The Determination and Communication of Levels of Assurance Other than High
The mission of the International Federation of Accountants (IFAC) is the worldwide development and enhancement of an accountancy profession with harmonized standards, able to provide services of consistently high quality in the public interest.

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The Determination and Communication of Levels of Assurance other than High

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5.1 Introduction
FOREWORD

This report is an extensive study of the determination and communication of levels of assurance other than high. The accurate determination and effective communication of levels of assurance provided in assurance engagements are critical issues for the well-being of the profession and the future development of assurance services. The development stage of new assurance services requires many decisions regarding their design, including how their level of assurance is determined and communicated. These decisions are very important as they will affect the risks and opportunities associated with providing new assurance services. The information contained in this study, which consists of an extensive literature review of related initiatives within and outside the profession accompanied by two empirical studies, are an important input for decision-making regarding the determination and communication of levels of assurance.

This study is conducted by an international network of auditing academics. The core of this network are auditing academics involved in the annual organization of the International Symposium on Audit Research (ISAR). The annual ISAR covers a broad range of auditing issues that are studied from a variety of perspectives. The ISAR network involves academics with diverse national backgrounds: Australia, the Netherlands, Singapore, and the United States. For the purpose of this study, an auditing academic from Germany was added to the project team.

This report is the result of efforts of many individuals. We would like to thank the national institutes and the audit firms in the 12 participating countries for their willingness to complete the questionnaires. The time-consuming completion of the questionnaire resulted in valuable empirical results. The IAPC is thanked for giving us the opportunity to extensively study the challenging issues of the determination and communication of assurance levels. Specifically we would like to thank Stuart Gooley, chairman of the IAPC subcommittee, and Michael Nugent of the IFAC staff. With their input to this project, including critical remarks, they have made a significant contribution to the quality of this report. Finally, we would like to thank our colleagues in the project team: they have all given their best efforts to the result of this project.

In our judgment, this is the most extensive study of the determination and communication of levels of assurance in the context of providing new assurance services. We are convinced that the issues dealt with in this study will continue to be crucial to the development of new assurance services. We therefore invite both practitioners and academics involved in assurance services to continue the analysis and debate about the determination and communication of levels of assurance.

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CHAPTER 1: INTRODUCTION

1.1 Motivation and Research Questions

The International Auditing Practices Committee (IAPC) has debated for a number of years the determinants of the level of assurance. Over the last couple of years, two major views have evolved: the single determining factor (work effort) view, and the multiple determinants (interaction of variables) view. In developing generally accepted international standards, it is important that these competing views be reconciled. It is possible to observe divergences occurring in different countries; for example, in the United States the Attestation Standards (2001) have been primarily based upon the work effort view, while in the United Kingdom, the independent professional review has been primarily based upon the interaction of variables view. Thus it is important that in the development of a generally accepted international framework, agreement is reached as to what are the significant determinants of assurance.

At the same time reservations have been raised about how to best communicate assurances at levels other than high. For example, concerns have been raised as to whether the negative form of assurance contained in the review report is the best way to communicate the level of assurance that the assurance provider has derived from the engagement. The issues addressed in this study are interrelated, with an understanding of the determinants of assurance facilitating the effective communication of different levels of assurance.

The objectives of this study, commissioned by the IAPC, are to conduct research on these two issues. These issues are addressed in the examination of the following nine research questions that provide the basis for the structure of the study:

1. What factors determine whether an assurance engagement is a moderate level assurance engagement and how do they do so?
2. What is the effect of the following variables on the moderate level of assurance: work effort, subject matter, criteria, process, quantity and quality of evidence? How, if at all, do these factors interact with each other?
3. What options and measurement issues are involved in providing levels of assurance (e.g., moderate versus high)?
4. What are the comparative advantages and disadvantages of the various models which can determine different levels of assurance? These models include the work effort model and the interaction of variables model.
5. How can a moderate level of assurance be best communicated?
6. What can we learn from the various national environments about the determination and communication of levels of assurance other than high?
7. Are there innovative reporting practices in the various assurance practices from which we can learn about the communication of levels of assurance other than high?
8. What can we learn from other professions about the determination and communication of levels of assurance other than high?
9. What can we learn from communication theory about communicating levels of assurance other than high?
The Determination and Communication of Levels of Assurance Other than High

The remainder of this introductory chapter will discuss the relevant IAPC exposure drafts and assurance standard. They provide the context for the discussion of the determination and communication of assurance levels. Subsequently, three reporting frameworks and two views on the determinants of assurance levels will be presented.

In order to address the nine research questions a broad spectrum of both academic and professional sources was reviewed. This review is contained in Chapter 2. The core of Chapter 2 is based on accounting and auditing research. In addition, communication theory is also discussed, as it provides insights on how readers understand messages contained in assurance reports. A concise overview of this broad body of literature is included in this chapter.

In Chapter 3 the initiatives undertaken by the assurance and other professions are considered. We examine what can be learned from current auditing theory, and we review the activities and initiatives undertaken by the IAPC. We also review specific assurance services, which are reasonably well-established in order to identify any lessons to be learned, as well as other literature produced by the professional accounting associations that covers assurance services at other than a high level. Finally, we include in this section a review of the approaches of other providers of assurance services, certification bodies and standards setters.

For a subset of research questions, survey questionnaires were administered to key respondents in National Institutes and audit firms from twelve countries. The questionnaires elicited views on both national (regulatory) assurance environments and on audit firm practices. Chapter 4 summarizes the findings of the National Institutes responses to the IAPC research questionnaire. Chapter 5 summarizes the findings of the audit firm responses to the IAPC research questionnaire. Finally, Chapter 6 provides a summary and conclusions. This concluding chapter is structured on the basis of the nine questions presented above.

1.2 Initiatives of the International Federation of Accountants

During the early 1990s, the International Federation of Accountants (IFAC) recognized that there was a growing demand for assurance services beyond financial statement audits and reviews. Assurance services, as defined by IFAC in the International Standard on Assurance Engagements (ISAE 100), refer to engagements that involve the evaluation or measurement of a subject matter that is the responsibility of another party against identified suitable criteria, in order to express a conclusion that provides the intended user with a level of assurance about that subject matter.

Many of these assurance services were already being provided by members of the profession. Over the last five years IFAC has attempted to provide guidance in the form of a framework for assurance services. While there has been widespread support for an assurance framework, controversy has existed as to how to determine and effectively communicate the potentially different levels of assurance for the different types of engagements. There have been developments in two areas. First, the level of assurance given by the assurance provider has expanded from high to moderate assurance. In 1988, the IAPC raised the concept of moderate assurance in the form of reviews of financial statements. Second, during the 1990s we have seen the IAPC attempt to develop a framework for a broader range of assurance services. These two developments, and the role of this study, are contained in the following table.

<table>
<thead>
<tr>
<th>High level of assurance</th>
<th>Financial Statements</th>
<th>Other Subject Matter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Determination: Work effort (test of control and substantive testing, determined by risk model)</td>
<td>Determination: Informed by this study</td>
<td></td>
</tr>
<tr>
<td>Communication: Positive opinion</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The evolution of the IAPC’s approach in both the determination and communication areas, and the current outstanding issues, can be identified by a review of the exposure drafts and current standard. Two draft standards were exposed leading up to the release of the IAPC International Standard on Assurance Engagements (ISAE 100). A review of the major issues in these documents follows.

**Exposure Draft 1: Reporting on the Credibility of Information (1997)**

In 1997, the IAPC released an exposure draft entitled “Reporting on the Credibility of Information.” This initiative by the IAPC recognized the increasing demand for assurance over a wide range of subject matter. While some accounting firms were already providing these assurance services (in some cases, this provision being a requirement of legislation), there was a general lack of guidance for assurance providers undertaking such engagements. The first exposure draft (ED) was issued with the purpose of:

> Providing generic standards that can be applied by practitioners to different types of engagements as they evolve.

The exposure draft suggested that the level of assurance on the credibility of information be expressed in the form of a conclusion in the report. The form of conclusion expressed being dependent on the nature of the subject matter and the agreed objective of the engagement. The general principles accompanying the ED also stated that the level of assurance being provided may vary from a low level to an absolute level. The determination of which relies on the inter-relationship of:

(a) The nature and form of the subject matter;
(b) The nature and form of the criteria applied to the subject matter;
(c) The nature and the extent of the process used to collect and evaluate evidence; and
(d) The sufficiency and appropriateness of the evidence likely to be available.

Since attainment of absolute assurance was not normally expected to be possible, assurance levels were expected to range from a low level to a high level.

To enhance communication to report users and to limit the risk users attach an assurance level beyond what is intended by professional accountants and what is reasonable in the situation, the ED also required that the report includes explanatory language reflecting the influence, in the particular engagement, of the four factors outlined above.

In summary, unlike the current approach taken in audit, the ED (Preface) “allows for any level of assurance to be expressed in the context of the specific engagement circumstances.” It also recommended that assurance “be expressed with regard to the identified limitations and the extent of work undertaken in each engagement.” It is noted that this flexible approach to assurance was also proposed by the Jenkins Committee in its report. The Jenkins Committee suggested that, in lieu of

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1. In 1991, the Special Committee on Financial Reporting, in short, the Jenkins Committee, was established by the American Institute of Certified Public Accountants (AICPA).
users’ differing information needs, users and auditors be given the freedom to identify the elements upon which assurance is to be provided, and then proceed to specify the assurance level desired by the user (AICPA, 1991).

Although both recommendations, by the ED and the Jenkins Committee respectively, were considered by many to be plausible and necessary (considering the need to be customer-focused), the reporting approach was controversial. The arguments generally surrounded the following two questions:

1. “Is having a range of assurance an appropriate basis for reporting?”; and
2. “Is it appropriate that the range be determined by the limitations and the extent of work undertaken in a particular engagement as outlined in this exposure draft?”


The idea of being able to report on a continuum proved to be unpopular, with many respondents seeing this as unworkable. In March 1999, a second draft, “Assurance Engagements,” was released, seeking comments on the provision of assurance at two levels: high and moderate. The background to the exposure draft stated that the primary consideration in reporting on assurance engagements was to “provide clear communication of the level of assurance justified in the particular circumstances.” The responses to this exposure process indicated that a major challenge facing the profession was to get the market to understand and value the concept of third party assurance. In this respect, the ability to effectively communicate with the market was seen to be a key to its success. Respondents expressed a number of concerns in relation to reporting: how best to communicate to users a moderate level of assurance, the feasibility of using a statement of negative assurance, and the desirability of having example reports within the standard.

A number of respondents to the exposure draft indicated some uncertainty on how to effectively convey a moderate level of assurance. There was concern that users would not understand this concept, for example, how it differed from positive or negative assurance. Suggestions were made on how to enhance communication, for example, a clear statement in the title of the report (or the heading of the conclusion paragraph) of the assurance level to be conveyed.

The feasibility of using a negative assurance report to express a moderate level of assurance was discussed by many respondents. They indicated that users were already familiar with this form of reporting as it was well-established in review engagements. In addition, it is recognizably different from positive expressions of opinion, highlighting the more limited extent of assurance conveyed. Providing negative assurance in all instances of moderate assurance engagements would help avoid confusing users. On the other hand, it was highlighted that present forms of negative assurance were difficult for users to understand, and continuing it in this context might maintain the expectations gap. The appropriateness of using negative assurance reports in these new forms of assurance engagements was also questioned.

A few respondents expressed the desirability of having model reports contained within the standard to provide a frame of reference, especially for smaller practitioners who had not yet established themselves in providing new forms of assurance reporting. This highlights the need for further guidance on the reporting issue. The IAPC exposure draft was based on a notion of flexible reporting adapted to specific engagement circumstances, identifying only minimum requirements on information to be included in the assurance report. It was envisaged however, that sample reports would be produced as standards were issued on specific subject matter engagements.
IAPC Standard: ISAE 100
The IAPC issued the International Standard on Assurance Engagements (ISAE 100) in June 2000. This establishes a framework for all assurance engagements (both moderate and high level assurance) and provides basic principles, essential procedures (black letters) and specific guidance for the performance of high level assurance engagements. The standard is set out in Appendix 1. Paragraphs 8-30 describe the elements, or determinants, of assurance engagements. Paragraphs 68-73 discuss the reporting associated with high level of assurance engagements, outlining the minimum information to be included in the report. The commentary highlights that a written report (as opposed to oral, or symbolic representation) is generally the most effective form for presenting the conclusions. It also notes that a standardized format is not prescribed for all assurance engagements, enabling the practitioner to tailor the reporting to specific engagement circumstances and facilitating effective communication to the intended user.

Two main pending issues arising from the IAPC initiatives discussed above remain. First, which factors determine the level of assurance of an engagement? And second, what entails the effective communication of assurance? Both issues are discussed in the two sections below.

1.3 The Communication of Assurance: Proposed Reporting Frameworks

Three Assurance Levels Frameworks
In the responses by the profession to the debate as to how to report assurance engagements, the following assurance frameworks have been suggested:

(1) Continuum of Assurance; and

(2) Specified Level(s) of Assurance:
    (a) High and Moderate Assurance Levels; and
    (b) Single Level of Assurance.

As noted, the debate about the reporting frameworks has mainly focused on communication issues and user perceptions. This is reflected in the arguments for and against the reporting frameworks presented below. However, the issue of the determination of assurance is in principle relevant for each reporting framework. Given the selection made by the IAPC in ISAE 100 for a reporting framework 2(a), the analysis of the determination of assurance is applied to the case of moderate and high assurance (see section 1.4). Although, the arguments for and against the frameworks have been discussed in previous reports and may be well-known, we present the arguments here to set the stage for the discussion of the communication issue later in this report.

Continuum of Assurance
The technical nature of this approach has been discussed already. Therefore, the following focuses on the arguments commonly voiced for and against this framework.

Main Arguments for:

(1) The flexibility incorporated in this framework reflects individual circumstances and user needs;

(2) Retaining such flexibility at the framework and general principles level will provide the scope for applying those principles in achieving suitable reporting results when developing specific standards on new subject matter; and
(3) The continuum allows for an approach, which recognizes that several variables may affect assurance in different ways, and that report users need to be advised of the impact of these factors and the resulting impact on level of assurance.

**Main Arguments against:**

(1) Difficulty in effectively communicating assurance levels on a continuum, with problems in preparing reports that adequately differentiate between assurance levels. One of the effects of this ineffective communication is reduced comparability.

(2) Permitting assurance at various levels may result in undue reliance on the reports once professional accountants move beyond traditional financial statement engagements;

(3) Given competitive market forces and, possibly litigation risks, practitioners may provide the lowest level of assurance and this may not be in the public’s best interest;

**Specified Levels of Assurance**

This is an alternative to the continuum assurance framework. Based on the responses to the IAPC EDs referred to earlier, there seems to be two basic models with variations within each.

**High and moderate assurance levels**

This approach proposes adoption of the current audit/review, high/moderate model, which has been commonly adopted for financial statement assurance engagements.

**Main Arguments for:**

(1) Users value some degree of uniformity and standardization of levels; and

(2) Communication of only two levels of assurance will be practicable, understandable and thus, more effective.

**Main Argument against:**

(1) Transition back to the old assurance framework would be taking a step backward and, disregarding the need for assurance services to be customer-focused.

**Single assurance level**

This model recommends limiting the level of assurance to a single level, as the standard form of engagement and the benchmark for all services, with that level being “high.” Provision would then be made for lower levels of assurance only when developing standards for specific engagements in circumstances where it is warranted, rather than promulgating different levels as a standard feature of assurance engagements.

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2 However, explanatory language required by the first Exposure Draft might mitigate the risk of such over-reliance.

3 The requirement by the first Exposure Draft in paragraph 9 of “Accepting the Engagement” may minimize the risk. This paragraph requires that “the professional accountant and the appointing party should agree on the objective of the reporting service engagement and the level of assurance to be provided as a result.”
\textit{Arguments for:}

(1) The current expectation gap existing in the audit environment may render having two levels of assurance inappropriate; and

(2) Introducing several levels of assurance reduces consistency and comparability and creates confusion and thus, may not serve the public’s best interests.

\textit{Arguments against:}

(1) This model seems to be inconsistent as it both proposes setting a high assurance level as a benchmark, and it also recommends varying assurance levels according to the individual requirements of different engagements; and

(2) It does not facilitate the meeting of individual users’ needs, which is the crux of assurance services.

\textbf{1.4 The Determination of Levels of Assurance: Interaction of Variables and Work Effort Views}

As stated earlier, with the publication of ISAE 100 a framework was provided for both high and moderate levels of assurance and specific guidance was provided for high level of assurance. Thus, with ISAE 100, the choice was made for a framework of two specified assurance levels. Given this choice, there is a need for specific guidance for moderate assurance engagements. However, currently there are at least two alternative models of which factors determine the level of assurance. These models are the interaction of variables view and the work effort view. The two views are described below on the basis of a report on the issues arising from exposure drafts of the ISAE that was attached to the final version of ISAE 100 when published by IAPC, and which is included at the end of Appendix 1 to this study.

\textbf{Interaction of Variables View}

The determination of the level of assurance that can be provided involves consideration of the inter-relationship between the following:

\begin{itemize}
\item \textit{Subject matter.} Some subject matter is inherently more capable of reliable measurement and support by relatively conclusive evidence.
\item \textit{Criteria.} While all criteria need to be suitable, depending on the nature of the subject matter, some criteria provide a means for more reliable measurement of the subject matter. A lower level of assurance will be provided when the criteria are qualitative rather than quantitative.
\item \textit{Process.} A major determinant of the level of assurance that can be provided is the nature, timing, and extent of the procedures adopted by the professional accountant to gather evidence on which to base the conclusion. The higher the level of assurance to be provided, the more comprehensive must be the procedures performed.
\item \textit{Quantity and Quality of Evidence.} The professional accountant will seek to obtain sufficient appropriate evidence as the basis for the provision of the level of assurance. In conjunction with the nature and form of the subject matter, criteria and procedures, the reliability of the evidence itself can impact the overall levels of assurance provided.
\end{itemize}

According to the interaction of variables view, the professional accountant uses professional judgment to determine the appropriate level of assurance taking into account the interrelationship of the four variables.
The Determination and Communication of Levels of Assurance Other than High

Work Effort View
The level of assurance provided by the professional accountant is determined, in the first instance, on the users’ needs (including cost considerations), and secondly, by the procedures performed to obtain sufficient appropriate evidence. The criteria and subject matter are viewed as prerequisites to the engagement. Both are considered when deciding whether or not the professional accountant is able to accept the engagement. Once the professional accountant determines that the criteria and subject matter support an assurance engagement, it is the work effort (the nature, timing and extent of the procedures performed) that determines the level of assurance. Consequently, if the professional accountant concludes that the professional accountant is unable to perform a high-level assurance engagement, the professional accountant would also be unable to perform a moderate-level assurance engagement.

