

## Assurance work (Lecture A865 – 6.47 minutes)

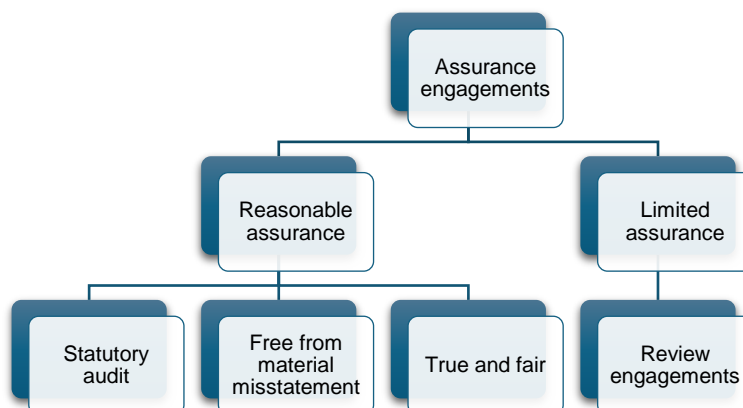
For several years, the Audit and Accounting Quarterly Updates have concentrated on auditing in the latter part of the updates. However, this quarter we have decided to take a look at assurance and the other types of assurance engagements that a practitioner may perform.

The *Handbook of International Quality Management, Auditing, Review, Other Assurance, and Related Services Pronouncements* issued by the IAASB defines an 'assurance engagement' as:

*An engagement in which a practitioner aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the subject matter information (that is, the outcome of the measurement or evaluation of an underlying subject matter against criteria).*

IAASB  
Handbook  
Glossary  
Terms  
Assurance  
engagement  
(extract)

The definition then goes on to clarify that each assurance engagement is classified on two dimensions: a **reasonable assurance** engagement or a **limited assurance** engagement.



Providing assurance means offering an opinion about specific information so the users of that information are able to make confident decisions in the comfort that the risk of the information being wrong is reduced (as it has been subject to some form of assurance work).

### Elements of an assurance engagement

There are five elements of an assurance engagement:



Putting these five elements in the context of an audit engagement:

#### *Three parties involved*

1. The preparers (management/directors)
2. The users (shareholders)
3. The practitioner (the audit firm)

#### *An appropriate subject matter*

This would be the financial statements that have been prepared by management/directors.

#### *Suitable criteria*

The applicable financial reporting framework, such as FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

#### *Sufficient appropriate evidence*

This would be the audit evidence obtained throughout the course of the audit fieldwork that is used to formulate the opinion.

#### *A written assurance report*

This would be the auditor's report which is presented to the shareholders and confirms whether the financial statements give a true and fair view.

### **Reasonable assurance engagements**

An audit is the only assurance engagement that provides **reasonable** assurance. Reasonable assurance is a high level of assurance, but it is not maximum or absolute assurance.

There is what is known as the 'expectations gap' that exists where auditing is concerned. The expectations gap is the difference between what the auditor is expected to do to comply with professional standards (ISAs (UK) and other regulatory requirements) and what the general public perceives that the auditor does.

An auditor can never provide 100% assurance on a set of financial statements. This is because of the inherent limitations of an audit which are as follows:

- Financial statements include subjective estimates and other judgemental matters.
- The auditor may place reliance on a client's internal controls which have their own limitations.
- Representations from management may have to be relied upon as the only source of evidence in some areas.
- Audit evidence is often persuasive rather than conclusive.
- The auditor does not test all transactions and balances as this is impractical. Auditors test on a sample basis.

Examples of the expectations gap include:

- A belief that the auditor tests all transactions and balances.
- A belief that auditors are required to detect all fraud. While ISA (UK) 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* places a certain level of responsibility on the auditor to obtain reasonable assurance that the financial statements are free from material misstatement whether caused by fraud, they are not responsible for detecting all fraud.
- A belief that auditors prepare the financial statements. This is the responsibility of management.

#### Illustrative auditor's report extract

##### Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether caused by fraud or error, and to issue a Report of the Auditors that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists.

As you can see from the above extract, the auditor's report is clear that the opinion is only reasonable assurance and is not a guarantee that the financial statements are 100% accurate.

A reasonable assurance **opinion** is also positively worded.

#### Illustrative positively worded audit opinion

##### Opinion

We have audited the financial statements of ...

In our opinion the financial statements:

- give a true and fair view of the state of the group's and of the parent company affairs as at 31 December 2023 and of the group's profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## Limited assurance engagement

A limited assurance engagement is increasingly being regarded as an alternative to an audit. Some professional bodies have introduced 'mini audits' for companies that fall into audit exemption although there is no statutory requirement to have this form of 'mini audit' (see also below).

A limited assurance engagement cannot give the same level of assurance as an audit. To that end, an 'opinion' (i.e. which provides reasonable assurance) is not provided. Instead, a limited assurance conclusion is expressed and this is known as 'negative assurance' based on the more limited procedures than are required with a statutory audit.

