THE STANDARD FOR LIMITED ASSURANCE REVIEW ENGAGEMENTS

Addressing the Needs of SMEs

The global marketplace for assurance services for small- and medium-sized entities (SMEs) is changing. As audit exemption for SMEs becomes more prevalent, the demand for non-audit assurance and related services is increasing. Small- and medium-sized accounting practices are ideally placed to help their SME clients determine what level of assurance over their financial statements can best meet their needs, and need to be prepared to respond accordingly.

The International Auditing and Assurance Standards Board (IAASB)'s International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*, issued in September 2012, can help.[1] Effective for periods ending on or after December 31, 2013, the revised standard includes strengthened requirements and additional guidance, and promotes a clearer understanding of the nature of a review engagement.

Merits of a Review Engagement

A review is a limited assurance engagement, which means it provides a level of assurance between that of an audit (a reasonable assurance engagement) and a compilation engagement (an engagement providing no assurance). ISRE 2400 (Revised) is designed not only to provide an effective and consistent level of limited assurance on financial statements, but also to allow for efficient delivery of the service proportionate to the complexity of the statements reviewed.

SMEs that do not require a statutory audit may still want some degree of independent assurance to increase the credibility of their statements, in which case a review can be an ideal solution. Additionally, since the work effort involved in performing a review engagement is generally less than that in conducting an audit, a review should be a more cost-effective option.

When to Conduct a Review Engagement

Under the standard, a practitioner can only perform a review when there is both a rational purpose and when a review engagement is appropriate in the circumstances. What constitutes a rational purpose? A common example would be when a review, as opposed to an audit, will satisfy legal or regulatory reporting purposes. An engagement without a rational purpose, for example, is one in which there is a significant limitation in the scope of the practitioner's work when management unreasonably restricts the practitioner's inquiries to specified individuals.

When would a review engagement be considered "appropriate in the circumstances"? When a practitioner believes engagement risk can be reduced to an acceptable level. A review may not be appropriate, for example, for complex entities, such as banks or insurance companies, when inquiry and analytical procedures alone may not reduce engagement risk sufficiently. In these cases, an audit engagement may be more appropriate.

Requirements

Since a review engagement is intended to provide only limited assurance, how will practitioners know when they have enough evidence to support a conclusion? First, let's look at the conclusion itself, which in its unmodified form states: "Based on our review, nothing has come to our attention that causes us to believe that these financial statements do not present fairly, in all material respects…" Someone with no

[1] ISRE 2400 (Revised) follows the release earlier in 2012 of International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements*, a standard that also addresses services that meet the unique needs of SMEs.

understanding of the standard might think a practitioner could express that conclusion having done nothing, i.e., nothing was found but nothing was done. This is the antithesis of what is required by the standard. Specifically, the standard requires that:

- every practitioner performing a review must comply with ethical requirements at least as demanding as those in the *Code of Ethics for Professional Accountants* (the Code) issued by the International Ethics Standards Board for Accountants, and the practitioner's firm must apply quality control standards at least as demanding as those required by ISQC 1;[2]
- the practitioner must develop an understanding of the entity and the applicable financial reporting framework, at least in areas required by the standard sufficient to identify areas where material misstatements are likely to exist; and
- the practitioner must perform inquiry and analytical procedures on every item material to the financial statements focusing on those where material misstatements are likely to arise.

The engagement partner must have competence in assurance skills and techniques and financial reporting appropriate to the engagement circumstances. As a result, the engagement partner will have a solid base of knowledge and understanding on which to base the review procedures to ensure they are effective and produce sufficient appropriate evidence to draw a conclusion. This adds significant weight to the conclusion and adds a meaningful level of assurance.

Review Engagement Procedures

The standard requires a practitioner to design inquiry and analytical procedures to address all material items in the financial statements and to focus on areas where material misstatements are likely to occur. There are also conditional requirements a practitioner must be aware of regarding related parties, going concern, fraud, and non-compliance with laws or regulations. The depth of inquiry and analytics is that required by a skilled practitioner with an understanding of the entity. The procedures must generate sufficient appropriate evidence to form the conclusion required by the report. The standard is designed so that if the practitioner does not become aware of a possible material misstatement, then performing inquiry, analytics, and procedures addressing specified circumstances may be sufficient. There is no requirement to do more work.

Note, however, that the practitioner can perform procedures other than inquiries and analytics, for example, observation or confirmation, at any point in the engagement. This is a matter of professional judgment. Performing these procedures does not turn the engagement into an audit—an audit is based on a different structure altogether—one of risk assessment, response to risks identified, and more comprehensive specified procedures—whereas the objective of a review engagement is to provide limited assurance on the financial statements as a whole.

Additional Review Procedures and Reporting

It may be that, in the practitioner's professional judgment, inquiries and analytical procedures either do not provide sufficient evidence to conclude on the financial statements, or something has come to the attention of the practitioner that would indicate the financial statements may be materially misstated.

In these instances, additional procedures must be performed to resolve the issue. Again, professional judgment in selecting these procedures is critical.

The additional procedures will result in the practitioner either:

[2] International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

- concluding that the matter is not likely to cause the financial statements to be materially misstated; or
- concluding that the matter does cause the financial statements as a whole to be materially misstated, in which case the misstatement must be referred to in the practitioner’s report; or
- being unable to draw a conclusion about the likelihood of a material misstatement, in which case, a scope limitation must be referred to in the practitioner’s report.

A review engagement is an important service that provides a meaningful level of assurance, increases the credibility of financial statements, and helps meet the needs of a changing market. ISRE 2400 (Revised) is designed to be a globally accepted benchmark for undertaking such engagements. If you read it, you will understand why.