1.5 Summary
This chapter has introduced the research questions of this project. All research questions relate to the determination and communication of assurance. The two main issues of the determination and communication of assurance arise from the initiatives of the IAPC related to assurance engagements. Regarding the communication issue, proposed reporting frameworks were discussed. The two main reporting frameworks concern a continuum of assurance and a specified level of assurance. Subsequently, with regard to the determination of assurance, the interaction of variables view and the work effort view were introduced.
CHAPTER 2: LITERATURE REVIEW

2.1 Objectives

The objective of this section of the study is to identify bodies of literature which provide us with insights in addressing the research questions stated in the first chapter. We therefore concentrate on the literature that directly informs these research questions. However, as many of the developments in the assurance services area have been quite recent, we find there has been relatively little empirical or theoretical research associated with the different assurance services, especially with regard to the ability to provide and communicate assurance at different levels. In addition to reviewing this emerging area of the literature, we therefore examine research predating the more recent developments in assurance services and the reporting thereon. This body of work includes studies investigating the factors impacting on audit quality (i.e., a high level of assurance), the messages associated with communications issued by assurance providers and the general field of communication theory. This literature, motivated from various theoretical perspectives, offers valuable insights into the determinants and communication of levels of assurance other than at a high level.

This literature review focuses on the auditing and assurance studies that are relevant to the two main issues related to various levels of assurance: the determination of assurance and the communication of assurance. Section 2.2.1 provides some background by discussing the academic literature on assurance services other than financial report audit and the research that has been conducted to date in this area. Section 2.2.2 reviews the professional accounting literature that has examined such services.

Section 2.3 reviews the small body of literature that has examined the factors determining levels of assurance. Being a recently identified research area, there has been relatively little empirical or theoretical research associated with assurance services and the ability to provide assurance at different levels. The literature on variations in the quality of audits is briefly examined here, as it provides insight into the factors identified by research as impacting the assurance associated within a single assurance product, namely a financial report audit.

Section 2.4 discusses communication theory. This theory has had a limited influence on audit and assurance research but is clearly relevant to the communication issue relating to different assurance levels. It provides a useful framework for interpreting the results of the empirical studies on the communication of levels of assurance, which are discussed in the subsequent section. In section 2.5, three sub-areas of research are presented. First, a review is undertaken of studies investigating whether users understand the distinction between audit and review. Second, the area of research concerned with the understanding of the messages conveyed in the communication of assurance providers are described. Third, studies on the interpretations given to key words and phrases are briefly reviewed.

Section 2.6 completes the chapter with a summary and conclusions.

2.2 Review of the Academic Auditing and Assurance Services Research

2.2.1 Review of Academic Studies on Assurance Services Other Than Financial Report Audits

The last decade has seen a rapid expansion in assurance services beyond the traditional financial statement audit. Initiatives such as the AICPA’s Special Committee on Assurance Services (SCAS), the Canadian

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1 A more detailed discussion of this is included in the following chapter on professional literature, in Section 3.4.
Institute of Chartered Accountants’ (CICA) Assurance Services Development Board (ASDB), and the Joint Assurance Services Task Force of the Australian profession have contributed to this growth in other assurance services. Given this broader range of services, covering different subject matters and different requirements by users, it is likely that the communication of assurance in some of these engagements will, by necessity, be at a level other than high (as is generally associated with an audit). Thus in this section the academic research examining these new forms of assurance services is reviewed in order to gain some insights into the determinants of the level of assurance that can be provided, as well as to examine any communication initiatives which are suggested.

To date, there appears to have been only four empirical papers in this area, and they relate to the products identified by the SCAS. Three studies were conducted using WebTrust as their setting (Houston and Taylor, 1999; Srivastava and Mock, 2000; Hunton, et al., 2000); while the fourth utilized the Performance Presentation Standards (PPS) developed by the Association for Investment Management and Research as its research context (Fargher and Gramling, 1996).

Fargher and Gramling (1996) conducted an experiment to examine firstly, whether users of voluntary information are influenced by attestation of the assertions contained in this information; and secondly, whether the type of assurance provided influences investment decisions of users of attested assertions. The evidence obtained suggested that attestations of voluntary assertions did not significantly affect users’ perceptions of information credibility nor their investment decisions. It was, however, found that when assertions were attested, users see Big Five audit firms as providing a higher level of quality than non-Big Five audit firms. Consistent with this result is the finding that performance results were considered to be more credible when they were attested by a Big Five firm than when they were attested by a non-Big Five firm. This study provides little additional insight into the reporting side as they do not attempt to explain why users perceive Big Five firms to be providing a higher level of quality than non-Big Five firms. That is, how do users of attested assertions differentiate between different levels of assurance?

Houston and Taylor (1999) examined consumer perceptions of WebTrust assurance services. They found that while WebTrust provided assurance of vendors’ business and security practices, it did not provide assurance directly on the areas sought by consumers, i.e., product and service quality. They thus concluded that WebTrust was not perceived to provide much value-added benefit for the consumer. This study is therefore more focused on determining how to make this service more relevant to its intended users, rather than examining the determinants of assurance.

Hunton, et al., (2000) assessed the impact of auditor-provided electronic commerce (EC) assurance on earnings forecasts and stock price estimates of professional analysts. On the basis of a survey of 37 analysts, they conclude that auditor-provided EC assurance has a positive impact on earnings forecasts and stock price estimates. Hence, this suggests financial analysts value EC assurance and that EC firms

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2 The AICPA adopts a somewhat broader definition of “assurance” than the IAPC, encompassing any independent professional services that improve the quality of information. In this respect, several other studies have examined “assurance services” (e.g., Fargher, et al., 1998). However, as these papers do not study assurance services as defined by the IAPC, they are not discussed any further.

3 “PPS are optional reporting rules for investment managers to use in reporting historical performance results. Pension fund sponsors place money with investment managers, who select securities and monitor investments on behalf of the pension fund sponsors. Fund sponsors select investment managers based, in part, on the investment managers’ asserted performance results.” This results in information asymmetry between investment managers and fund sponsors, with investment managers motivated to present results in the most favorable light. PPS was developed to mitigate this information asymmetry. However, adherence to PPS is voluntary, as is attestation of PPS compliance (Fargher and Gramling, 1996).

4 For convenience, throughout this report, the term Big Five audit firms refers to the large international audit firm networks. As a result of mergers, over time the number of these firms has reduced from eight to five. The current five large audit firms are Arthur Andersen, Deloitte & Touche, Ernst & Young, KPMG and PricewaterhouseCoopers.

5 Which equates to higher levels of assurance.
with certain high-risk profiles might enhance their financial viability in the capital market by voluntarily obtaining EC assurance.

Using WebTrust assurance as their setting, Srivastava and Mock (2000) “determine the types of evidential networks that professional accountants require in order to plan and provide assurance” and then, “develop a theoretic decision model for the problem of whether the auditor should take on the assurance service represented by the evidential network.” Their analyses suggest that different levels of assurance may be optimal for the three main categories of assertions (business practices, transaction integrity and information protection) considered in a WebTrust engagement. However, this study did not consider communication issues between users and assurance providers. That is, how can different levels of assurance be conveyed to users such that the possibility of miscommunication or of an expectations gap is minimized?

In short, the literature on new forms of assurance services is emerging concurrently with the development of these new types of engagements. Relatively little empirical academic research has been conducted in this field, with the studies examined providing little insight into the determinants of different assurance levels, or on how assurance levels other than high can be effectively communicated.

2.2.2 Review of Professional Studies on Assurance Services Other Than Financial Report Audits

The numerous professional publications in this area provide descriptive evidence of the variety of assurance services being offered in practice. The literature documents assurance being provided in areas as diverse as electronic commerce (Bennett and Sylph, 1998; Muysken, 1998; Pace, 1999), environmental reporting (Beets and Souther, 1999), strategic planning and risk management (English, 1999), information systems (Hughes, 1999), internal control (Grant, 1998) and eldercare (Wolosky, 1998). There are two academic studies related to this branch of the professional literature. See and Mock (1999) surveyed via in-depth interviews and questionnaires 21 experienced auditors from four Big 5 audit firms. Their study found that several “assurance-like” services were already being provided in Singapore, that many potential services identified by the AICPA were thought to be feasible in the Singapore market, but that a number of factors such as effect on perceived auditor independence and lack of expertise were thought to be important constraints to be considered. Dassen and Schelleman (2001), using a similar approach as See and Mock (1999), studied the market for assurance services in the Netherlands. In addition to 46 auditors, they also surveyed potential buyers of assurance services (i.e., 67 companies).

The focus of this body of work, however, is largely limited to justifying and outlining how practitioners should position themselves to take advantage of the vast revenue and growth opportunities that these services present (Elliott, 1996; Debreceny, et al., 1997; Choo, et al., 1998; Schmidt, 1998). The literature outlines that assurance can be provided at levels other than high. These studies highlight the existence of a broad range of assurance services, indicating there may be a demand for the provision of assurance at levels other than high. However, there is very little or no discussion in these publications as to the determinants of assurance or the form in which these assurance services can best be communicated.

2.3 Research on Factors Determining the Level of Assurance

As was found for the literature relating to the different assurance products, there has also been little empirical academic research examining the factors giving rise to different levels of assurance. This does not suggest that the area does not warrant research; rather, it reflects the emerging nature of this research field.
The only empirical paper that has attempted to study any combination of the determinants of assurance in a systematic way is Roebuck, et al. (2000). The study used a 2×2 between-subjects research design, with the subjects being members of the Australian Shareholders’ Association. They used alternative report formats to examine whether assurance report users differ in their identified level of assurance as a result of the description of the nature of the engagement (historical versus prospective) and the amount of work performed (higher versus lower level). General questions were asked about the reports, and it was found that shareholders desired such assurance reports, but many did not find the format suggested by the IAPC useful for their decision-making. With regard to the empirical analysis of the study, a higher level of assurance was found to be attached to historical compared with prospective reports, but no difference was found for reports attempting to communicate higher versus lower levels of assurance as a result of the description of work performed. These results suggest that the IAPC should consider the use of alternative wording in order to accurately communicate the level of work performed in assurance engagements. It however did show that users were discerning with respect to the subject matter of the reports.

The implications arising from this study have to be considered in their context. The respondents to the study were prospective users, and it finds, that on the basis of the proposed description of work effort by IAPC, prospective users do not perceive a different level of assurance. It does not mean that a different level of assurance was not intended by the report preparer, or that work effort was not a determinant of the intended (preparer) level of assurance. The major implication arising from the study is that the preparer is not effective in communicating the intended level of assurance when using the wording suggested by the IAPC. It shows that the report user did respond to the subject matter, and irrespective of the description of work effort, ascribe a higher level of assurance to the historically oriented subject matter.

The interaction of these two variables, work effort and subject matter, was also statistically examined in this study. It was found that there was no interaction between these two variables. Again, this result must be interpreted within the context of the study. This is on the intended message perceived by the prospective user, rather than the preparer, as well as the fact that it may indicate a failing of the description of the work effort.

**Literature investigating differences in audit quality**

There exists a vast literature on variation in the quality of audits. These distinctions in audit quality can be interpreted as variations in assurance. Although the audit is considered as a single level of quality product (high assurance), there is a large body of research, which shows that the perceived quality of audits does differ among various users. Perceived quality differences can occur if, for example, auditing standards outline a minimum quality or level of assurance for an audit, with some firms able to differentiate their service from that provided by others by providing a quality above this minimum. These studies demonstrate that there is a difference in perceived level of assurance by users, and also the actual level of assurance provided, even within the profession’s high quality product, the financial statement audit.

In examining the actual level of assurance provided, one of the major foci in the literature has been on whether the Big Five audit firms provide a higher quality audit than the non-top tier firms. The argument is that the top tier firms have more reputation capital at stake than the audit firms outside this tier, thus they will invest more in quality of labor, in decision support systems, and in better audit process and quality controls such as more tiers of review of working papers. The research supporting this notion includes evidence that the market is more likely to respond to surprise earnings announcements if the auditor is a Big Five firm (Teoh and Wong, 1993). Further, the Big Five auditors are less likely to be sued (Palmrose, 1986). Industry specialization studies (with industry specialists expected to be associated with

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6 Based upon those suggested at the time by the IAPC Exposure Draft “Reporting on the Credibility of Information.”
higher quality audits) have found that the specializations are concentrated in the Big 5 firms (for example, in Australia, Craswell and Taylor 1991). Audit fee studies have found that Big 5 auditors are paid approximately 30% more for their comparative audits than non-Big 5 audit firms, indicating that there are perceived differences in the quality (Craswell, et al., 1995). In examining the perceptions of quality, the major finding has been that the Big 5 are perceived to provide a higher level of quality than other assurance providers.

The extensive research on the factors impacting on audit quality has only been briefly reviewed in this section. These studies are of limited relevance to the question of level of assurance less than high as they focus on variances in quality of a single assurance product, ie., a financial statement audit. However, in so far as they identify the various elements that may influence the assurance (quality) associated with an engagement, they are useful in informing our knowledge of the determinants of moderate assurance engagements, especially given the limited research focusing specifically on this issue. They do show that other than guidance prepared by the IAPC, other factors influence the level of assurance contained in the report. The major ones are the use of a Big Five auditor, or the use of an industry specialist auditor. They suggest that even the level of assurance provided by audit is over a range, rather than by a point. Meeting the professional standards for auditing and not exceeding these will result in offering assurance at the minimum of this range of high assurance. Some firms will offer assurance above this minimum level outlined in the standards in order to differentiate their product. It is assumed by users that the Big Five do provide some level of audit assurance above the minimum ascribed by standards, and this is the reason for which they are able to derive the fee premium described earlier.

If there is a difference in the level of actual or perceived assurance through any of the factors, such as work effort or higher set criteria, this is not being communicated through the current reporting framework. The reports for the high assurance service use standard words to describe the level of work effort, the criteria under which the audit is prepared, and the conclusion of the assurance provider. This will explain perceived level of assurance differences, but not actual differences. For a particular assurance service such as audit, actual differences must be contained in audit firm policies regarding work effort and quality control, if the differences in actual quality are to be believed. For perceived differences in assurance level to result, these differences must be effectively communicated through the audit firm name, as there are usually no other differences in the reporting.

Having reviewed the research on the above-mentioned studies and issues, the interesting thing is that none of these findings can necessarily be carried over to the provision of assurance at levels other than high. All of the empirical and theoretical studies that have been undertaken to date have been on high levels of assurance. With the reporting of assurance at levels less than high being less well developed, it may be that firms will try to distinguish themselves by for example describing greater work effort, or using more suitable criteria, in their reports. It may also be that the providers of high quality audits will be assumed to also provide higher assurance for services other than audit, irrespective of the proposed reporting framework. However, if this is through means other than reputation, such as work effort, they may actually attempt to communicate this in their reports. It is hoped that such practices will be identified in our review of assurance services currently provided at other than at a high level by the professional assurance services firms. The results of the analysis of this survey are contained in Chapter 5 of this study.

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7 There are a number of definitions of industry specialist, and these are reviewed in Hogan and Jeter (1999).

8 This indicates that the reputation effect of the Big Five will carry over into assurance at levels other than high.
2.4 Communication Theory

Communication has been cited as one of the fundamental postulates of auditing (Schandl, 1978). It is central to the audit or assurance function. Assurance reporting is a communication process, with the medium of communication being the written text of the assurance report. The sender (assurance provider) initiates a message and encodes it, translating it into a signal, (the text). The message is then transmitted through a channel (the report) to a receiver (user) who decodes the message. These fundamental elements of communication underlie the reporting process.

It follows, therefore, that theories on communication, or the sharing of information, may provide useful insights as to how to construct reports on moderate assurance. Communication concepts from areas of study such as linguistics, information theory, psychology and sociology provide a source of methods and ideas on how to improve the communication associated with assurance reports. This is an extensive and diverse body of work and the discussion below is limited to the aspects of this literature that are considered most relevant to the issue of assurance communications.

Fiske (1990) describes the two dominant methods of analyzing the communication process: the process and semiotic schools of thought. Process analysis views communication as a one way linear phenomenon, while semiotic analysis characterizes communication as concerned with the production of meaning through sharing and exchange. Under this dichotomy, communication can be improved in two main ways:
(a) By determining methods of better transmitting the message (the process view); or
(b) By examining the context of the report and how it affects interpretation (the semiotic view).

(a) Process view — improving message transmission

The process school views communication as the transmission of messages. Perhaps the best known communication model in this field is the information theory of Shannon and Weaver (1949). They propose a linear model of communication, where information flows from a source, through a channel, to a receiver. This technical view sees communication as enhanced when the system carries the maximum amount of information. Information theorists focus on concepts such as “noise” (anything added to the information signal that is not intended by the source) and “redundancy” (the repetition of key ideas and the transmission of information that is predictable). Communication is viewed as the applied science of maintaining an optimal balance between predictability and uncertainty, to minimize “noise” and maximize the information transmitted. This is done by focusing on the “channel”: the means by which the information is communicated.

Linking these ideas to the issue of assurance reporting, Hronsky (1998) notes that the extant audit literature predominantly adopts the process perspective of communication. That is, communication problems are thought to arise from inadequate wording of the audit report (the “channel”), which does not convey the message intended by the auditor. This rationale seeks to improve the reporting process by improving the transmission of the message, and seeking a more effective wording.

An interesting consideration at this point is (physicist) Bridgman’s (1927) notion of operationalism in relation to the meaning of words and phrases: a statement can be said to have meaning only if it can be translated into operations to test it. The doctrine of operationalism has been applied in the social sciences, where notions are hard to quantify and research findings are often subject to dispute. The essence of this idea is that actions speak more clearly than words, and the only way to be sure of communicating an idea is by couching it in terms of a procedure that one can actually perform. For example, the operational definition of a cake is its recipe. From the standpoint of science and operationalism, it is pointless to speak of objective reality independent of the operations of the experimenter/originator of the message. Applied
to the phrase “moderate level of assurance” or “high level of assurance” (or indeed, any proposed wording for a moderate assurance report), the test lies in whether a set of concrete procedures exists which can be performed to arrive at the meaning suggested by the phrase.

The process school of communication theory, therefore, suggests that effective communication can be achieved by focusing on the channel of communication and improving its ability to transmit information. This approach overlooks the human factor in communication, which is addressed by the semiotic school.

(b) Semiotic view — understanding the context of communication

The linear depiction of communication favored by the “process” school of thought is complicated by adding a human element to the framework. The semiotic model of communication allows a more complex view of human communication, seeing it as the production and exchange of meaning. This literature examines how messages interact with people to affect the meaning perceived and is concerned with the relationships between source and receiver which determine this meaning. In this view of communication, the receiver of the message (e.g., reader of the assurance report) plays a more active role, bringing their attitudes and experiences to bear in creating the meaning of the text. Schandl (1978) explores this “psychology of information,” discussing the concepts of memory, meaning and clues.

