



Agenda Item 1

Proposed Revisions to AR-C section 90 for Closer Convergence With ISRE 2400 (Revised)

Discussion Memo

Objective of Agenda Item

To vote to ballot to expose the proposed revised AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services* and AR-C section 90, *Review of Financial Statements* for public comment.

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.

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A first read draft of the proposed revised AR-C sections 60 and 90 was presented to the ARSC at its meeting in May 2018.

Issues For Discussion With ARSC

Definition of Limited Assurance

At its meeting in May 2018, the ARSC considered whether the definition of *limited assurance* in proposed revised AR-C section 90 should be consistent with the definition in ISRE 2400 (Revised). After discussion, the ARSC directed that the definition read as follows (the base below is the definition from ISRE 2400 (Revised). Additional language is show in ***bold italics*** and deleted language in ~~strikethrough~~):

Limited assurance—The level of assurance obtained where ~~engagement risk~~ ***the risk that the accountant expresses an inappropriate conclusion is not*** reduced to a level ***as low as an audit but 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~~ ***about whether the accountant is aware of any material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.*** The combination of the nature, timing and extent of evidence gathering procedures is at least sufficient for the ~~practitioner~~ ***accountant*** to obtain a ~~meaningful~~ ***meaningful*** level of assurance ***that is meaningful to the accountant.*** ~~To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the financial statements.~~

Please note that the deletion of the term “engagement risk” and the addition of the words “the risk that the accountant expresses an inappropriate conclusion” in the first sentence is at the direction of the ARSC. The ARSC noted that the defined term “engagement risk” only appeared in the definition of *limited assurance* and directed that the term be deleted and replaced with the definition of that term.

At its meeting in May 2018, the ARSC considered the definition of *limited assurance* in conjunction with its consideration of the term *limited assurance engagement* from the draft proposed revised AT-C section 210, *Limited Assurance Engagements*. The definition of the term *limited assurance engagement* contained in the exposure draft of the proposed revised attestation standards reads as follows:

Limited assurance engagement. An attestation engagement in which the practitioner obtains limited assurance. Limited assurance is obtained when the practitioner has obtained sufficient appropriate evidence to reduce attestation risk to a level that is greater than it is for an examination engagement but appropriate as the basis for the practitioner’s conclusion about whether any material modification should be made to the subject matter in order for it be in accordance with (or based on) the criteria or to the assertion in order for it to be fairly stated.

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The ARSC is asked to consider whether the definition of *limited assurance* in proposed revised AR-C section 90 is appropriate.

Definition of Review Evidence

At its meeting in May 2018, the ARSC considered the definition of *review evidence* in proposed revised AR-C section 90. After discussion, the ARSC directed that the definition of *review evidence* be revised to include the language from the definition of *audit evidence* from AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. The proposed revised definition is as follows. Additional language is shown in ***bold italics*** and deleted language in ~~strikethrough~~:

Review evidence. Information used by the accountant to provide a reasonable basis for obtaining limited assurance. ***Review evidence includes both information contained in the accounting records underlying the financial statements and other information, which primarily consists of the results of analytical procedures and inquiries. Sufficiency of review evidence is the measure of the quantity of review evidence. Appropriateness of review evidence is the measure of the quality of review evidence; that is, its relevance and reliability in providing support for the conclusions on which accountant's review report is based.***

The following is the definition of *audit evidence* from AU-C section 200:

Audit evidence. Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. Sufficiency of audit evidence is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence. Appropriateness of audit evidence is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

Action Requested of ARSC

The ARSC is asked to consider whether the definition of *review evidence* in proposed revised AR-C section 90 is appropriate.

Requirement to Plan and Perform the Review With Professional Skepticism

The proposed revised AR-C section 90 includes the following requirement:

11. 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 - .A16)

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At its meeting in May 2018, the ARSC directed that application guidance be included similar to that included in AU-C section 200. The proposed application guidance reads as follows (emphasis added to provide context for the questions posed in the Action Requested of ARSC box below):

.A12 Professional skepticism includes being alert to the following, for example,

- Review evidence that contradicts other review evidence obtained.
- Information that brings into question the reliability of documents and responses to inquiries to be used as review evidence.
- Conditions that may indicate possible fraud.
- Circumstances that suggest the need for review procedures in addition to those required by this section.

.A13 Maintaining professional skepticism throughout the review is necessary if the accountant is, for example, to reduce the risks of

- overlooking unusual circumstances.
- over-generalizing when drawing conclusions from review observations.
- using inappropriate assumptions in determining the nature, timing, and extent of the review procedures and evaluating the results thereof.

.A14 Professional skepticism is necessary to the critical assessment of review evidence. This includes questioning contradictory review evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of review evidence obtained in light of the circumstances; for example, in the case when fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

.A15 The accountant may accept records and documents as genuine unless the accountant has reason to believe the contrary.

.A16 The accountant neither assumes that management is dishonest nor assumes unquestioned honesty. The accountant 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 accountant of the need to

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maintain professional skepticism or allow the accountant to be satisfied with less than *adequate* review evidence when obtaining limited assurance.

The following language from paragraph .A25 of AU-C section 200 is not included in paragraph .A15 of proposed revised AR-C section 90:

Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud (for example, if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document may have been falsified), GAAS require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

Action Requested of ARSC

The ARSC is asked to consider whether the proposed application guidance is appropriate. Specifically, the ARSC is asked to consider the use of the phrase *adequate review evidence* in proposed paragraph .A16 preceding. Paragraph .A26 in AU-C section 200 refers to *persuasive audit evidence*.

Overall Action Requested of the ARSC

The ASB is asked to consider the proposed revised AR-C sections 60 and 90 and to vote to ballot to expose the proposed revised AR-C sections for public comment.

Agenda Items Presented:

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| Agenda item 1A | Proposed revised AR-C section 60, <i>General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services</i> marked to show changes from extant |
| Agenda item 1B | Proposed revised AR-C section 90, <i>Review of Financial Statements</i> marked to show changes from extant |
| Agenda item 1C | Draft wrap document for exposure draft of proposed revised AR-C sections 60 and 90 |
| Agenda item 1D | Mapping of the requirements International Standard on Review Engagements (ISRE) 2400 (Revised), Engagements to Review Historical Financial Statements to the related paragraphs in proposed AR-C sections 60 and 90 |