of ARSC

The ARSC is asked to consider whether the proposed requirement that the accountant plan and perform the review with professional skepticism is appropriate. If so, the ARSC is asked whether the proposed application guidance provides the appropriate guidance.

Materiality in a Review of Financial Statements

At its meeting in January 2017, the ARSC discussed the concept of materiality in a review engagement and observed:

- That it would be helpful to have a clear communication to CPAs that, because it is an attribute of the financial statements, materiality does not change based on the level of service performed.
- In a review, the CPA would, at a minimum need to qualify deviations in order to be able to accumulate possible misstatements to conclude whether the CPA is aware of any material modifications that need to be made to the financial statements.

Further, Ethics Code section 1.400.040, Negligence in the Preparation of Financial Statements or Records, states that a member is considered in violation of the "Acts Discreditable Rule" if the member fails to correct financial statements that are materially false and misleading.

Consistent with ISRE 2400 (Revised), the proposed revised AR-C section 90 includes the following requirements:

.20 The accountant should determine materiality for the financial statements as a whole, and apply this materiality in designing the procedures and in evaluating the results obtained from those procedures.

.21 The accountant should revise materiality for the financial statements as a whole in the event of becoming aware of information during the review that would have caused the accountant to have determined a different amount initially.

Action Requested of ARSC

The ARSC is asked to consider whether it agrees with the proposed explicit requirements with respect to materiality in a review engagement.

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Expression of an Adverse Conclusion

As stated in the Background section of this discussion memorandum, the ARSC may be at the point that requiring an adverse conclusion when a known misstatement is material and pervasive should be considered. Consistent with ISRE 2400 (Revised), the proposed revised AR-C section 90 includes the following requirements (the “or is otherwise aware” wording was added to the AR-C section 90 requirement):

.68 If the accountant determines, or is otherwise aware, that the financial statements are materially misstated, the accountant should express:

- (a) A qualified conclusion, when the accountant concludes that the effects of the matter(s) giving rise to the modification are material, but not pervasive to the financial statements; or
- (b) An adverse conclusion, when the effects of the matter(s) giving rise to the modification are both material and pervasive to the financial statements.

.70 When the accountant expresses an adverse conclusion on the financial statements, the accountant should use the following phrase:

“Based on my (our) review, due to the significance of the matter(s) described in the Basis for Adverse Conclusion paragraph, the financial statements are not prepared, in all material respects, in accordance with (the applicable financial reporting framework).”

.71 In the basis for conclusion paragraph, in relation to material misstatements that give rise to either a qualified conclusion or an adverse conclusion, the accountant should:

- (a) Describe and quantify the financial effects of the misstatement if the material misstatement relates to specific amounts in the financial statements (including quantitative disclosures) and the effects of the departure on the financial statements have been determined by management or are known to the accountant as the result of the accountant’s procedures. If the effects of the departure have not been determined by management or are not known to the accountant as a result of the accountant’s procedures, the accountant is not required to determine the effects of the departure; however, in such circumstances, the accountant should state in the report that such determination has not been made by management;
- (b) Explain how disclosures are misstated if the material misstatement relates to narrative disclosures; or
- (c) Describe the nature of omitted information if the material misstatement relates to the non-disclosure of information required to be disclosed. The practitioner should include the omitted disclosures where practicable to do so.

Action Requested of ARSC

The ARSC is asked to consider whether the it agrees with permitting the expression of an adverse review conclusion and, if so, whether the proposed requirements and guidance is appropriate.

Further, if the ARSC agrees with permitting the expression of an adverse review conclusion, whether a recommendation should be made to the Audit Issues Task Force that AU-C section 930, *Interim Financial Information* be revised so as to be consistent with AR-C section 90 and AT-C section 210, *Limited Assurance Engagements*.

Inclusion of Statement Regarding Independence and Compliance With Ethical Responsibilities in the Accountant's Review Report

Paragraph .73h of the proposed revised AR-C section 90 requires the accountant's report to include:

- h.* A statement that the accountant is independent and has fulfilled the accountant's other ethical responsibilities in accordance with relevant ethical requirements relating to the review engagement;

The inclusion of the statement would result in the accountant's review report being consistent with the proposed revised audit report (currently in public exposure) as well as the proposed revised examination, review, and agreed-upon procedures reports currently proposed by the Attestation Standards Task Force.

The following represents the revised accountant's review report:

An Accountant's Review Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When a Review Has Been Performed for Both Periods

Circumstances include the following:

- Review of a complete set of comparative financial statements.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily

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applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are independent of XYZ Company, and have fulfilled our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our review.

Accountant's Conclusion

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Action Requested of ARSC

The ARSC is asked to consider whether it agrees with the requirement to include a statement that the accountant is independent and has fulfilled the accountant's other ethical responsibilities in accordance with relevant ethical requirements relating to the review engagement. If so, does the ARSC agree with the placement in the illustrative review report?

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Proposed Timeline for Issuance of Revised Standard

May 2018	Discuss first read draft of proposed revised AR-C sections 60 and 90 and primary issues.
August 2018	Discuss revised drafts and consider voting to expose for public comment
Sep – Dec 2018	Public exposure of proposed revised AR-C sections
January 2019	Consider comment letters received on exposure draft of proposed revised AR-C sections
May 2019	Consider voting to issue as final revised AR-C sections
Jun/Jul 2019	Issuance of standard

Agenda Items Presented:

Agenda item 2A	Proposed revised AR-C section 60 – Redline to show edits from extant
Agenda item 2B	Proposed revised AR-C section 90 – Redline to show edits from extant
Agenda item 2C	Mapping document – ISRE 2400 (Revised) to AR-C sections 60 and 90

ISRE 2400 (Revised) is available at
[https://www.ifac.org/system/files/publications/files/International-Standard-on-Review-Engagements-2400-\(Revised\)-Engagements-to-Review-Historical-Financial-Statements.pdf](https://www.ifac.org/system/files/publications/files/International-Standard-on-Review-Engagements-2400-(Revised)-Engagements-to-Review-Historical-Financial-Statements.pdf).