Human memory is described as consisting of organized structures of information, or schemata: patterns or models in which the elements of our memory are organized. These systems of concepts, opinions and events are constructed from experience and learning, with data being evaluated and classified by the individual understanding them. How an individual interprets a particular message depends on the way their memory is conditioned, or “programmed.”

In terms of meaning, communication occurs through words: “signs and labels...[with] no objective identity” (Schandl, 1978). An individual’s capacity to understand and interpret the meanings of words and sentences has been labeled “semantic reaction”: the effective and psychological responses to words and other stimuli involving meanings (Korzybski, 1958). The semantic reactions of an individual depend on their previous experience, their knowledge of the terms used in the message, their emotional state and their relationship to the sender. Words and phrases evoke a certain state of understanding, determined by the individual experiences, memories and knowledge structures of individuals. In a similar vein, Richards (1936) argues that words are merely symbols interpreted in context; meanings don’t reside in words, they reside in people. Meaning is vital: semantic blindness (aphasia) makes communication impossible.

Another important element of human communication highlighted by Schandl (1978) is the existence of clues: elements which assist the receiver in the interpretation of the group of data received. Examples are their relationship with the sender, previous communications, circumstances surrounding the communication process, and the medium of communication. These guide the interpretation of the data and help the receiver to make inferences by indicating the appropriate schemata in their memory.

The concepts of memory, meaning and clues can be applied to the assurance reporting domain. The report is composed of symbolic signs (words) referring to the attributes of the subject matter, work effort, criteria, qualifications, etc. Meaning is generated through an interaction between the report user and clues available. Users are conditioned by their memory/schemata: their understanding of how and in what context these signs (words and phrases in the assurance report) are combined to form specified meanings (codes) as well as governing conventions (Hronsksy, 1998), such as general assurance standards. Clues available to assist interpretation include prior relationships with the assurance provider, and the structure and form of the report itself. “Aberrant decoding” (Eco, 1965) may occur where the user produces a meaning different to the one intended, i.e., an expectations gap arises.
Schandl (1978) highlights that the major problem associated with human communication is predicting the effect of the data on the receiver: their interpretation, and the inferences drawn. Interpretation involves clarifying the meaning of a message, or elucidating its significance. It is an enrichment of the data by fitting it into different schemata. Inference goes one step further, and is a conclusion that is arrived at by reasoning or implications. In terms of communication, each message evokes a whole array of information, and each piece of information may evoke an array of possible inferences. In short: memory, meaning and clues interact. Data are interpreted by individuals, who will actively look into surrounding circumstances to aid in this process. The human mind interprets the data according to certain clues and prevailing schemata (which vary between individuals).

Hronsky (1998) analyses the audit report using a similar perspective, adopting a more complex view of the communication process than the process model. She proposes that meaning is not absolute, or intrinsic in the wording, but produced by an interaction of the user, the text (audit report) and the referent (the subject of the audit report, in that case, the validity of the financial statements). Hronsky concludes that the meaning of audit reports will always be subject to variation as they are contextually bound; thus communication gaps will always be present in the reporting process. An interesting implication arising from this conclusion is that the expectations gap can never be entirely eliminated, no matter what actions are taken to address it. Thus, the profession should consider whether “the gap” is a factor that should be used as justification to proscribe action with respect to issuing a moderate assurance standard.

**Overcoming obstacles to communication**

While Hronsky (1998) argues that communication gaps in audit reporting are inevitable, efforts can still be made to minimize the obstacles to communication. Instances where the communication process does not operate properly include where the:

- Data is not perceived;
- Data is perceived incorrectly. For example, the schemata evoked by previous data or expectations distort the reception of the message;
- Data is incorrectly interpreted; and
- Correctly interpreted data still results in an incorrect inference (Schandl, 1978).

Schandl (1978) goes on to elaborate ways in which message preparers can retain “control of the information process” and ascertain that data are correctly interpreted, with proper inferences being made.

1. The receiver should be in the mental and physiological situation where he is capable of perceiving the data.
2. The message should be in symbols or signs that are understandable by the receiver. Symbols and words will be interpreted by the receiver. If they have to cope with the uncertainty or ignorance of the meaning, they may misinterpret the data. Further, certain signs or symbols may have connotations. They may evoke certain clues in the mind of the receiver that may favor or hinder the desired interpretation and create competing inferences by them. This stage of the communication process is

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9 This is consistent with post-structuralist theories of communication, which view meaning as a dynamic force, unfolding through the whole of a discourse, and liable to change depending on the identity of the user (Benveniste, 1971). In relation to communication through written text (as in assurance reports), there is an extensive literature on the role of the reader in communications. Reader-response theory is concerned with the question of whether meaning resides in the text or the individual use of the text. The works of Eco (1979) and Tompkins (1980) are examples of this line of thought but, as they are ancillary to the concerns of this study, are not investigated further.
important as a delay in interpretation may result in a total failure of communication: it may turn off the receiver’s attention and prevent the reception of the rest of the data.

(3) An adequate quantity of data should be supplied. Furnishing more details, explanations, and instructions as clues for the receiver aids in their understanding. This must be weighed against the fact that the ability of a human being to concentrate on data is not unlimited. If the quantity of data and details exceeds a certain limit, the capacity of the receiver to draw the proper inference and to understand the data decreases.

(4) Data should be organized in appropriate groups. This categorization should be conducive to proper interpretation and inferences. “If you want to say something new, you should start with something the [receiver] already knows.” Grouping data in this manner (associating new concepts with related familiar concepts) enhances the receiver’s understanding of an unfamiliar concept.

(5) Misinterpretation of data and wrong inferences should be discovered early. For example, through the use of feedback.

An addition to this list is the notion of Schramm (1954) that if assurance report messages are to be understood by users, assurance providers must orient their communications to the lowest common denominator among the report’s heterogeneous readership.

The above elements can be used to inform the process of developing an effective reporting model for a moderate assurance level. Schandl’s (1978) second point suggests that proposed reporting forms should not stray too far away from current models. The third and fourth points reflect a need for adequate descriptions of work performed, the scope of the engagement and its limitations, presented in a well-considered structure. The first and fifth points highlight the importance of processes such as education of the public on assurance issues, and user-testing of any reporting model developed.

In sum, concepts from the domain of communication theory provide a framework within which to understand the communication associated with assurance reports, and a foundation from which to prescribe effective approaches to the design of reports of moderate level of assurance. With this background, the following section considers the empirical studies that have examined the communication issue in relation to assurance reports.

2.5 Research on the Communication of Levels of Assurance

The literature informing this issue has been classified into three sections. Firstly, studies that have examined the effectiveness of communication associated with reports issued in limited assurance engagements are discussed. Second, the literature relating to audit/assurance reports in general is examined to identify important communication issues that arise in this context. The third section examines the specific issue of words and phrases, and how varying interpretations of these may have implications for the communication of different levels of assurance.

Studies of Reports of Limited Assurance Engagements

A stream of research has examined the reporting of lower levels of assurance, and their effective communication. These studies were predominantly undertaken in the early 1980s when the United States introduced the concept of review, and are primarily concerned with whether alternative reporting formats were understandable to, and correctly interpreted by, users. This group of studies addresses issues of

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10 These are generally associated with a moderate (as opposed to high) level of assurance.
understandability of the levels of assurance that are communicated by audit and review and provide empirical evidence directly relevant to the issue of the effectiveness of current forms of reporting moderate assurance. This is in accordance with Schandl’s (1978) principle discussed in section 2.4, which suggests that user feedback should be used to ascertain that the message conveyed is being interpreted correctly. The studies are summarized in Table 2.1:

<table>
<thead>
<tr>
<th>Study</th>
<th>Assurance Report Examined</th>
<th>Subjects</th>
<th>Key Findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pany and Smith, 1982</td>
<td>Audit, limited review (yearly and quarterly), no involvement</td>
<td>Financial analysts</td>
<td>No significant differences found between audit and the two forms of review – suggests these users cannot distinguish between these engagements.</td>
</tr>
<tr>
<td>Johnson, et al., 1983</td>
<td>Audit, review, compilation, no involvement</td>
<td>Lenders</td>
<td>Level of assurance did not affect lending decisions. Lack of significant differences between limited assurance engagements.</td>
</tr>
<tr>
<td>Johnson and Pany, 1984</td>
<td>Review engagement and no involvement (financial forecasts)</td>
<td>Bank lenders</td>
<td>Lenders perceived increased financial statement reliability when these were reviewed by an accountant. No significant difference in loan decision.</td>
</tr>
<tr>
<td>Pillsbury, 1985</td>
<td>Eight reports, including the review of interim financial statements</td>
<td>Auditors, bankers</td>
<td>Bankers perceived a higher level of assurance than did auditors.</td>
</tr>
<tr>
<td>Nair and Rittenberg, 1987</td>
<td>Nine report types, including unqualified audit, unqualified review and qualified review</td>
<td>Auditors, bankers</td>
<td>Disagreement between the groups as to message contained in the review report.</td>
</tr>
<tr>
<td>Yardley, 1989</td>
<td>Negative assurance arising from the performance of mandated procedures</td>
<td>Auditors, bankers</td>
<td>Audit perceived to provide more assurance than review, but more so for auditors.</td>
</tr>
<tr>
<td>Bartlett, 1991</td>
<td>10 different reports, including audit and review.</td>
<td>Auditors, bankers</td>
<td>Audit perceived to provide more assurance than review, but more so for auditors.</td>
</tr>
<tr>
<td>Brown, et al., 1993</td>
<td>Short form audit report, expanded audit report, review</td>
<td>Shareholders (MBA students)</td>
<td>Users perceive differences, but not the differences expressed by the auditing guidelines.</td>
</tr>
<tr>
<td>Gay, et al., 1998</td>
<td>Audit versus review</td>
<td>Auditors, preparers, and users</td>
<td>Users and preparers perceive lower level of assurance compared with auditors. Concerns about levels of assurance provided.</td>
</tr>
</tbody>
</table>

Two main implications can be drawn from this research. First, the evidence suggests that users may have difficulties distinguishing between audit engagements and more limited engagements, based on current methods of reporting. Second, there is support for the fact that an expectations gap exists, in so far as there is a difference between the intended level of assurance provided by the preparer (auditor) and the identified user group.

In relation to the first point, Johnson and Pany (1984) document that users do infer a level of assurance from review reports. However, they may infer too high an assurance, as found by Pany and Smith (1982), Johnson, et al (1983) and Nair and Rittenberg (1987). These studies report that user perceptions and actions in response to review reports do not differ significantly from those in the case of audit reports.
This suggests that limited assurance reporting, in the forms investigated in these studies, was not effective in communicating a lower level of assurance. Findings of later studies (for example, Brown, et al., 1993; Gay, et al., 1998) however, do indicate different perceived levels of assurance arising from review reports. This suggests that as these reports become more common, users obtain a better understanding of the nature and level of assurance intended.

The most recent study in this area of literature (Gay, et al., 1998) is a very comprehensive study and is discussed in more detail. Using subjects from three different backgrounds, Gay, et al. (1998) attempted to examine the levels of assurance that preparers and users of audit and review reports attach to the messages that these reports convey.

This was achieved by measuring the meaning of review and audit report messages through focusing on limited assurance review engagement reports and general purpose financial statement audit reports. Gay, et al., (1998) provided some insight into whether users of review and audit reports understand the messages conveyed, and whether they are able to distinguish between the two levels of assurance. They found that subjects had different perceptions of the degree of reliability of financial information and the levels of assurance provided by review and audit reports. Results indicated that relative to auditors, other subjects found financial information to be less reliable, they attach a lower level of assurance to review and audit reports, and they assess a lower level of truth and fairness for financial statements. An important finding is that all groups, including auditors, “were skeptical about the clarity with which assurance levels and the extent of work performed were communicated.”

In summary, this section of the literature provides evidence on the effectiveness of current methods of reporting, and their usefulness as communication devices. It highlights the issues relevant in communicating levels of assurance other than high. However, certain limitations of this body of research must be noted. Its primary shortcoming in the context of the present study is that its examination of moderate assurance engagements is limited to financial statement reviews. Further, these studies are useful in identifying issues, but provide little in the way of effective solutions to the communication problem.

### Understanding the Messages Conveyed in the Communication of Assurance Providers

As well as the literature specifically examining the communication associated with limited assurance reports to date, research on assurance communications generally may indicate issues that are informative in the development of thought on how best to communicate moderate assurance.

The dominant form of assurance communication that has been investigated has been the audit report, and numerous studies have focused on the understandability of this communication device. One particularly relevant issue examined in the research is whether the messages conveyed in qualified reports are effectively communicated. These studies look at whether different messages of reliance (qualifications) are adequately perceived by users. A number of these studies were contained in the review by Strawser (1991). It is essential to understand this aspect if we are to move forward and develop services that

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11. These being preparers of financial information, assurance service providers and users of financial information.

12. Due to the different amount and nature of work involved in an audit and a review, professional standards often imply that a high level of assurance is attached to an audit while a moderate level is associated with a review.

13. It is interesting to note that one of the responses contained in Chapter 4 refers to the work of Strawser in suggesting that communication issues are not that serious.
The Determination and Communication of Levels of Assurance Other than High

attempt to effectively communicate different levels of assurance, and any reservations. The relevant studies are summarized in Table 2.2.
These studies are relevant to this study in that they demonstrate that effective reporting is not only being able to communicate the message (e.g., qualification) intended. If there are any reservations, this has the potential to add an additional level of complexity to the reporting. Thus the ability to communicate reservations under any level of assurance needs to be carefully considered in any proposal considering effective communication with review reports.

In addition to the above research that has examined users’ understanding of assurance report qualifications, several studies have investigated the changes in user perceptions arising from alternatively worded reports. These have explored issues such as the effect of introducing the current (expanded) suggested form reports (Gay and Schelluch, 1993; Innes, et al. 1997) or the impact of changes in wording (Bailey, et al. 1983; Kelly and Mohrweis, 1989). This research implicitly adopts the process view of communication, aiming to enhance communication by modifying the “channel” of the message — the assurance report. These studies show that revisions in wording have the potential to significantly improve communication: for example, Kelly and Mohrweis (1989) found that users’ understanding of the purposes of the audit and the responsibilities assumed by management were significantly improved by wording changes. Therefore, the issue of specific wording utilized is one that warrants careful consideration in the development of new reports relating to engagements resulting in a moderate level of assurance. Research examining this issue is examined in more detail in the following section.

**Interpretations of key words and phrases**

A pertinent issue when considering the communication of moderate levels of assurance is the meaning associated with common phrases in the assurance domain. The word “moderate” in this context implies a
lower level of assurance (and correspondingly a higher risk of relying on the associated services and report) than the use of the term “high.” A significant concern that arises is the precision with which assurance providers will want to communicate the level of assurance provided. Because “moderate” is used in everyday language, there is the risk that different groups will ascribe different meanings to it: users of assurance services may interpret the word differently to the assurance provider. Research on the precision with which risk and uncertainty is communicated may be instructive. Such studies have examined concepts such as “reasonably possible,” “probable,” “moderate” and “high” with a view to determining whether they are associated with certain levels of confidence or assurance.

A study by Amer, et al., (1994) provides evidence on how auditors interpret the terms “moderate” and “high.” They conduct an experiment in which audit managers interpret 23 probability phrases used by an audit senior in estimating the collectibility of a client’s accounts receivable. Results showed high variance in auditors’ interpretation of these phrases, and relatively low awareness of the variability with which these phrases are interpreted by other auditors. Of interest is the result demonstrating that the terms “moderate” and “high” were assigned mean probabilities of 0.50 and 0.85, respectively. In particular, the data (although not directly related to the level of assurance provided) suggests that the term “moderate” implies a likelihood no better than chance.14

A relatively large body of literature in accounting has examined the use and interpretation of verbal expressions of contingent loss likelihood (e.g., “reasonably possible,” “probable,” “remote,”), as used in SFAS No. 5 (Schultz and Reckers, 1981; Jiambalvo and Witner, 1985; Harrison and Tomassini, 1989; Raghunandan, et al., 1991; Reimers, 1992). These studies generally show a low correspondence between auditors’ interpretation of verbal probability terms and the associated numerical probabilities. For example, auditors do not seem to interpret the verbal expressions of probabilities to cover the intended range of probabilities (Reimers, 1992).

There is generally poor consensus across auditors and users in terms of the interpretations assigned to a verbal expression. Harrison and Pearson (1989) found that the members of the American Bar Association interpret the terms “remote” and “probable” differently from auditors. Research in psychology also demonstrates that there is generally high variance across individuals in the interpretation of verbal probabilities (Budescu and Wallsten, 1985; Wallsten, et al. 1986).

Other studies in psychology suggest that compared to verbally expressed probabilities, numerically expressed probabilities are superior in that these are applied more consistently and with smaller within- and between- user variability (e.g., Budescu, et al., 1988). Judgments using verbal expressions are also more variable and less accurate than those using numerical probabilities (Rapoport, et al. 1990). The difficulty in applying these findings to assurance services lies in the determination of the appropriate numerical probability to assign to certain concepts, such as “moderate assurance.”

Overall, these studies suggest that care must be used when describing or trying to quantify a level of assurance with such phrases. The findings reflect the semiotic view of communication, that words and phrases interact with people to affect the meaning perceived. The empirical research shows that there are costs and benefits associated with using numerical versus verbal probabilities, with relatively strong evidence that decision quality (in terms of accuracy, consistency, reduced variability) is improved using numerical probabilities. One implication, subject to empirical verification, is that expressions of levels of assurance in the form of numerical probabilities may lead to reduced interpretation ambiguity and improved decision quality, from the users perspective. However, expressions in numerical form may

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14 Statement of Financial Accounting Standards No. 5 “Accounting for Contingencies,” is the authoritative pronouncement in the U.S. on disclosure of uncertain events.
suggest a precision that assurance providers may be unable (due to cognitive reasons) and/or unwilling (due to litigation concerns) to express. These should be considered in any deliberation on the communication of varying levels of assurance.

Standard setters should also be concerned with how auditors have been found to interpret the meaning of the word “moderate.” There is also the issue of the level of assurance that users attach to this qualitative expression. To what extent do auditors consistently interpret the term “moderate level of assurance”? The answer to this question has implications on the type of services offered by auditors that have “moderate” levels of assurance, and to their interpretation and application of related assurance guidelines. Again this is an issue that will be explored in the review of the current audit firm practices, contained in Chapter 5 of this study. However, it must be remembered that the lack of consensus by auditors in interpreting the intended level of assurance can lead to inconsistent application of applicable standards.

A related issue, therefore, concerns the consistency with which users attach meaning to the phrase “moderate level of assurance.” There has been little research on this issue to date.15 This issue has implications on the demand that users have for these services (with moderate levels of assurance), and to their relative reliance on such services. Mismatches between auditors’ and users’ interpretations can adversely affect the demand for such services, and lead to user dissatisfaction, potential litigation, as well as reputation losses among accounting firms, even if appropriate assurance standards have been followed.