A negative assurance conclusion will typically be worded as follows:

*Nothing has come to our attention that causes us to believe that the financial statements of Sunnie Industries Ltd as at 31 December 2023 are not prepared, in all material respects, in accordance with FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland.*

In contrast to an audit opinion, no opinion is being expressed in an assurance conclusion. Although some assurance is provided that the information 'appears reasonable'.

## Summary

The table below summarises the principal differences between a reasonable assurance engagement (an audit) and a limited assurance engagement:

Reasonable assurance engagement	Limited assurance engagement
Auditors gathers sufficient and appropriate audit evidence to be able to draw a reasonable conclusion.	The practitioner gathers sufficient and appropriate evidence to be able to draw limited conclusions.
The auditor concludes that the subject matter conforms in all material respects with the identified suitable criteria.	The practitioner concludes that the subject matter, with respect to identified suitable criteria, is plausible in the circumstances.
	The practitioner provides a negatively worded

The auditor provides a positively worded assurance opinion.	assurance conclusion.
This opinion provides a high level of assurance (confidence).	The conclusion provides a moderate or lower level of assurance than an audit.
An audit involves performing thorough audit procedures to obtain sufficient and appropriate audit evidence which includes tests of controls and substantive procedures.	Significantly fewer procedures are performed and will consist mainly of inquiries and analytical procedures.

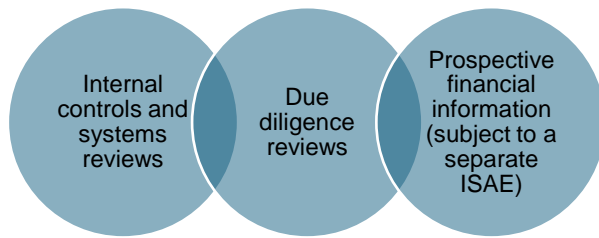
## Guidance for assurance engagements other than audits

The International Standard on Assurance Engagements (ISAE) 3000 provides guidance to practitioners on carrying out an assurance engagement other than audits or reviews of historical financial information. A summary of the requirements of ISAE 3000 is as follows:

Ethical requirements	Practitioners should comply with ethical requirements such as those issued by the relevant professional body (e.g. ACCA's <i>Code of Ethics and Conduct</i> )
Quality control	The practitioner should implement quality control procedures that are applicable to the individual engagement
Engagement	The terms of the engagement should be recorded in an engagement letter, and the practitioner should agree on the terms of the engagement with the engaging party
Planning and obtaining evidence	The practitioner should plan the engagement so that it will be performed effectively, and should consider materiality and assurance engagement risk, and sufficient appropriate evidence should be obtained on which to base the conclusion
Reporting	The assurance report should be in writing and should contain a clear expression of the practitioner's conclusion about the subject matter information

The approach required by ISAE 3000, and the work carried out in an assurance engagement, may be similar in some respects to an audit, although the context is different.

Some of the most common areas where assurance engagements on other information will typically arise include the following:



## **Internal control and systems reviews**

This type of work is similar to when an auditor carries out controls testing to assess the operating effectiveness of a client's internal control system.

## **Due diligence reviews**

There is very sparse guidance on due diligence reviews, although it is a common form of assurance. Ordinarily, the assurance provider is engaged by a potential acquirer of a business who wishes to delve into information concerning the target business. The assurance provider will attempt to verify specific representations made by management of the target company and to offer practical recommendations concerning the acquisition process.

## **Prospective financial information**

It should be noted that there is separate guidance in the form of ISAE 3400 *The Examination of Prospective Financial Information*. Prospective financial information (PFI) is highly subjective in nature because it relates to events and actions that have not yet occurred (and may not occur). Hence its preparation requires the exercise of professional judgement.

To comply with ISAE 3400, the terms of the engagement must be agreed on and sufficient knowledge of the business should be obtained. In addition, the period of time covered by the PFI should be clarified – for example, it could be a forecast covering up to 12 months or it could be a projection covering a five-year period.

Written representations should be requested from management concerning the intended use of the PFI, the completeness of significant management assumptions and also management's acceptance of its responsibility for the PFI. The assurance report provided by the practitioner should make it clear that management is responsible for the PFI and also the assumptions on which it is based.

As PFI is purely subjective and speculative, an opinion cannot be provided on whether the results in the report will be achieved hence only negative assurance can be given in such an engagement.

## **Review engagements**

The objective of a review engagement is for the practitioner to state whether, on the basis of the procedures carried out, anything has come to the practitioner's attention that causes them to believe that the financial statements are not prepared in accordance with the applicable financial reporting framework.

Hence, a company that claims audit exemption may choose to have a review of their financial statements instead. This review will still provide some assurance but will cost less and be less disruptive than an audit.

In a review engagement, the procedures carried out will focus mainly on analytical procedures and enquiries of management. Tests of control will not be carried out and because only limited assurance is being expressed, substantive procedures will be minimal.

In other words, there is no requirement to comply with the ISAs (UK) in a review engagement.