To summarize, the extant literature provides empirical evidence on various issues pertinent to the communication of moderate assurance. The effectiveness of current forms of reporting on limited assurance engagements has been investigated, although these relate exclusively to assurance provided on financial statements. Research has also examined the implications of alternative types of assurance reports (e.g., qualified versus unqualified) and variations in report wording on user perceptions. This body of literature flags significant issues to consider in the development of effective communication vehicles for new types of assurance engagements.

2.6 Summary and Conclusions

In this chapter we have reviewed the academic and professional literature that has examined factors that determine the levels of assurance on engagements. There is relatively little literature in this area. We do see that potential users respond to differences in subject matter, and do not respond to the IAPC’s proposed approach to describe work effort. There is some evidence to support the view that there are distinguishing factors beyond work effort in determining the level of assurance. The only factor that has been empirically examined and identified thus far is subject matter, and this has been on the basis of historical versus prospective information. No factors other than subject matter and work effort have to date been empirically tested.

There is support for the view that in communicating various levels of assurance, the intended user may use factors other than those contained in any of the proposed frameworks. The user uses referents for quality, such as Big Five or assurance providers known as specialists in the industry, to assume a level of assurance. While the research to date has been on high assurance engagements, there is no reason to presume that it will be different for assurance engagements at levels less than high. It may be however, with the reporting process much less developed for such assurance engagements, that an assurance provider can communicate various levels of assurance within an acceptable range, through the description of the determinants such as work effort or criteria, or the form of the opinion.

15 There is a study currently being undertaken by Hasan, Roebuck and Simnett, which has the potential to address this question.
Communication theory, a body of literature generally distinct from the audit and assurance services research, describes and renders more comprehensible the process of communication underlying assurance reporting. It indicates that communication can be improved by addressing the nature of the assurance report itself — the channel through which the information is provided — (according to the process school of thought) as well as by considering the role of the reader in the process (according to the semiotic school). Empirical studies that have been undertaken to date explore various issues relating to communication, including the impact of qualifications and alternative phrasing on user perceptions. The insights provided by communication theory allow a systematic and informed approach to addressing these issues, enabling the design of reports, which effectively communicate different levels of assurance.
CHAPTER 3: REVIEW OF INITIATIVES UNDERTAKEN BY PROFESSIONAL ASSOCIATIONS

3.1 Objectives of Reviewing the Initiatives Undertaken by Professional Associations

The objective of this aspect of the literature review is to identify, understand and to learn from the initiatives undertaken by professional associations with regards the determinants of reporting on assurance services at a level other than high, and how best to communicate such levels of assurance (see question 6 in chapter 1). In section 3.2 we examine what can be learned from current auditing theory with regards the determinants of assurance at levels other than high, and methods of communicating such assurance. In section 3.3 we review the activities and initiatives undertaken by the International Auditing Practices Committee (IAPC). We also review the findings of the AICPA Special Committee on assurance services (SCAS) (section 3.4). We then review specific assurance services which are reasonably well-established (section 3.5), as well as other literature produced by the professional accounting associations that cover assurance services at other than a high level (section 3.6). Finally, we review the approaches of other providers of assurance services, and certification bodies and standards setters (section 3.7) and consider the implications for this study in section 3.8.

3.2 The Determinants of Assurance: Implications Arising from a Review of the Risk-based Audit Approach

This section will discuss the risk-based approach to auditing financial statements. Under this approach, auditors assess risk and concentrate their audit attention in areas of higher risk, whether this risk be defined as strategic business risk (as evaluated under new audit methodologies), or financial risk (as encapsulated in the current international auditing standards). The international auditing standards are currently being reviewed by the IAPC. It does not matter under which risk paradigm this review is undertaken, as the major concern is on the factors influencing the level of assurance (the inverse of risk) that is sought.

First, how audit assurance is obtained under risk-based auditing approaches will be discussed. Subsequently, the implications of the risk-based audit approach for the two views of moderate assurance, i.e. the interaction of variables view and the work effort view, will be presented. This review will first be undertaken for engagements covering financial statement audits, currently the assurance services profession’s best-developed product. Although this is a particular subject matter with well-defined criteria, it will still be useful to examine determinants of financial statement assurance. Under the work effort view, the work of the auditor is argued to be the only criterion. Under the interaction of variables approach, it should be remembered that we are holding subject matter and criteria constant for financial statement assurance engagements. Under each approach it will be of interest to see whether there are any other factors that influence the level of assurance.

Auditors, in providing a high level of assurance, adopt a risk analysis approach to determining what is sufficient appropriate audit evidence. Consequently, for financial statement audits, risk is managed and reduced to an “acceptable” level, and risk represents the inverse to assurance.

The auditing standards define audit risk at the financial report level as “the risk that the auditor will give an inappropriate audit opinion when the financial report is materially misstated.” It is commonly argued that audit risk can be controlled by the nature and scope of the auditor’s procedures. The auditor reduces audit risk by performing audit procedures until there is sufficient appropriate evidence for each significant
audit objective to provide reasonable assurance that the financial reports are not materially misstated. It can be argued that the entire audit process is related to evidence collection and at all stages of the audit the auditor is undertaking work effort.¹

Under the current approach contained in the auditing standards for financial statement audits,² audit risk is a function of inherent risk, control risk and detection risk. The auditor determines the level of inherent risk by obtaining knowledge of the client and the environment in which the client operates. While the auditor cannot change inherent risk or control risk in the short run, the auditor can obtain evidence of a reduced assessed level of control risk by examining the control environment and the control procedures, and then testing their effectiveness. Detection risk is thus inversely related to the effectiveness of auditing procedures. The auditor assesses inherent risk and control risk separately or in combination, and together with the results of analytical procedures, makes a judgment about the likelihood of material misstatement in the account balance or class of transactions affected. The auditor alters the detection risk, by determining the nature, timing and extent of audit procedures, to achieve the desired level of audit risk.

**Nature of risk factors**
Recognition of risk factors should affect auditors’ assessment of inherent risk. Using questionnaire surveys listing a range of risk factors, prior studies have examined auditors’ perceptions on the relevance and importance of risk factors to their risk assessment (Monroe, et al., 1993; Haskins and Dirsmith, 1993; Hermanson, 1993). Wright and Bedard (2000) concluded that prior research has found strong support on the linkage between risk factors and risk assessments.

**The relationship of risk assessment with determinants of assurance**
A review of the empirical studies was undertaken to identify the factors that risk assessment had impacted on in determining the level of assurance. All studies identified with risk assessment as their focus had been undertaken in a financial statement audit, thus subject matter had not been considered. In fact, the only determinant that has been systematically examined is evidence collection (work effort). It is clearly documented that auditors respond to changes in control risk in the expected way — higher control risk, less or nil tests of controls and more extensive substantive testing (e.g., Basu and Wright, 1997; Brown and Solomon, 1990; Daniel, 1988; Waller, 1993). However, the expected impact of inherent risk assessment on the extent, timing or nature of the audit procedures, as required by the professional pronouncements, is less clear. The results to date have not identified a strong association between audit procedures and the level of risk. Using archival data taken from actual audits, Mock and Wright (1993, 1999) found very little association between the level of (and changes in) risks and the nature or extent of audit tests.³ This implies that the theoretically constructed audit risk models may not be descriptive of audit practice. In Wright and Bedard (2000), risk factors were generally not associated with differences in extent of testing. This later study includes a broader set of risks such as liquidity and profitability in which an association was found for those limited factors on the nature of tests. Risks related to liquidity and profitability are now generally considered as part of business risks, and auditors limited but greater responsiveness of evidential plans to such risks might be reflected in the auditors’ actual perception in

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¹ This is a much broader view than a commonly held view that work effort relates to evidence collection, and that there is a distinction between the planning stage and the evidence collection stage. This narrower view sees the evidence collection stage as the substantive stage of the financial report audit process. If you accept this narrower view that there is a distinction between the planning phase and the evidence collection phase of the audit process, then there would be many determinants of assurance other than the amount of evidence collected.

² Commonly referred to as a financial risk approach.

³ A potential limitation is that perhaps the accounts examined (such as the accounts receivable) are subject to standardized programs that are not as subject to adjustments for risk.
formulating audit strategy. Houston (1999), in an experiment, found evidence that client risk factors affect the nature of audit testing decisions.

O’Keefe, et al., (1994) investigated the relationship between labor inputs (quantity and mix) and client characteristics on a cross-sectional sample of engagements conducted by a major auditing firm. They found that both the level of hours and mix (e.g., staff, senior) employed were significantly associated with client size, complexity, leverage and inherent risk, but not with control reliance. Some of these measures (e.g., leverage) capture the client’s business risk, which suggested the existence of a relationship between client’s business risk and audit risk.

**Summary of implications for this study**

The implications for this study arising from a review of the audit risk model are hard to draw out. If work effort is associated with a narrow view of audit evidence sometimes contained in the auditing literature, then there are numerous factors, which impact the level of assurance. However, if work effort covers all stages of the audit process, including the planning, evidence gathering and conclusions and reporting stages, then the number of factors is significantly reduced.

The auditing standards discuss relevance and reliability of audit evidence, and provide some guidance as to what determines the reliability of audit evidence. It is claimed that the reliability of audit evidence is influenced by its source and nature. Although reliability depends on individual circumstances, the following generalizations adapted from the auditing standards are useful:

- Evidence from sources outside an entity is more reliable than evidence obtained solely from within an entity;
- Evidence generated internally is more reliable when the internal control structure is effective than when the internal control structure is ineffective;
- Evidence obtained directly by the auditor is more reliable than evidence obtained from the client; and
- Evidence in the form of documents or written representations is more reliable than oral representations.

However, even given these factors, there is nothing to suggest that an appropriate level of assurance cannot be reached by exerting a greater amount of work effort.

Is there evidence that factors other than work effort are not important? As stated earlier, the financial statement audit risk model is applied to a particular subject matter and well-specified criteria. It has been argued earlier that subject matter may be important along the lines of historical versus future oriented engagements. We do see that the financial statement audit has a combination of historical and future-oriented objectives. However, the predominant amount of audit effort is aimed at historical objectives. The major future-oriented objective is assessment of the going concern assumption. It may be that for financial statement audits the profession is comfortable in providing a high level of assurance because the engagement is dominated by historical objectives. If the assurance provider had to provide assurance only on the going concern objective, then they may be reluctant to provide a level of assurance at the high level.

Work effort is a major defining characteristic for financial statement audits or reviews. The criteria for financial statement audits are well accepted. More specifically, the auditor is assessing whether financial statements are properly prepared using the identified financial reporting framework, while undertaking the audit in accordance with appropriate auditing standards. Thus this evaluation of the audit risk model
provides little guidance on the issue of whether availability of suitable criteria is an important element in the assurance services framework.

In short, current auditing theory suggests that work effort is the primary determinant of assurance, as a higher work effort reduces risk, which is the inverse of assurance. However, this theory stems from assurance relating almost exclusively to financial statements, where the subject matter and criteria are relatively well defined. Thus caution is needed in trying to extend these findings to a support of the work-effort model in areas of assurance where the subject matter and criteria are not so well defined.

3.3 IAPC

The evolution of the IAPC assurance framework was briefly outlined in Chapter 1. A key feature of the second exposure process was the change from the concept of a continuum of assurance to an approach suggesting two levels, high and moderate. In this section, a more detailed analysis is presented of the arguments underlying this change. A review was undertaken of the response letters to the second Exposure Draft entitled Assurance Engagements (the exposure draft in which this change in reporting approach was proposed). In total, 25 responses were received by the IAPC. The following quotes summarize some of the comments and concerns relating to the determinants of a moderate level of assurance (work effort view and an interaction of variables approach), and the ability to effectively communicate a moderate level of assurance. These quotations should help the reader appreciate the logic of different views to gain a better understanding of the factors determining and affecting the communication of various levels of assurance.

Determinants of levels of assurance other than high

Recall that for this version of the ED a decision had been made to limit the levels of assurance to two: moderate and high. However, the process contained in the ED by which these two levels could be reported was in effect an interaction of variables approach. Thus associations opposed to this approach would be more likely to state their opposition. Below are a few of the arguments, which were forwarded.

Whilst the level of assurance represented by ‘high’ is intuitively obvious, ‘moderate’ is not so readily comprehended: it might, for example, represent anything from ‘just below high’ to ‘just above low’. The work effort required could vary considerably, depending on the degree of moderate assurance the professional accountant intends to provide. .... users are entitled to expect a reasonably consistent approach in broadly similar circumstances.

Also, if ‘moderate’ may include any degree of assurance up to ‘just less than high’, a particular problem may arise (especially at the upper end of the range): in the absence of procedural guidance specific to that type of engagement, it may be difficult for professional accountants to decide whether the engagement was a review or an audit.

... therefore recommends the IAPC to clarify whether it intends moderate assurance to represent this wide range and, if it does, to provide guidance on how the professional accountant is to: (a) determine the appropriate degree of moderate assurance, and (b) differentiate a review from an audit.

The views on the move from a continuum to two levels of assurance only was strongly supported in the following response:

[W]e strongly support the decision to limit the framework to two levels of assurance – an audit engagement, designed to convey a high level of assurance, and a review engagement, designed to convey a moderate level of assurance. While, in theory, there is a spectrum of levels of assurance, we believe that a common understanding by both practitioners and users of the “products” delivered is important to the viability of these evolving services. Both audit and review engagements are reasonably well understood in the marketplace. For that reason, we support building the framework, at least for now, on those two products. However, we continue to have fundamental concern regarding how the concept of levels of assurance is dealt with in the ED.
This view of the audit and review is consistent with the semiotic view of communication, where symbols of different levels of assurance are created. The comments also state that both the audit and review products are readily understood. Our literature review suggests that while this may be true of audit, there is still some confusion about the level of assurance conveyed by a review report.

With regards the interaction of variables framework, the following response stated that:

*The framework proposes that, in addition to the criteria, the subject matter, process and the quantity and quality of evidence all influence the level of assurance provided. We do not believe that the framework provides sufficient guidance on the inter-relationship among these factors to allow practitioners to reach a consistent conclusion, given the same set of circumstances, as to what level of assurance can be provided... For an assurance engagement to be effective, the practitioner must clearly define the subject matter and determine the level of assurance that the user needs when accepting the engagement, ensure that there are suitable criteria against which the subject matter can be assessed, and design the work effort to be able to provide that required level of assurance.*

The interaction of suitability of criteria with other determinants of assurance was one of the major issues creating concern with this ED. Some of the quotes include:

*...disagrees with the concept that criteria should be used as a determinant of the level of assurance. Rather suitable criteria should be a prerequisite to performing an assurance engagement. Criteria are such a critical element of an assurance engagement that they must conclusively meet all of the characteristics of paragraph 52 [of the ED] to support providing any level of assurance.*

*...We reject the concept ...that criteria may exist which, while unsuitable for audit, would be suitable for a review. Either the criteria have the characteristics of suitable criteria or they do not. There is no sound basis for the position that the characteristics of suitable criteria can be somewhat relevant and reliable (and, therefore, somewhat irrelevant and unreliable) and so, while not suitable for audit would still be considered adequate for a review engagement....*

The position of suitable or reasonable criteria being a binary choice (suitable or not suitable) has become entrenched in some countries, and is built into their regulations. One of the comments responded that suitability equates to quantifiability (at least with regards the reliability of evidence aspect). For example, in the US Attestation Standards, the practitioner shall perform an engagement only if he or she has reason to believe that the following two conditions exist:

*• The assertion is capable of evaluation against reasonable criteria that either have been established by a recognized body or are stated in the presentation of the assertion in a sufficiently clear and comprehensive manner for a knowledgeable reader to be able to understand them.*

*• The assertion is capable of reasonably consistent estimation or measurement using such criteria.*

In other countries we see approaches more consistent with an acceptance that criteria are evolving and that it is possible to provide a level of assurance against current best practice, even though it may not meet a threshold of suitable criteria. For example, the Report from the Verifiers in the Shell Report 2000 states that “there are no generally accepted international environmental or social reporting guidelines or social reporting and verification standards. We based our approach on emerging best practice and principles within international standards for assurance engagements...”

There is no doubt that for evolving assurance services there will also be evolving reasonable or suitable criteria. Thus conceptually it is possible to view the concept of reasonableness or suitable criteria as a continuum. This line of reasoning differs from the argument that criteria may be “somewhat irrelevant and

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unreliable” to one which suggests that for a particular user group there is always going to be a “most relevant and reliable” set of criteria, perhaps evolving against best practice. An example of this is the criteria evolving in the environmental arena, for example, with the establishment of the Global Reporting Initiative (GRI; discussed below in section 3.5).

Do criteria always need to meet a specific standard before an assurance service is permitted, and who judges this standard? These questions can be addressed using a cost-benefit analysis, and the costs and benefits may differ in various jurisdictions. The first approach is a safer approach and may be preferred in highly litigious environments. One cost of this may be stifled innovation. The second approach might encourage innovation and may be preferred in a less litigious environment.

Perhaps, on the other hand, it is acceptable to provide an assurance service against evolving best practice. The current approach adopted in the US attestation standards and the Canadian assurance services standards suggests that it is not sufficient to use evolving best practices, but that there should be a benchmark against which criteria can be judged as suitable. If those criteria continues to evolve, such as those of the GRI relating to sustainability reporting, then it appears that assurance providers must be encouraged to adopt best practice, rather than staying with criteria that in prior years were judged as suitable but have now been superseded as best practice.

For an international standard setting body aiming to position the profession as a high quality provider of assurance services, it is desirable that it both provides guidance as to what constitutes suitable criteria, and also encourages the use of international best practice criteria. There is an argument that it should recognize that in some countries, best practice criteria may not be sufficient if they do not meet all the conditions of suitable criteria, and in other countries best practice may be encouraged, even if a high level of assurance cannot be achieved. As stated before, this argument may be moot if best practice is always considered suitable, in which case innovation will not be stifled. It does appear that whichever approach is preferred, one of the most beneficial things that both the international and the national assurance services regulators can do is establish a library of suitable criteria regimes or international best practice regimes for their members.

Communication of a moderate level of assurance

The responses to the ED also highlight concerns about the best ways to communicate levels of assurance other than high. Some of the following comments were identified during our review of the submissions.

- *We are concerned that there is insufficient guidance on how to communicate the conclusion in a review engagement. The ED states only that the “…. conclusion may be expressed in the form of a statement.” Negative assurance is suggested as one way that statement might be conveyed.*

- *Will anyone understand what a “statement of moderate assurance” will look like, and how it differs from positive or negative assurance? What will readers interpret by the term “statement?” We believe that the phrase is too general to convey the form of conclusion that should be expressed in a review engagement.*

- *We believe that a major objective of the framework is to have a clear, unambiguous indication of the level of assurance being provided. Paragraphs 36 and 37 leave the door open too wide by suggesting that the report might not express either an opinion or negative assurance.*

- *While there are different views among … practitioners on the use of negative assurance, expressing a moderate level of assurance through a negative assurance report is already well accepted in international auditing standards.*

As highlighted in the earlier review of the academic literature (see section 2.5 above), several research studies have found evidence of some level of misunderstanding of the level of assurance conveyed by moderate assurance reports. The comments above indicate that there is also some disquiet among the
practitioners preparing the reports. This emphasizes the importance of addressing the communication issue, both from a user and preparer point of view. The view on difficulties of communicating assurance are also expressed in the following quote:

One of the items that concerned me was the comment in paragraph 20 of the preface to the report that discussed “negative assurance.” I have a problem trying to come up with what wording would be used to express a clear moderate opinion if we do not use negative assurance. The paragraph suggests that the statement “… may be expressed in the form of a statement on whether anything has come to the attention of the professional accountant that causes the professional accountant to believe that the subject matter does not conform, in all material respects, with the identified suitable criteria.” To me this seems to be an unworkable concept. How do you express that you did not find anything that causes concern other than by a negative assurance statement.

A further statement from another party examines the issue of how broad the levels of moderate assurance should be:

The levels of assurance are not specifically defined in the ED other than by reference to high and moderate. We believe that those levels should be associated with identifiable and relatively narrow ranges. We are concerned, therefore, when some respondents interpreted the wording of the draft to allow the moderate level of assurance to be a broad range, essentially varying from very low to just below high (e.g., 5% to 95%). Such an interpretation would defeat the purpose of defining two specific levels of assurance and severely undermine the integrity of the framework. We feel that further clarification is very much needed to avoid very different possible interpretations of the two levels of assurance in the framework.

Similar views were expressed by another respondent, stating that a “sliding scale of assurance would be impossible for practitioners. It is good that they have limited themselves to just two.”

Further:

This draft does not stipulate how to express a conclusion when a moderate level of assurance is provided. We suggest the following:

1. whether anything has come to the attention of the professional accountant that the subject matter does not conform with the identified suitable criteria in material aspects, or the subject matter is reasonable.
2. whether the subject matter is authentic, e.g. systems or processes exist or not, behaviors happen or not.

A further comment was made with respect to Paragraph 73 of the Exposure Draft.

It is not clear what forms of symbolic representation are permissible in the context of clear communication. The guidance should be clarified.

These concerns highlight the uncertainty surrounding the communication of different levels of assurance and indicate that the reporting on such engagements is an area in which detailed guidance must be provided. A major issue is whether the levels of assurance should be limited to the one level, moderate, or whether “moderate” should cover a range of levels less than high. If assurance providers express this level of confusion over the most appropriate reporting form, user groups are even less likely to understand the implications of a moderate assurance engagement. This has negative implications for the delivery of a competitive assurance service that meets user needs.

3.4 AICPA Special Committee on Assurance Services (SCAS)

A great deal of the impetus in the development of a number of assurance services and their associated assurance levels came from the Assurance Services Executive Committee (ASEC) of the SCAS. This section briefly reviews the history of the SCAS. For a current view, we refer to the SCAS website at http://www.aicpa.org/assurance/index.htm.
The SCAS was originally set up to:

1. Develop a new concept of assurance services that will be the foundation for new opportunities;
2. Identify and define some specific services for practitioners to deliver; and
3. Create ongoing mechanisms to develop opportunities in the future (Pallais, 1996).

To realize its charges, the ASEC undertook some information gathering exercises. Research was conducted to understand the changing environment; to identify decision-makers’ information and assurance needs; to identify the threats that practitioners face in the new assurance services market; and to identify the competencies that the profession needs in order to provide the new services.

A survey was conducted to ascertain the information needs of a wide range of potential customers, including management, boards of directors, investors and the public. It was considered that findings obtained would allow the ASEC to identify decision-makers’ unsatisfied information needs and consequently, take the appropriate measures to fill the information and assurance gaps.

Findings from the interviews generally suggested that:

1. Different decision-makers have different information needs. For example, creditors required future information about a firm and its risks while investors may be more interested in the systems and product quality of the firm;
2. Financial statements and other currently produced assurance products are insufficient to meet the current information needs of decision-makers; and
3. The public does not perceive the profession as necessarily the most appropriate assurance providers. For example, an interviewee perceived “auditor skills to be limited and inadequate” while another felt that “accountants don’t provide guidance to clients; they just don’t understand the business.”

The ASEC finally settled on a definition of assurance services which encompassed the relevance of information as well as its reliability (Nugent, 1999):

Assurance services are independent professional services that improve the quality of information, or its context, for decision makers.

This concept of assurance services is distinguished from attest services (audit and audit related services) in so far as the goal of assurance services is “information improvement, not the issuance of a report on it (though there might be a report). … It is the service itself that provides value, not the report, although a report is one way to demonstrate value. … Assurance services help people make better decisions by improving information available to them.”

In contrast to the ASEC’s view of assurance services, the IAPC view is that: “the objective of an assurance engagement is for a professional accountant to evaluate a subject matter that is the responsibility of another party using identified suitable criteria, and to express a conclusion that provides the intended user with a level of assurance about that subject matter.” Clearly the IAPC concept of assurance is narrower and more audit-related than the SCAS concept. Evidently the ASEC did not want their range of potential assurance services limited by reporting implications. The definition of assurance services promoted by both the SCAS and IAPC are discussed further in a paper by Alford (1999).

The survey also suggested possible assurance service areas that practitioners could venture into. Specifically, the committee developed six main product areas, which were expected to present the

5 “Assurance Services—Definition and Interpretive Commentary” http://www.aicpa.org/assurancescas/comstud/defncom/index.htm
profession with vast revenue and growth opportunities. These were assurance services relating to risk assessment, business performance measurement, information system reliability, electronic commerce, health care performance measurement, and elder care.

A review was undertaken of the assurance provided in relation to each of these products to try and identify the determinants of reporting on assurance services at a level other than high, and how best to communicate such levels of assurance.

It was found that in some areas (for example, health care assurance), guidance on the provision of assurance had not yet developed. In other areas such as elder care and business performance measurement, the SCAS task force has identified the types of assurance service that can be provided, but offers little detail on how to report/communicate the results of the engagement. In the area of risk advisory services, a special task force is working towards developing a common language and framework for understanding and communicating this issue. The development of a standard set of communication tools for a particular assurance service is of direct relevance to this study. Once implemented, the SCAS framework on risk advisory services may provide useful insights on communicating particular levels of assurance.

One product area highlighted by SCAS is providing assurance on the reliability of information systems. The AICPA and CICA have developed the SysTrust engagement, which entails the assurance provider issuing a report on whether management maintained effective controls over its system to enable the system to function reliably. A reliable system is one that has the characteristics of availability, security, integrity, and maintainability. The assurance provider determines whether controls over the system exist and performs tests to determine whether those controls were operating effectively during the period covered by the attestation/assurance report.

What is interesting for the purposes of this study is the fact that the SysTrust service is provided only at the high level of assurance, governed by the Statement on Standards for Attestation Engagements (SSAE) No. 10, Attestation Standards, AT sec. 101 “Attest Engagements” in the United States, or in Canada under the CICA Handbook- Assurance, Section 5025, “Standards for Assurance Engagements”. Indeed, the SysTrust principles explicitly forbid the issuance of a review-level SysTrust attestation report (although a client may request an agreed-upon procedures engagement related to the SysTrust principles and criteria). No justification for this approach is provided. The absence of different levels of assurance in relation to this particular product means little insight can be gained as to the determinants of assurance in this setting. While the SysTrust criteria clearly play a part, the effects of subject matter and work effort are less clear.

One of the earlier assurance products developed relating to electronic commerce is WebTrust. Developed by the AICPA and CICA, WebTrust is a unique seal of assurance, signifying that businesses carrying the seal comply with standards practices and controls (Bennet and Sylph, 1998). Principles and criteria such as availability, business practices and transaction integrity, online privacy, security, non-repudiation, customized disclosures and confidentiality are considered in a modular approach in providing this assurance service. As for SysTrust, the practitioner guidance provided assumes the provision of assurance at a high level, although the assurance service can be restricted to particular modules/principles. In relation to the communication issue, a notable finding is that WebTrust reports, although expressed in a positive form, all contain an inherent limitations paragraph. This has implications for the determination issue, apparently acknowledging that subject matter does influence the level of assurance provided.
Implications for this study from the developments of the SCAS

There is very little consideration of the factors determining the level of assurance to be provided. In fact, at early stages of the development of SCAS it was appreciated that frameworks for assurance services and reporting models may be an impediment to their development. This view represents a difference in emphasis for the committee (SCAS) compared with those professional bodies responsible for regulating assurance services. While the SCAS was charged with promoting the use of innovative assurance services for the profession, the profession is responsible for maintaining the profession’s most important asset, its reputation as a high quality assurance services provider.

It is widely acknowledged that “new concepts of reporting need to be developed that will effectively communicate the nature and extent of the assurance effort and assurance findings.” Under the SCAS definition of assurance, however, information improvement is the focus of the service rather than the issuance of a report. As stated, requiring a written report is seen to be “unnecessarily constricting”, and predetermined presentation formats are believed to hinder the growth of services, and be unresponsive to the needs of decision makers. In this context, it appears that the communication of assurance levels is not an issue in certain engagements, as the nature of the service provided does not render it conducive to reporting.

From this discussion it is apparent that the approach adopted by SCAS in relation to assurance services differs to that taken by the IAPC. The Elliott report was instrumental in identifying rich assurance services opportunities, but the focus is on information improvement for the user, as opposed to developing a standardised framework on the determination and communication of these new assurance services. Thus in the US, there is a relative absence of moderate assurance reporting in practice (further discussed in Chapter 5). For example, with SysTrust, only a high level of assurance is allowed to be provided. The approach taken by US standard-setters is to consider assurance services on a product by product basis. Guidance on the provision and reporting of assurance services is contained in the Statement on Standards for Attestation Engagements (SSAE), which is further discussed in section 3.6(c).

3.5 Reporting a Moderate Level of Assurance for Specific Assurance Products

An important aspect of professional initiatives includes current practices in assurance services. While these are discussed in detail in Chapter 5 (encompassing the results of the national firm survey), this section examines two specific areas in which a moderate level of assurance is used, namely assurance provided in relation to internal control, and environmental and sustainability reports. For both of these services there have been detailed discussions of the determinants of assurance, as well as a discussion of the relevant communication issues. Thus they provide case examples for different assurance and communication frameworks. For these reasons, the evolution of these two assurance services is examined below, along with any lessons to be learned with regard to this study.

(a) Internal control reports

Increasing emphasis on proper corporate governance has contributed to a greater focus on reporting on internal controls. For example, in the United States, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) produced in 1994 a report titled Internal Control — Integrated Framework, delineating guidelines for the voluntary reporting by management to external parties on the adequacy of internal control over financial reporting. In the United Kingdom, the Committee on the Financial Aspects of Corporate Governance recommended in the Cadbury Report that directors include in
the financial report a statement on the effectiveness of their internal control structure, and that auditors should report on the statement. This was incorporated into the “Code of Best Practice” relating to corporate governance and endorsed by the London Stock Exchange. While it does not require compliance, it requires listed companies to publish a statement of compliance with the code.

The provision of internal control reports is common in practice (see for example, Ragunandhan and Rama, 1994; Willis and Lightle, 2000). In the United States, it has been stated that about one in four public companies and three in five Fortune 500 companies voluntarily report on internal control (Ricchiute, 2001). Hermanson (2000) surveyed nine financial statement user groups and found agreement that management reporting on internal controls was important. McMullen, et al., (1996) went beyond examining user perceptions and tested for an association between the issuance of an internal control report and the quality of financial reporting. They found that companies issuing management reports on internal control were the ones with no significant internal control related problems.

In Australia, the Auditing and Assurance Standards Board issued AUS 810 in May 1999, which provides guidance to auditors in relation to special purpose reports on the effectiveness of control procedures, e.g., those required under specific legislation. This standard recognizes that such engagements can be audit, review, or agreed-upon procedures engagements, with an audit engagement providing a “high but not absolute level of assurance” and a review providing a “moderate level of assurance.” The standard outlines that the lower level of assurance provided by a review engagement is “a reflection of the nature, timing and extent of tests of operating effectiveness, which will ordinarily be limited to discussion with entity personnel and inspection of the system in operation for deviations from the specified design. This may involve observation of, and inquiries about the operation of the internal controls for a small number of transactions or events. An audit however will, in addition, ordinarily involve reperformance of control procedures on a test basis to provide more evidence on which to base an opinion.” This suggests that the work effort view is a major underpinning of the conceptual foundation for the different levels of assurance.

In relation to the communication aspect, AUS 810 outlines the elements that should be contained in an auditor’s report about the effectiveness of control procedures. Of particular interest is the requirement that “explanatory details about the variables that affect the assurance provided and other information as appropriate” be included. Also required is a separate paragraph headed “Inherent Limitations” stating:

(i) Because of inherent limitations in any internal control structure, it is possible that errors or irregularities may occur and not be detected. Further, the internal control structure, within which the control procedures that have been audited operate, has not been audited and no opinion is expressed as to its effectiveness;

(ii) An audit is not designed to detect all weaknesses in control procedures as it is not performed continuously throughout the period and the tests performed on the control procedures are on a sample basis; and

(iii) Any projection of the evaluation of the control procedures to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.\(^7\)

These prescriptions suggest that internal control engagements, being of a different nature to financial statement audits, should be reported on accordingly. The assurance provider’s report should specifically incorporate details on the nature of the subject matter and other variables influencing the level of assurance.

\(^{7}\) AUS 810 “Special Purpose Reports on the Effectiveness of Control Procedures,” paragraphs .13-.14

\(^{8}\) Commonly referred to as a financial risk approach.

\(^{9}\) AUS 810 “Special Purpose Reports on the Effectiveness of Control Procedures,” paragraph .67k.
In the UK, the Auditing Practices Board Briefing Paper, *Providing Assurance on the Effectiveness of Internal Control* (2001) discusses the elements of providing assurance on internal control. In engagements where the subject matter is the effectiveness of the design and operation of the internal control system, it is outlined that the level of assurance provided will be a function of many factors. These include the nature of the entity, the extent of the practitioner’s knowledge and the scope of the engagement (para 53). In engagements where the subject matter also includes management’s risk identification process, the absence of suitable criteria is highlighted; consequently, a high degree of judgment is required of the practitioner. It is argued that this in turn means that sufficient appropriate evidence cannot be gathered to provide a high level of assurance. Paragraph 56 suggests the possibility of obtaining sufficient evidence to provide moderate assurance, and providing a conclusion expressed in the form of negative assurance.

The Briefing Paper emphasizes the importance of clearly distinguishing between providing assurance on internal control design and providing assurance on the operation of a system of internal control in accordance with its design, with each of these engagements having a clearly different scope. The framework proposed focuses on the interrelationship between business objectives, risk identification, control design and control operation; it is proposed that practitioners will need to express their conclusions in the context of each of these. Given this conceptual basis, the APB suggests that most engagements will result in a narrative (as opposed to short-form) report. An example report is included as an illustration.

The APB’s preference for narrative reports is indicated: “the more extensive the scope of an internal control assurance engagement, the more information needs to be included in the practitioners’ report. Only if this information is provided to the user, can the user understand the judgments that support the practitioners’ conclusions” (para 60). It is further stated that a formalized short form opinion is insufficient as it does not enable users to “understand the context in which the opinion is given or the judgments that have had to be made in reaching the conclusion, and the reasoning underpinning those judgments. Consequently, short form reports expressing assurance regarding internal controls are likely to lead to misunderstandings and unfulfilled expectations.”

In the United States, recent attention has been given to the issue of reporting on internal control, with the Commission on Fraudulent Financial Reporting (the Treadway Commission), the U.S. General Accounting Office, and The Federal Deposit Insurance Corporation (FDIC) all calling for mandatory public reports. To date, only one has succeeded: the FDIC, which requires public reporting for federally insured banks and thrifts exceeding specific benchmarks. However, as outlined above, there is quite a deal of voluntary reporting on internal control occurring in the U.S. (Ricchiute, 2001). Such engagements on evaluation of internal control are covered by the attestation standards that have recently been released in this country. These are discussed in more detail in the following section.

The development of practice and technical guidance on internal control assurance highlights some of the variations in the way in which practice has evolved around the world. There are differences in the factors that are perceived to affect the level of assurance, as shown by the difference in the US attestation and Canadian assurance approach, which emphasize work effort, and the UK and Australian approach, which see a number of factors interacting to create the level of assurance. For this service the form of communication follows the philosophy associated with the service in each country, with the factors

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10 A similar view was expressed by a few respondents to the IAPC audit firm survey (discussed in Chapter 5), indicating that users found long form reports more useful than short form. However, other respondents expressed that user misunderstanding was a problem primarily because of the lack of familiarity with the reporting framework. Educating users would thus be one way of overcoming this misunderstanding gap.
deemed to be determining the assurance level provided being communicated to the users of the assurance service.

Are the two views expressed inconsistent? We know that reviews of internal control are currently being undertaken in practice in various parts of the world. We know that in the UK there is a distinction made between providing assurance on internal control design and providing assurance on the operation of a system of internal control in accordance with its design, with each of these engagements having a clearly different scope. It is argued in the UK that it is possible to provide a high level of assurance on operations, but not on design. Under the North American approach, if this was true that a high level of assurance could not be offered on design, then assurance services on design issues would not be permitted. We are unable to identify and determine whether such services are provided in the United States. If they were permitted, they must be on the basis that high assurance can be offered for such a service.

If we consider the approach in the United Kingdom and the determinants of assurance for internal control, they are clearly saying that the subject matter is important. However, the subject matter that we are considering is not future-oriented, as may be regarded as a common basis of distinction to date. The subject matter relates to the unique characteristics of internal control which include the nature of the entity, and the extent of the practitioner’s knowledge. In engagements where the subject matter also includes management’s risk identification process, the absence of suitable criteria is highlighted. We are unsure of the basis on which the nature of the client becomes a defining characteristic of the level of assurance that can be provided. It may be an “inherent risk” characteristic, and may drive the evidence that is sought, but the rationale for this being one of the defining characteristics of assurance is unclear. We are also unsure of the basis on which the extent of the practitioner’s knowledge becomes a defining characteristic of the level of assurance that can be provided. This again seems undesirable as a basis for giving guidance on the level of assurance that can be provided. The general view is that the practitioner should always have the appropriate level of knowledge before they accept an appointment.

With regards the absence of suitable criteria, the argument appears to come back to that which we raised under section 3.3. For an international standard setting body aiming to position the profession as a high quality provider of assurance services, it may be considered desirable that it provides guidance to its members as to what constitute suitable criteria, and encourages the use of international best practice criteria. A possible approach is to recognize that in some countries, best practice criteria may not be sufficient if they do not meet all the conditions of suitable criteria, and in other countries best practice may be encouraged, even if a high level of assurance cannot be achieved.

(b) Environmental and sustainability reports

Corporate environmental reporting has become increasingly prevalent in recent times. Public environmental reporting (PER) comes down to the voluntary public presentation of information about an organization’s environmental performance over a specified period, usually a financial year. An organization’s PER may be published as a stand-alone document, a website or as part of an annual report. Recently, some organizations have expanded the concept of PER by bringing the environmental and social aspects of operations together with traditional economic reporting to produce triple bottom line or sustainability reports. Internationally, environmental reporting is a rapidly growing trend and it is claimed to form an integral part of organizations’ communication with stakeholders and society.

There is significant literature on voluntary disclosure (see for example, Botosan, 1997) which seeks to explain this phenomenon. Botosan (1997) found that manufacturing companies with higher levels of voluntary disclosures had a lower cost of equity capital. This suggests that these disclosures do have information value, which in turn explains the demand for assurance services in relation to the disclosures.

This is reflected in the AA1000 Series (AA1000S), Accountability Management set of standards produced by the Institute of Social and Ethical Accountability (ISEA). These recognize that firms can improve their accountability and performance by learning through stakeholder engagement.
organizations have asked for guidance on what and how to report. Indeed, these disclosures have in the past not been governed by generally accepted standards, which makes them difficult to compare. This is one of the reasons for examining carefully this particular type of engagement, because precise criteria are less well defined. Deegan and Rankin (1999) concluded that this form of reporting is typically not of a standard to satisfy the information needs of various classes of users. Tilt (1994) investigated the attitudes of pressure groups as one of the users of corporate social disclosures. The 146 organizations surveyed (80.8% of which were environmental groups) indicated they found such disclosures to be insufficient and low in credibility. 92% of the respondents believed that standards were needed to enforce proper disclosure, with external audits being seen as the most appropriate way to enforce such regulations.

In light of the skepticism often associated with corporate environmental reports, providing assurance on such disclosures is one way to mitigate this problem. Indeed, it has been argued that it may be the “next step” in the evolution of corporate environmental reporting (Beets and Souther, 1999). The importance of assurance engagements in relation to environmental reports is reflected in the research being conducted in the regulatory sphere: the IAPC released a discussion paper in 1995 examining “The Audit Profession and the Environment,” and the European Federation of Accountants (FEE, Fédération des Experts Comptables Européens) sought to stimulate debate relevant to assurance engagements on environmental reports in its discussion paper (1999).

In relation to reporting on such engagements, the FEE Discussion Paper (1999) raised a number of pertinent issues. Comments were sought on how to ensure that users understood the limitations of an assurance report as well as the benefits provided, with the FEE noting the wide variations in practice in reporting on the credibility of environmental reports. The responses highlighted that standardization of the report is a high priority in order to ensure better understanding. A clearer understanding of auditor and user perspectives of the style and content of such reports was also seen to be necessary in enhancing the communicative ability of these assurance reports. The IAPC project “Assurance on Environmental Reports” has been deferred pending completion of this research into moderate levels of assurance.

It is recognized that developments are taking place with the Global Reporting Initiative (GRI) (2000). This group represents organizations interested in the area of sustainability reporting. It has produced detailed Sustainability Reporting Guidelines (SRG). It is claimed that these guidelines represent the first global framework for comprehensive sustainability reporting, encompassing the “triple bottom line” of economic, environmental and social issues. While the GRI’s mission statement does not specifically address needs for or practices in verification (independent assurance) regarding sustainability reports, the GRI does encourage the development and adoption of principles for verification, as this can enhance the quality, usefulness and credibility of information used within the reporting organization and the underlying management systems and processes. The GRI recognizes that verification of sustainability reports is at an early stage in its evolution. It therefore encourages the development and use of principles and guidelines for verification practices. Annex 3 of the SRG is included to provide additional guidance on verification for the benefit of users and verifiers as well as GRI reporters. This annex identifies that there is no consensus on what should be included in such a statement or opinion. They outline that any verification arrangements and processes be informed at the outset by an up-to-date expectation about the reported information.

13 The GRI was convened by the Coalition for Environmentally Responsible Economies (CERES) in partnership with the United Nations Environment Programme (UNEP). It incorporates the active participation of corporations (e.g., General Motors), non-governmental organizations, accounting organizations (e.g., the UK Association of Chartered Certified Accountants and the Canadian Institute of Chartered Accountants), business associations and other stakeholders from around the world (Global Reporting Initiative, 2000. http://www.globalreporting.org).
They outline 8 major components of the form and content of verifiers’ statements or reports. These are:

- An identification of the subject matter about which the verifier is providing assurance, as well as the title and date of the report or other medium (e.g., website) that contains the subject matter.

- An acknowledgement that the reported subject matter is the responsibility of the organization’s management and that the verification statement is the responsibility of the verifier.

- The purpose of carrying out the verification.

- The nature and source of criteria used in evaluating the subject matter, developing findings and reaching conclusions; if the purpose of the verification is to provide assurance about the extent to which the sustainability report complies with the GRI guidelines, these should be referred to in the verifier’s conclusion or opinion.

- The procedures carried out and any standards followed in the course of the verification, including the extent to which stakeholders were involved in planning and participating in the verification process.

- An identification of the party or parties responsible for the verification, as well as an indication of the relevant qualifications or competencies of those who carried out the work and their relationship to the preparers of the report.

- A statement or opinion as to the conclusions reached and an indication of the level of assurance provided about the subject matter, including any reservations or limitations.

- The date and place of issuing the verification statement or report.

The GRI has expanded its involvement in the verification aspect of sustainability reporting through the formation of the Verification Working Group. This group aims to create a forum for the discussion of the needs, expectations and best practices in sustainability reporting verification. Its role involves, among other things:

- Encouraging the standardization of verification methodologies;

- Pushing for the recognition of legitimacy and competence of assurance providers;

- Creating a forum for report preparers, users and verifiers to reach mutual understandings; and

- Being a source of tools to facilitate understanding between interested parties.

One such tool is the “Overarching Principles for Providing Independent Assurance on Sustainability Reports,” a Working Paper. This is intended as a discussion and feedback mechanism, with the Principles to be included in the 2002 version of the GRI Guidelines. They are a set of “recommendations and expectations,” not intended to replace existing standards. Diagram 1 provides an overview of these overarching principles of the GRI for providing independent assurance on sustainability reports.

As can be seen in diagram 1, developing the business case includes consideration and determination of at least the following elements:

- Goals and Expectations: “The reporting organization identifies and states its goals and expectations as to how independent assurance about the sustainability report will contribute to advancing strategic objectives and strengthening stakeholder relations.”

- Scope: “The reporting organization decides the scope and nature of the subject matter within the sustainability report for which independent assurance is to be provided. This may be the report as a whole or specific parts of it, and may depend upon the objectives for the assignment. The extent or
level and nature of assurance that can be provided therefore varies with the type of reported information in question, which in turn affects the objectives of the assurance-providing assignment.”

- Objectives: “The reporting organization determines the exact purpose and objective of the assurance-providing assignment relative to the scope and subject matter.”

- Benefits and costs: “The reporting organization identifies the benefits that it can be expected to gain as a result of the assurance-providing process.”

Relevant for the issue of the determination of assurance is that in the discussion of the Scope element the GRI suggests that the level of assurance varies with the type of information, i.e., subject matter.

Five general principles are included in the Working Paper, of which the second relates to prerequisite conditions for assurance engagements and the fourth relates to the communication of results. As outlined in diagram 1, four prerequisite conditions need to be considered and satisfied by a reporting organization and an assurance provider before an assignment is commissioned to provide independent assurance about a sustainability report or part(s) thereof. These four conditions relate to:

- Evidence to Support Reported Information: Appropriate evidence needs to be available to support the information in the sustainability report that is going to be subject to an assurance assignment. Assurance cannot be provided regarding an assertion by management for which there is no available supporting evidence.

- Criteria against which to evaluate evidence: Criteria need to be available or established against which evidence can be compared and evaluated by the assurance provider as the basis for reliable, objective findings and conclusions. Where such criteria are not readily available, it is necessary for the assurance provider and reporting organization to devise ones that are suitable having regard to the nature of the subject matter in question and the objectives of the assignment. Characteristics for assessing the suitability of criteria include relevance and completeness regarding the subject matter and objectives of the assignment, reliability, clarity, and consistency when used by similarly

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14 The principles are: the case for independent assurance; prerequisite conditions for assurance assignments; approaches and procedures; communication of results; and attributes of assurance providers.
qualified assurance providers, and neutrality or freedom from bias in shaping the assurance provider’s conclusions.

- Resources to carry out the Assignment: The reporting organization needs to be prepared to commit the resources necessary for the assurance provider to obtain and evaluate the required evidence.

- Cooperation in carrying out the assignment: A reporting organization needs to be willing to cooperate with an assurance provider in providing access to staff, facilities and records, as determined by the scope, subject matter and objectives of the assignment.

Relevant for the issue of the determination of assurance are the remarks regarding criteria. The GRI clearly suggests that suitable criteria can be devised on a case by case basis for specific assurance engagements. These criteria should be developed jointly by the assurance provider and the reporting organization.

The communication of results can be done in a report, statement, or other formats such as symbols. The aim is to communicate the findings/conclusions reached relative to the objectives of the assignment. This section discusses the content of the assurance provider’s report, setting forth a list of elements that are expected to be included. This list is substantially similar to that outlined in Annex 3 of the SRG.

The November 2000 GRI Symposium included a session on “Verifying GRI Reports.” The discussion focused on three principal themes:

1. Verification of GRI reports is likely to evolve incrementally over time, with progress requiring multidisciplinary co-operation, based on verifier community dialogue with report users and preparers about their expectations;

2. Verification and verifiers need to be multi-disciplinary, innovative, adaptive and credible; and

3. The role of the GRI being to assist in this process in practical, consensus-building ways, without itself being a verifier, accrediting verifiers or setting detailed standards for verification.

Thus it is clear that the GRI considers assurance to be an important issue, and further, is willing to consider reports of different levels of assurance. While guidance is offered as to the contents of the report, for as to how these different levels of assurance should be communicated, the GRI offers little guidance.

The quality of international corporate sustainability disclosure and communication has been assessed by UK consultants SustainAbility and the United Nations Environment Programme (UNEP). This has resulted in the release of “The Global Reporters” (November 2000). The top ranked companies appeared to be all European: BAA, Novo Nordisk, The Co-operative Bank and British Telecom (shared third), BP Amoco and Royal Dutch Shell Group (shared fifth). By means of example, the independent verification of the sustainability report of BAA is available at http://www.baa.co.uk and the verification of the environmental and social report of the Danish Novo Group at http://www.novo.dk. The review statements of the environmental and social report of Novo consists of both quantitative and qualitative verifications. The accuracy of the quantitative data has been verified by a formal external verification undertaken by Deloitte & Touche, while the assurance of the relevance and completeness of the report and its underlying processes has been verified by an independent consultant, with the assistance of a panel of experts. An overview of key information of 19 examples of environmental and sustainability assurance engagements is provided in Appendix 2.

Environment Australia has also contributed to the international development of “Public Environmental Reporting” guidelines. Recently, it has released A Framework for Public Environmental Reporting: An Australian Approach (March 2000). In this report, it was argued that the communication value of the
The Determination and Communication of Levels of Assurance Other than High

report should be given adequate consideration as the relevance of the information presented has a strong influence on its usefulness to the reader. Some of the qualitative characteristics are considered to be integral to the verifiability of the report and can be used by verification bodies to form an opinion on the content of the report. These characteristics are the following: relevance, reliability, comprehensibility, neutrality, completeness, comparability, timeliness, credibility and verification. The report states that the primary purpose of a third-party independent verification of a PER is to legitimize their accountability relationship by providing assurance to the stakeholders that the information contained within the report is accurate. It is claimed that this assurance will add significant credibility to the PER. In the report it is further argued that verification involves confirming that the data reported and/or the systems used to generate them, are accurate and complete, and that the report provides a balanced view of the organization’s performance. In doing so, the verifier may use the qualitative principles as well as the following principles as verification criteria: validity (the validity of the data and its accuracy); inclusivity (consultation with relevant stakeholders); and continual improvement (achievement of objectives and targets, and steps taken to improve performance). It is noted that there are currently four primary levels of assertion used by verifiers:

- **LEVEL 1**: Data verification - the checking of randomly selected data trails, focusing on ensuring that data and statements included in the report are accurate and fair.

- **LEVEL 2**: Verification of completeness of reporting — assessing the level of reporting against the organization’s policy, aspects and impacts, and objectives and targets, to assess the completeness of reporting against identified significant environmental impacts.

- **LEVEL 3**: Report verification incorporating site level compliance auditing — incorporating the level of compliance of operations at the site level into the verification process, to assess the accuracy of the report in representing the actual performance of the organization.

- **LEVEL 4**: Report verification incorporating re-sampling and analysis — including re-sampling and analysis of data streams as part of the verification process to determine the accuracy of the data from site level.

It is mentioned that all four levels of verification would generally require site visits by the verifiers. A combination of these processes can be used to suit the organization’s verification requirements. In general, Level 1 is appropriate for first-time reporters whereas a combination of Levels 1 and 2 is considered good practice. Inclusion of Level 3 is useful if no separate site audits are undertaken. Level 4 is generally only recommended for the largest of operators with significant potential for stakeholder scrutiny.

In the area of environmental and sustainability reporting, therefore, a number of groups have considered the issue of assurance. Given the emerging nature of reporting, however, the thinking on assurance, or verification, has hardly moved beyond the idea that such reports need to be verified. The guidance provided by groups such as FEE and GRI highlight the importance of assurance. In addition, the GRI initiatives are relevant to the issue of the determination of assurance. First, the GRI initiatives suggest that assurance level is affected by the nature of subject matter. In addition, while having the requirement of suitable criteria, they suggest that these can be devised on a case by case basis for specific assurance engagements.

Regarding the communication issue the GRI provides a basic set of guidelines on the contents of sustainability verification reports. This is a growing area, with many interested parties, and it is clear that any developments in assurance services in this area will need to consider the concurrent developments occurring within other organizations such as the GRI and FEE.
3.6 Other Professional Literature

Professional accounting bodies in several countries have addressed the issue of levels of assurance and how best to communicate it. This section considers specific examples from Canada, the UK, the US and Germany.

(a) CICA Research Study (1980)

For many years, the Canadian accounting profession has been a leading contributor in any discussion on reporting on assurance engagements at levels other than high. Much of their early thinking appears to be encapsulated or flowing from a research study that was undertaken in 1980. According to this CICA research study, the level of assurance provided on an engagement is determined by the extent of audit effort, auditability of the subject matter and attestor competence, and the results of the audit effort.

Audit effort is a major determinant of the level of assurance according to this framework. Different levels or mixes of audit effort (e.g., a comprehensive enquiry-based review of a system and its controls, compliance procedures, substantive tests of major information items produced by the system) offer various degrees of assurance potential. Although some may argue that anything less than a full audit does not enable any systematic basis for extrapolation as to whether material errors may exist, lack of research and experience in this area means that the effectiveness of various sets/levels of audit procedures remains unexplored. This view of audit effort as a determinant of assurance levels is analogous to the IFAC view of the nature, timing and extent of procedures being one determinant of assurance.

Two other factors determining assurance levels are the auditability of the representation and the professional competence of the attestor. Auditability essentially deals with the subject matter of the engagement: the study highlights that certain representations may not be susceptible to satisfactory verification. Suitable criteria (i.e., comprehensive measurement standards against which to judge the propriety of a representation) are recognized to be a vital precondition to auditability, although the CICA study does not examine this issue in detail. Again, these determinants are analogous to those identified in the IFAC framework.

A final determinant of the level of assurance, according to this research study, is the result of the audit effort. While this may seem to be a conceptual leap, with the findings of the audit effort reflecting the credibility of the representation, it derives from a more general framework in which audit qualifications are viewed as providing lower levels of assurance. This view is outside the perspective that this study has been requested to take by the IFAC.

The CICA research study also identifies the reporting alternatives for engagements of a lower level of assurance as a listing of findings and an expression of assurance. An expression of assurance is “in concept at least, a significant step beyond a list of findings. It represents an explicit extrapolation from specific findings to the reliability and fairness of the representation taken as a whole. This, in turn, requires that the public accountant evaluates his results and decides whether they support, or give cause to doubt, the representation.”

Possible objections to the expression of limited audit assurance might be classified into two groups:

- Concerns that there may be an insufficient basis for extrapolation. If one accepts a requirement of a minimum audit effort sufficient to add a significant but limited degree of credibility, then it follows that the public accountant has a defensible basis for expressing limited audit assurance;

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15 Although, in some areas, it appears that their thinking has evolved since this time.
Concerns relating to the communication itself. One may agree that there is a sufficient basis for providing limited audit assurance but argue from an information content, professional liability or general understandability standpoint that it would be better not to try to express it.

A basic perceived problem with negative assurance is that it can hold at any point on a scale of assurance probabilities. It can be true if one knows absolutely nothing about the subject and has performed no tests whatsoever. It can also be true where a competent audit examination has been undertaken but a cautious auditor hedges his/her opinion.

This argument overlooks two important considerations. First, although it may be literally true at all points on a continuous assurance scale, negative assurance is a symbol which can be defined to have a narrower meaning. More specifically, in practice it has come to be associated with limited assurance and is clearly differentiated from the audit opinion.

The concern of user interpretation is that users will tend to read more into negative assurance than is warranted in the circumstances. The extreme view then claims it is therefore better to omit any expression of limited assurance. This position is considered illogical, concluding on the one hand that intended users have the ability to understand limitations, but concluding on the other hand that they may be misled by the statement of negative assurance. One must also consider what a user may infer if no assurance is expressed.

Legal liability considerations are also considered in an appendix to the study. It is argued that it is unlikely that an accountant’s liability will be significantly affected by whether or not they express negative assurance, except if the assurance goes beyond what might reasonably be implied by the procedures performed and the results thereof in the particular circumstances. This would be an argument against a view presented earlier in this study, that perhaps legal considerations may be a reason for differentiating specific rules between countries.

(b) Independent professional review in the UK

In the UK, the March 2000 Company Law Review proposals included the possibility of an Independent Professional Review (IPR) of financial statements. This was intended for smaller companies, which did not meet the proposed audit threshold of £4.8m in turnover. The proposed statutory, regulated IPR is intended to offer a lesser form of assurance than audit. It involves an analytical review of accounts (probably prepared by the reviewer) and assurances from directors. Unlike the audit, there is no independent verification of material items. The main saving of the IPR process is dispensing with the evidence-gathering that makes up such a large portion of audit costs. The review is intended to give users some confidence in the integrity of the accounts they read; the assurance is at a level less than high.


*On the basis of our review we are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the provisions of the Companies Act 20XX and the requirements of the Financial Reporting Standard for Smaller Entities (FRSSE).*

Responses to this Discussion Paper reveal the significant issues underlying the value of the “less-than-audit” assurance provided by the IPR. The ICAEW council withdrew its support for the concept, believing it would confuse the public, disappoint expectations and threaten reputations. It saw the IPR as a “piggy-in-the-middle with its costs, questionable assurance and its very own expectations gap. It’s audit or
nothing.” Note that a significant part of the ICAEW criticism stemmed from the fact that the IPR does not necessarily provide independent verification, without which “assurance is valueless.”

The Association of Chartered Certified Accountants (ACCA) was of the belief that the IPR would not provide a meaningful level of assurance to users and could not become a credible alternative to the audit. In addressing the issue of whether the limited assurance provided by an Independent Professional Review would be of value to intended users of the review report, the ACCA stated:

> The moderate level of assurance provided by a review may not be sufficiently high to be distinguished in the minds of users from the assurance that they would derive from the simple involvement of a qualified accountant in the preparation of the financial statements. Conversely, we suspect that many users will mistakenly assume that the IPR provides a high level of assurance. We believe, overall, that users seeking a level of assurance over and above that provided by the involvement of a qualified accountant would be better served by an audit.

The ACCA response further emphasized that an IPR was not sufficiently distinguished from an audit to avoid unrealistic expectations as to the extent of assurance provided, believing that many users assume a high level of assurance for any report issued with financial statements.

(c) The United States Attestation Standards (2001)

The Statement on Standards for Attestation Engagements (SSAE) issued in January 2001 by the US Auditing Standards Board covers engagements undertaken to “issue an examination, a review, or an agreed-upon procedures report on subject matter…” The word “examination” as used in the US standards refers to a high (audit) level of assurance.

A summary of the standards of reporting is outlined below:

- The report identifies the subject matter or assertion being reported on;
- The report states the practitioner’s conclusion about the subject matter or assertion;
- All the practitioner’s significant reservations about the engagement shall be included in the report; and
- In certain circumstances the report may be restricted to specified parties.

It was noted that in the suggested content of the reports, certain statements should be included. For a review report: “that a review is substantially less in scope than an examination, the objective of which is an expression of opinion on subject matter, and accordingly no such opinion is expressed.” For agreed-upon procedures: statements relating to the levels of work (scope) of the engagement are restricted to those agreed upon by the prospective parties. It is also suggested that the practitioner should not provide negative assurance for agreed-upon procedures

Examples of the wordings suggested for the various reports follow.

Examination Report

...Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting [identify the subject matter — for example, XYZ Company’s schedule of investment returns] and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion...

...In our opinion...
Review Report

...Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on [identify the subject matter — for example, XYZ Company’s schedule of investment returns]. Accordingly, we do not express such an opinion...

...Based on our review, nothing came to our attention that caused us to believe that the...[subject matter]...is not presented, in all material respects, in conformity with [identify the criteria— for example, the ABC criteria set forth in Note 1].

Agreed-upon Procedures

...We have performed the procedures enumerated below, which were agreed to...solely to assist in evaluating the accompanying...

...We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on the accompanying...Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

SSAE 10 has chapters devoted to certain services. Under SSAE 10, Chapter 3, whenever a practitioner reports on prospective financial statements that are, or reasonably might expect to be, used by a third party, the practitioner should perform an examination, a compilation, or an agreed-upon procedures engagement of the prospective financial statements. Chapter 3 of SSAE 10 does not provide guidance for engagements to review a financial forecast or projection, which essentially means that a review is not permitted.

SSAE 10, Chapter 4, provides guidance to a practitioner who is engaged to issue an examination or a review report on pro forma financial information. Paragraphs 4.08 and 4.09 identify the objective of a practitioner’s examination or review procedures applied to pro forma financial information. SSAE 10, Chapter 5, provides guidance to the practitioner who is engaged to issue an examination report on the effectiveness of an entity’s internal control. Paragraph 5.10 prohibits the practitioner from accepting an engagement to review the effectiveness of an entity’s internal control.

SSAE 10, Chapter 6, provides guidance for engagements related to an entity’s compliance with specified requirements, or the effectiveness of an entity’s internal control over compliance with specified requirements. Chapter 6 provides guidance to practitioners concerning performance and reporting for engagements to examine or apply agreed-upon procedures to this subject matter. Paragraph 6.07 prohibits the auditor from accepting an engagement to perform a review of an entity’s compliance with specified requirements or about the effectiveness of an entity’s internal control over compliance. SSAE 10, Chapter 7, provides guidance for the practitioner concerning the performance of an attest engagement with respect to management’s discussion and analysis (MD&A). Paragraphs 7.05-7.07 identify the conditions for performing an examination engagement on MD&A. Paragraphs 7.08-7.14 identify the conditions for performing a review engagement on MD&A.
An interesting comment was made by the US in its response to the 1999 International Exposure Draft on Assurance Services with regard to subject matter: “We...disagree with the concept that the level of assurance is determined by the nature of the subject matter. The dependence of the level of assurance on the nature of the subject matter and the suitability of the criteria would imply that there would be some instances where a high level of assurance could not be attained. We believe the performance of a review should be based on the professional accountant’s intent to perform such an engagement.”

(d) The Canadian Statements on Assurance Services
The Canadians have developed their own “Standards for Assurance Engagements.” Section 5025 of these standards relates the level of assurance provided to the work effort involved. It clearly excludes the impact of other factors (e.g., criteria, subject matter). Those factors must meet certain standards whatever level of assurance is being provided in an engagement. In addition, their standards dealing with review engagements define such engagements in terms of the work performed relative to that performed in an audit.

(e) Reporting practices in Germany
As the project seeks to answer the questions on determinants of assurance and methods of communication form an international perspective, a review was undertaken of one non-English speaking environment. As the German economy has such a significant impact within Europe, that country’s reporting practices were deemed worthy of attention.

The clear emphasis in this domain is the audit of historical financial statements and the reporting about the conclusion. Due to the fact that the preparation and audit of financial statements is regulated by German Commercial Code (Handelsgesetzbuch, HGB), legal aspects clearly dominate this discussion (Erle, 1990). The research on the communication of the practitioners’ opinion focuses on the well known “expectation gap,” without exception with regard to the audit of historical financial statements (Porter, 1991). For example, Ruhnke and Deters (1997) showed in an empirical survey, that an unqualified opinion in the auditor’s report is regularly understood as a signal that going concern of the enterprise is not endangered.

The discussion on the understandability of the auditor’s report was resumed in the context of the revision of the German HGB in 1998, which changed the former short form report to an auditor’s report according to ISA 700. The emphasis of this discussion is a comparison of ISA 700 and the relevant German Auditing Standards (PS) PS 400 (Böcking, et al., 2000). But this discussion does not show any aspects that are relevant to our research project concerning different levels of assurance.

The audit of the management report (Lagebericht) under German Commercial Code may be of some relevance to the current study. The management report is part of the scope of the audit due to § 317 HGB and contains, among other things, a report on R&D and on the anticipated development of the enterprise (Selcher, et al., 2000). In the auditor’s report it has to be expressed whether the management report is in agreement with the financial statements. Up to the change in the German Commercial Code the requirement of § 317 was that “the management report may not give a false impression of the position of the enterprise.” In 1998, this requirement was changed in a positive direction: “The management report provides a suitable understanding of the position of the enterprise.” The objective of this change was to reduce the expectation gap. There is some doubt, whether this aim has been achieved. Empirical research on this question appears not to exist.

There is some German literature on topics mentioned in the appendix of ISAE 100. In the discussion on these topics, e.g., Environmental Reports or Internal Control Systems, the emphasis is put not on the level of assurance but almost exclusively on the suitable criteria and how these criteria can be substantiated.
The result seems to be that these criteria are contracted in detail in the description of the engagement and the identification of the subject matter in the engagement assignment. Thus, although the subject matter may not actually be suitable for a high level of assurance engagement, pre-engagement agreement on the criteria results in the practitioner giving a high level of assurance with regard to the criteria used.

The report on an audit has to follow German Auditing Standard PS 400 that is close to ISA 700. For all assurance engagements that differ from audits in purpose and scope, the reporting has to be made in the form of an attestation report (Bescheinigung). These attestation reports are standardized by German Auditing Standards on special subject matters, e.g., PS 820 on Environmental Reporting, PS 880 on Certifications on Software and PS 890 on WebTrust-Certifications. Within these reports it is stated, that the subject matter conforms to the identified criteria and do not conflict with other evidence obtained. Literature on whether users do understand the distinction between audit and other assurance engagements does not appear to exist.

It can be summarized that in the German domain there is no substantial discussion about different levels of assurance and the reporting thereon. The explanation may be that practitioners try to avoid the problem of a moderate level of assurance and how it could be measured by detailed agreements on the criteria that have to be reported on.

The initiatives of the four professional bodies discussed in this section highlight that while the concept of a limited level of assurance is new (as evidence by the 1980 CICA study), uncertainty remains as to whether it is a sufficiently distinct product the profession can offer (as evidenced by the concerns over user understanding of the Independent Professional Review in the UK). Indeed, in some countries such as Germany, the concept does not appear to have any influence within their assurance framework.

3.7 Other Assurance Providers and Standard Setters

Various websites have been reviewed to search for other assurance providers and standard setters. This section highlights the relevant information that was found for the purposes of this study. In particular, this section highlights the approach taken by assurance providers and standard setters outside the accounting and auditing profession. While these initiatives provide little insight into the determinants of (alternative levels) assurance, the frameworks used by these bodies are a source of ideas on the communication of assurance, and what must be included in a report.

16 PS 400.5.


18 To some extent the GRI, discussed in Section 3.5, concerns an initiative outside the accounting profession. While the accounting profession actively participates in this initiative, it does so together with a large number of organizations outside the accounting profession.
(a) Evaluation Profession

Joint Committee on Standards for Educational Evaluation

The Joint Committee on Standards for Educational Evaluation is a private nonprofit organization, representing a coalition of major professional associations concerned with the quality of evaluation in education settings. Evaluation involves assessing the strengths and weaknesses of programs, policies, personnel, products and organizations to improve their effectiveness. Thus while it has a different objective to assurance engagements, in so far as evaluation involves assessing subject matter against a given rationale and procedures in order to express a conclusion, there is a degree of overlap with assurance services.

The Joint Committee sets standards in evaluation and is accredited by the American National Standards Institute (ANSI). Standards approved by ANSI become American National Standards. Two sets of evaluation standards (on personnel evaluations and program evaluations) have been published and a third set of standards to guide teachers’ evaluations of students is under development. The Program Evaluation standards (1994) are reviewed in the following discussion, as they provide some interesting insights for the assurance services framework.

The framework of these standards is divided into four broad areas: utility, feasibility, propriety and accuracy. The utility standards are intended to ensure that an evaluation will serve the information needs of intended users. The feasibility standards are intended to ensure that an evaluation will be realistic, prudent, diplomatic, and frugal. The propriety standards are intended to ensure that an evaluation will be conducted legally, ethically, and with due regard for the welfare of those involved in the evaluation, as well as those affected by its results. The accuracy standards are intended to ensure that an evaluation will reveal and convey technically adequate information about the features that determine worth or merit of the program being evaluated.

There is little to be learned about the determinants of assurance from this framework, as the program evaluation process does not focus on arriving at a particular level of assurance. In relation to the issue of communicating assurance, the accuracy standards are the most relevant. These contain guidelines on documentation; describing purposes and procedures; and using valid, reliable and systematic information. In terms of the conclusion, the emphasis is on a “justified conclusion”: “The conclusions reached in an evaluation should be explicitly justified, so that stakeholders can assess them.” The framework also highlights the need for “meta-evaluation,” whereby the evaluation itself “should be formatively and summatively evaluated against these and other pertinent standards, so that its conduct is appropriately guided and, on completion, stakeholders can closely examine its strengths and weaknesses.” An important aspect of this reporting system, therefore, is providing stakeholders (or users of the assurance service) with sufficient and appropriate information to achieve a level of transparency that allows them to form their own assessment of the evaluation. That is, in addition to expressing a conclusion, sufficient background information is required.

Evaluation Associations

Many countries have established a national evaluation association. We have reviewed websites of the evaluation associations in the US, Canada, Europe, Australia-Asia, France, Germany, and the UK. Useful information for the purposes of this study was found on the American and the European evaluation association’s websites.

The American Evaluation Society

The American Evaluation Society has issued guiding principles for evaluators. They should guide the professional practice of evaluators, and inform evaluation clients and the general public about the principles they can expect to be followed by professional evaluators. Some interesting principles are presented below.

_Evaluators should adhere to the highest appropriate technical standards in conducting their work, whether that work is quantitative or qualitative in nature, so as to increase the accuracy and credibility of the evaluative information they produce._

_When presenting their work, evaluators should communicate their methods and approaches accurately and in sufficient detail to allow others to understand, interpret and critique their work. They should make clear the limitations of an evaluation and its results. Evaluators should discuss in a contextually appropriate way those values, assumptions, theories, methods, results, and analyses that significantly affect the interpretation of the evaluative findings. These statements apply to all aspects of the evaluation, from its initial conceptualization to the eventual use of findings._

_Evaluators should practice within the limits of their professional training and competence, and should decline to conduct evaluations that fall substantially outside those limits._

_Evaluators should negotiate honestly with clients and relevant stakeholders concerning the costs, tasks to be undertaken, limitations of methodology, scope of results likely to be obtained, and uses of data resulting from a specific evaluation. It is primarily the evaluator's responsibility to initiate discussion and clarification of these matters, not the client's._

_Evaluators should record all changes made in the originally negotiated project plans, and the reasons why the changes were made. If those changes would significantly affect the scope and likely results of the evaluation, the evaluator should inform the client and other important stakeholders in a timely fashion of the changes and their likely impact._

_When planning and reporting evaluations, evaluators should consider including important perspectives and interests of the full range of stakeholders in the object being evaluated._

_Evaluators should allow all relevant stakeholders to have access to evaluative information. If different evaluation results are communicated in forms that are tailored to the interests of different stakeholders, those communications should ensure that each stakeholder group is aware of the existence of the other communications._

_Evaluators should maintain a balance between client needs and other needs._

The European Evaluation Society

The European Evaluation Society has developed a guide for evaluating EU expenditure programs. Some extracts of this guide are provided below.

It is argued that it is probably impossible to arrive at a single definition of “evaluation,” which will have universal appeal. Therefore, it was chosen to identify some crucial elements which should normally characterize evaluations:

• “evaluations should be analytical — they should be based on recognized research techniques”

• “evaluations should be systematic — they require careful planning and consistent use of the chosen techniques”;

• “evaluations should be reliable — the findings of an evaluation should be reproducible by a different evaluator with access to the same data and using the same methods of data analysis”;

• “evaluations should be issue-oriented — evaluations should seek to address important issues relating to the programme, including its relevance, efficiency and effectiveness”; and
• “evaluations should be user-driven — this means that successful evaluations should be designed and implemented in ways that provide useful information to decision-makers, given the political circumstances, programme constraints and available resources.”

The European Evaluation Society stresses that the usefulness of an evaluation will depend on its findings, conclusions and recommendations, and on how well these are reported and disseminated. The following thoughts were expressed on how reporting and disseminating an evaluation can contribute to its utilization: target the message to the audience; ensure that evaluation reports are timely; and involve stakeholders in the design of the evaluation. It is further noted that the evaluation report should follow a logical structure. An example of a typical structure for an evaluation report contains the following elements: title page; table of contents; executive summary; introduction (e.g., purpose of the evaluation in terms of scope and main evaluation questions); research methodology (e.g., design of research, analysis of data); evaluation results; and annexes.

In order for an evaluation to be useful, it must be understood. The European Evaluation Society argues that this is the primary responsibility of the evaluator. However, it is recognized that the sponsor may be called upon to defend the report to stakeholders and other audiences, and so the responsibility is to some extent shared. An evaluation report should be written such that a potential reader is able to understand: the purpose of the evaluation; exactly what was evaluated; how the evaluation was designed and conducted; what evidence was found; what conclusions were drawn; and what recommendations, if any, were made.

It is further recognized that writing an evaluation report can be challenging. “On the one hand, the report must provide sufficient information in an analytically rigorous way to constitute a firm foundation for conclusions and recommendations. On the other hand, the report must be comprehensible to the intelligent non-specialist.” Therefore, technical language should be kept to a minimum and technical or unfamiliar concepts should be explained. It is noted that the clarity of an evaluation report can be reduced due to:

• “failing to describe the programme being evaluated in sufficient detail (i.e., assuming that everyone who reads the evaluation report will be sufficiently acquainted with the programme and its rationale)”;

• “failing to describe the methods used in the evaluation for the collection and analysis of data, to justify the choice of methods used or to indicate the strengths and weaknesses of the selected methods”;

• “using information without giving the source”;

• “arriving at findings which are not based firmly on evidence”;

• “reaching conclusions which are not explicitly justified (i.e. not systematically supported by findings), so that an independent reader cannot assess their validity”; and

• “making recommendations which are not adequately derived from conclusions.”

(b) International Organization for Standardization
The International Organization for Standardization (ISO) has been developing voluntary technical standards over almost all sectors of business, industry and technology since 1947. ISO has member bodies all around the world. ISO has expressed its views on how conformity assessment works. Certification/registration comes down to the written assurance by a third party that a product, service, system, process or material conforms to specific requirements. The most well known examples are the certification of quality management systems and environmental management systems as conforming, respectively, to ISO 9000 and ISO 14000 standards. More than 360,000 organizations worldwide have been certified to an ISO 9000 and/or ISO 14000 standard. It should be noted that ISO itself does not assess the conformity of quality or environmental management systems to ISO 9000 or ISO 14000 standards.
standards. ISO does not issue certificates of conformity to these standards. ISO 9000 and ISO 14000 certification is carried out independently of ISO by more than 720 “certification” or “registration” bodies active nationally or internationally. Although ISO does not control the certification bodies, it contributes to best practice and consistency in their activities through ISO/IEC Guide 62, which states the general requirements for certification bodies carrying out assessment and certification/registration of quality systems. ISO/IEC Guide 66 does the same in connection with environmental management systems. ISO/IEC Guide 28 offers general rules for a model third-party certification system for products. ISO/IEC Guide 65 states the general requirements that a third party operating a system must meet if it is to be recognized as competent and reliable.

The Joint Standards Australia/Standards New Zealand Committee and the International Standards Organization (ISO) have been involved in setting standards and reporting requirements for a number of years on a variety of topics. In order to glean an appreciation of the methods and description of reporting requirements, a review was undertaken of the following standards:

- AS/NZS ISO 14012: 1996 Guidelines for environmental auditing — Qualification criteria for environmental auditors
- AS/NZ4360: 1995 Risk Management

These standards are relevant to the issue of levels of assurance other than high as the subject matters — environmental auditing, quality systems, risk management — include those involved in engagements where a moderate level of assurance may be provided.

It was found in all instances that the standards are deliberately instructive of processes e.g. how individuals undertaking an activity should proceed rather than offering creative solutions to problematic issues. Consequently, reporting on the activities undertaken is secondary. In fact there are very few comments on the levels of assurance provided or reporting considerations. In one instance it is suggested that “audit report formats should be formalized to the extent practicable.” In another instance it is suggested that the “audit report should faithfully reflect both the tone and content of the audit.” In no instance was any reference made to the level of assurance provided, or determinants of the level of assurance, in the report.

A more detailed review was undertaken on the Risk Management standard as this was one of the specific assurance service areas suggested by the SCAS. Despite there being no specific reporting references in the standard, mention is made when undertaking risk analyses that likelihood of a risk occurring be expressed in terms of probability, frequency or a combination of exposure and probability. One could infer that built into such a methodology is an inference about differing levels of assurance/probability of an event/risk occurring, and this would have implications for reporting.

(c) The Internal Auditors Association

The Internal Auditors Association is responsible internationally for the development of standards applicable to members undertaking work roles associated with Internal Auditing. Due to the diversity of
work undertaken by this profession, much of it centers around risk assessment and management as opposed to financial aspects. It was thus considered worthwhile to review standards relating to reporting.

Standard 430 specifically deals with reporting and communicating results. Whilst the standard highlights the reporting of discussions and conclusions, and the purpose, scope and results of the audit, it does not make reference to conveying a certain level of assurance. Specific Standard 410 “Planning the Audit” also discusses the reports design. Again no specific reference is made to providing a “level” of assurance. Rather, detailed findings along with recommendations are considered the desired output.

(d) Public Sector

Audits are also undertaken within the public sector and are in compliance with the various legislative requirements of the public sector entity and the country/environment in which the activity is taking place. The US “Yellow Book” contains Government Auditing Standards for audits of government organizations, programs, activities, and functions, and of government assistance received by contractors, nonprofit organizations, and other nongovernment organizations. In the government auditing standard on assessing the reliability of computer-processed data, it is stated that:

Completeness and accuracy reporting requirements of the Yellow Book and GAO’s Communications Manual require that data sources and the methods used to determine data reliability should be stated in the report. When material is included in a report for background or informational purposes and is insignificant to audit results, staff can normally meet this reporting standard by citing the data source in the report.

For computer-processed data which is critical to the assignment’s objective(s), the report should assure readers that the information relied on is credible and reliable. Specifically, it should

- identify the scope of work done when system controls are relied on to reduce data testing, and
- describe the testing of the computer-processed data, including the tests performed, their purpose, and the error rates disclosed.
- present any factors known to limit the data’s reliability and if significant, the sensitivity of the results to the accuracy of the data.

The standard further requires that auditors/evaluators should consider the appropriateness of presenting any conclusions or recommendations based on the data. Examples of report language are given that can be used to meet established reporting standards. In particular, in case:

- Reliable Data Is Used
  
  To achieve the assignment’s objective(s) we extensively relied on computer-processed data contained in [cite data base used]. We assessed the reliability of this data including relevant general and application controls and found them to be adequate. We also conducted sufficient tests of the data. Based on these tests and assessments we conclude the data are sufficiently reliable to be used in meeting the assignment’s objective(s).

- Unreliable Data Still Usable
  
  To achieve the assignment’s objective(s) we extensively relied on computer-processed data contained in [cite the data base used]. Our review of system controls and the results of data tests showed an error rate that casts doubt on the data’s validity. However, when these data are viewed in context with other available evidence, we believe the opinions, conclusions, and recommendations in this report are valid.

- Unreliable Data Not Usable
  
  To achieve the assignment’s objective(s) we extensively relied on computer-processed data contained in [cite the data base used]. Our review of system controls and the results of data tests showed an error rate that casts doubt on the data’s validity. Since the assignment’s objective(s) require specific statements based on this data and sufficient independent evidence is not available, we were unable to provide specific projections, conclusions, or recommendations.

- Reliability Is Not Determined
The Determination and Communication of Levels of Assurance Other than High

To achieve the assignment's objective(s) we extensively relied on computer-processed data contained in [cite the data base used]. We did not establish the reliability of this data because [cite the reason(s)]. As a result, we are unable to provide projections, conclusions, or recommendations based on this data. Except as noted above, GAO’s work was conducted in accordance with generally accepted government auditing standards.

A review was also undertaken of the public sector in Australia, in particular of the Audit Office (NSW Auditor General), along with the reporting requirements of the Federal Auditor General. Section 58 of the Financial Management and Accountability Act 1997 requires the Auditor-General to make various statements regarding the preparation of the financial statements. The audit report is an opinion, similar to the audit reporting framework in the private sector. It is somewhat more detailed, however, no indication of the level of assurance to be attached to such a report is indicated. On inquiry of the Assistant Auditor General of NSW, an identical situation was apparent. He stated that levels of assurance had not been contemplated within the public sector. The various Acts require “an audit” which attaches a certain level of assurance under the current auditing standards. The belief was that within the public sector reporting framework describing a level of assurance is not on the agenda.

A further review was undertaken of a number of Performance Audit Reports: should these reports indicate something other than an “audit,” then the reporting may infer a level of assurance other than high. The reports all contained a great degree of detail. The words “Audit” and “Audit Opinion” were used which then assumes the same level of assurance as attached to the financial statement audit opinion. The scope of the audits was detailed, along with factual findings. The audit opinion proved to be a statement of fact rather than the expression of an opinion, e.g., “the audit office concluded” was the wording used. There was also no reference to the work effort undertaken.

The Canadian public sector provides an interesting counterpoint to the Australian experience. Their “value for money” work is undertaken with a view to identify and report significant issues, provide recommendations for improving controls and achieving legislated objectives. The objectives for each engagement are specified clearly, with the work being designed to conclude on these specific objectives. In almost all cases, work is planned and performed to provide an “audit level” (i.e., high) level of assurance. In contrast to Australia, however, reporting in the Canadian public sector does occur at different levels of assurance. Reasons such as the nature of the program/activity being examined; limitations in the Audit Act or the cost of providing a high level of assurance, lead to the performance of an engagement labeled a “review.” This is deemed to provide a moderate level of assurance, due to the limited examination and testing of systems it involves and the fact that much of the evidence available is persuasive rather than conclusive in nature.

(e) Information Security Product Evaluation

Information Security Product Evaluation against recognized criteria provides assurance that a security product will provide the security expected whenever it is required. The Australasian Information Security Evaluation Program (AISEP) has been established to meet the increasing demand for information security evaluation. Prior to 1995, all information security evaluations were performed by the Defense Signals Directorate (DSD), in its role as the National Computer Security Advisory Authority. Under AISEP, evaluations are performed by impartial companies against internationally recognized standards, the Information Technology Security Evaluation Criteria (ITSEC) and the Common Criteria. The results of these evaluations are certified by DSD as having rigorously followed the criteria in all aspects. Only companies licensed by DSD may perform such evaluations. DSD has examined these companies (known as AISEFS: Australasian Information Security Evaluation Facilities) to ensure that they meet the strictest standards of technical expertise, quality control and commercial integrity. The Information Technology Security Evaluation Criteria (ITSEC) are uniform standards adopted by the UK, France, Germany, the Netherlands and the EC). Some useful extracts from ITSEC are provided below:
Assurance needs to be addressed from several different points of view and, in these harmonized criteria, it has been decided to distinguish confidence in the correctness in the implementation of the security enforcing functions and mechanisms from confidence in their effectiveness.

Evaluation of correctness assesses whether the security enforcing functions and mechanisms are implemented correctly. Seven evaluation levels labeled E0 to E6 have been defined, representing ascending levels of confidence in correctness. E0 represents inadequate confidence. E1 represents an entry point below which no useful confidence can be held, and E6 represents the highest level of confidence. The remaining levels represent an interpolation in between. Correctness is addressed from the point of view of construction of the Target of Evaluation (TOE), covering both the development process and the development environment, and also the point of view of operation of the TOE.

The six successful evaluation levels E1 to E6 span a wide range of potential confidence. Not all of these levels will necessarily be needed by or appropriate for all market sectors that require independent evaluation of technical security measures. Not all combinations of functionality and confidence will necessarily be sensible or useful. For example, low confidence in the functionality required to support a military multilevel security requirement will not normally be appropriate. In addition, it is unlikely that high confidence in the correctness of a TOE will be combined with a requirement for a low strength of mechanisms.

In order for the results of an evaluation against these criteria to be certified by a national certification body, the evaluator will have to produce a report containing the results of evaluation in a form acceptable for consideration by the certification body. The precise format and content of such reports are beyond the scope of these criteria.

In this section we have provided an overview of providers of assurance services outside the accounting profession. In general, these other professions give limited attention to the issue of the determination of assurance. Probably the only surprising observation in this area is that the ITSEC assumes six confidence, or assurance, levels. On the communication issue, there is more relevant material. A first observation is that the other providers of assurance services have hardly standardized their engagement reports. Hence, the design of assurance reports varies from engagement to engagement. A second observation is that the other providers in general recommend a detailed, or long, engagement report. The details concern in general the engagement objectives, scope, activities conducted and the conclusion.

### 3.8 Summary and Conclusions

In this chapter we have reviewed the initiatives undertaken by professional associations, both in accounting and other professions, in order to help identify the determinants of levels of assurance other than high, and methods for best communicating this. We review the current auditing theory, as well as other initiatives of assurance services professions, to help us in this undertaking.

In our review of the audit risk model we find that, taking a broad definition of work effort, an appropriate level of assurance can be obtained by exerting the appropriate level of work effort. What are the implications of this finding for this study, in particular is there evidence that factors other than work effort are not important? As identified in the chapter, the financial statement audit risk model is applied to a particular subject matter and well-specified criteria. Work effort is a major defining characteristic for financial statement audits or reviews. The criteria for financial statement audits are well accepted. As this model stems from a particular type of engagement where the subject matter and criteria are well-accepted, it is concluded however that it provides limited guidance in identifying the determinants of assurance in engagements where the subject matter and criteria are not as clearly defined.

It has been argued that subject matter may be important in so far as the information is historical or future oriented. We do see that the financial statement audit has a combination of historical and future-oriented objectives. However, the predominant amount of audit effort is aimed at historical objectives, with the major future-oriented objective being the going concern assumption. It may be that the auditing profession is comfortable in providing a high level of assurance because the engagement is dominated by
historical objectives. If the assurance provider had to provide assurance only on the going concern objective, then there may be a reluctance to provide a level of assurance at the high level.

In short, current auditing theory suggests that work effort is the primary determinant of assurance, as a higher work effort reduces risk, which is the inverse of assurance. However, this theory stems from assurance relating almost exclusively to financial statements, where the subject matter and criteria are relatively well-defined. Thus caution is needed in trying to extend these general findings to a support of the work-effort model over competing models of assurance. The chapter then reviewed the initiatives of the IAPC. In our review of these initiatives we find little other than the fact that the Committee is split on the determinants of assurance, although clearly two models have become dominant over time: the work effort model and the interaction of variables model. There is little beyond re-iteration of stated positions regarding the determinants of assurance. With regards the best means of communicating levels of assurance other than high, it appears there has been less discussion of this issue, on the basis that it is necessary to identify the determinants of assurance first, and that this will have an effect on how best to communicate the level of assurance.

The initiatives of the SCAS were also reviewed. At early stages of the development of SCAS it was appreciated that frameworks for assurance services and reporting models may be an impediment to their development. The emphasis was on developing innovative new assurance services, and there was less emphasis on the communication aspect. It was widely acknowledged that new concepts of reporting needed to be developed which effectively communicated the nature and extent of the assurance effort and assurance findings. However, in reviewing the evolution of these services, issues of communication appear to have become a major influence in their development.

As far as the development of these services is concerned, it appears that subject matter has become a determinant of assurance. These services have been developed with their own task forces, and communication recommendations are not consistent across the services. It is interesting to note that for some services, such as SysTrust, only a high level of assurance is allowed to be provided. The justification for this is not clear. It is also interesting to see that cautionary language is added to the suggested report for other services such as WebTrust, again highlighting the fact that subject matter is important. This suggests that there are more factors than work effort considered in determining the level of assurance and the communication considerations.

We also reviewed developments in the area of two assurance services: internal control reporting and environmental and sustainability reporting. Internal control reporting is widely acknowledged as one of the most developed assurance services outside those associated with financial statements. The development of practice and technical guidance of the various professional bodies on internal control assurance highlights some of the variations in the way in which practice has evolved around the world. There are differences in the factors that are perceived to affect the level of assurance, as shown by the difference in the US attestation and Canadian assurance approach, which emphasize work effort, and the UK and Australian approaches, which see a number of factors interacting to create the level of assurance. For this service the form of communication tends to follow the philosophy associated with the service in each country, with the factors deemed to be determining the assurance level provided being communicated to the users of the assurance service.

Are the two views expressed inconsistent? We know that reviews of internal control are currently being undertaken in practice in various parts of the world. We know that in the UK there is a distinction made between providing assurance on internal control design and providing assurance on the operation of a system of internal control in accordance with its design, with each of these engagements having a clearly different scope. It is argued in the UK that it is possible to provide a high level of assurance on operations,
but not on design. Under the North American approach, if it was true that a high level of assurance could
not be offered on design, then assurance services on design issues would not be permitted.

The UK approach to the determinants of assurance for internal control clearly indicates that the subject
matter is important, and further, within subject matter there are sub-components that are important. The
major distinction made within subject matter in this review to date has been on the basis of historical
versus future-oriented. However, the subject matter within internal control is not future-oriented. The
subject matter relates to the unique characteristics of internal control which include the nature of the
entity, and the extent of the practitioner’s knowledge. In engagements where the subject matter also
includes management’s risk identification process, the absence of suitable criteria is highlighted.

There are some suggestions that the nature of the client becomes a defining characteristic of the level of
assurance that can be provided. We are unclear of the basis on which this suggestion has arisen, and
believe that this would not be an appropriate basis on which to write guidance. At least to date the basis
for this factor has not been clearly and convincingly argued. It may be better seen as an “inherent risk”
characteristic, and may drive the amount or type of evidence that is sought. Another suggestion has been
that the extent of the practitioner’s knowledge becomes a defining characteristic of the level of assurance
that can be provided. We are also unsure of the basis on which this suggestion has developed. This again
seems undesirable as a basis for giving guidance on the level of assurance that can be provided. The
general view is that the practitioner should always have the appropriate level of knowledge before they
accept an appointment.

It has also been argued that the suitability of criteria be a factor determining the level of assurance. There
is agreement that suitability of criteria affects the level of assurance. The difference is the approach
suggested for this factor. In Canada and the US it is argued that the service should not be provided without
suitable criteria. In other countries the suitability is a determining factor. With regards the impact of the
suitability of criteria, for an international standard setting body aiming to position the profession as a high
quality provider of assurance services, it may be considered desirable that it provides guidance as to what
constitutes suitable criteria, and encourages the use of international best practice criteria. It could possibly
recognize that in some countries, best practice criteria may not be sufficient if they do not meet all the
conditions of suitable criteria, and in other countries best practice may be encouraged, even if a high level
of assurance cannot be achieved. It however appears desirable that the IAPC issue standards that apply to
all its constituents.

There is very little thought given to the communication issues associated with internal control reporting
other than providing an inherent limitations section paragraph on the nature of the internal control service
in the body of the report. This appears to be a widely regarded way of reporting and effectively
communicating the nature of this service. However, there is currently little evidence on the effectiveness
of this method of communication.

The second assurance service that was examined in detail was the issuing of assurance on environmental
and sustainability reports. The GRI, which is providing guidelines in this area, has given some substantial
thought to the determinants of assurance. One of the assumptions is that subject matter does influence the
level of assurance. Further, the sustainability service is also of interest because it is possible to trace the
evolution of suitable criteria for this service (see Wallage, 2000, for a description of the process of
obtaining suitable criteria for sustainability reports). Even though the criteria to date may not meet the
standard of “suitable” (in some eyes), there are criteria that are emerging as world best practice. The
tracing of this service highlights one of the dilemmas for the IAPC. This is the dilemma between the
development of innovative assurance practices and control and maintenance of the reputation of the
It is very hard to determine what are suitable criteria, and this seems to be one of the greatest value-adding activities that IAPC and national professional bodies can provide for their members.

The other thing that is highlighted by the review of this assurance service is the profession should be careful in using the term “suitable criteria,” especially in the context of being either suitable or not suitable. For a profession that wants to be at the forefront of providing high quality assurance, it appears that the criteria that should be specified are best practice criteria. If criteria that were suitable (or best practice) and were used last year have been superceded this year, the current best practice guidelines should be the criteria that members are encouraged to use.

A review was made of other accounting-related assurance services literature that was considered relevant. This started with a review of the 1980 CICA research study, which examined assurance at levels other than high. This shows that the issues have been around for over 20 years, and also that the Canadian profession has been at the forefront of discussion over this period. The comprehensive 1980 framework highlights audit effort, auditability of the representation, and professional competence of the attestor as determinants of the level of assurance. Auditability essentially deals with the subject matter of the engagement: the study highlights that certain representations may not be susceptible to satisfactory verification. Suitable criteria are recognized to be a vital precondition to auditability, although the CICA research study does not examine this issue in detail. Again, these determinants are analogous to those identified in the IFAC framework. Thus the framework suggested could be argued to be more consistent with the interaction of variables approach than the work effort approach.

The CICA research study also identifies the reporting alternatives for engagements of a lower level of assurance as a listing of findings and an expression of assurance. An expression of assurance is “in concept at least, a significant step beyond a list of findings. It represents an explicit extrapolation from specific findings to the reliability and fairness of the representation taken as a whole. This, in turn, requires that the public accountant evaluates his results and decides whether they support, or give cause to doubt, the representation.”

The CICA and the AICPA have also recently developed very comprehensive standards on assurance or attestation services. This is consistent with these two countries adopting a more prescriptive approach towards the development of these services. Both countries emphasize the work effort approach, although the US has written their standards on a subject-by-subject basis, indicating that subject matter is important. As far as the communication aspect is concerned, both countries emphasize the negative assurance reporting approach, on the basis that this appears to be well-understood by their constituents.

Other countries have tended to advocate approaches more consistent with the interaction of variables approach. In the UK, this did get considerable criticism at the discussion stage of the Independent Review. Issues of difficulty of communication arose, with the difficulties of reporting anything less than a high level of assurance highlighted. In a review of assurance services in Germany it was concluded that there was little discussion about different levels of assurance and their communication issues.

Finally, a review was undertaken of the initiatives undertaken by groups of assurance providers and standards setters outside the accounting profession. This included the International Standards Organization, the Internal Auditors Association, various public sector groups, and other organizations. It is true to say that the discussion of the determinants of assurance, and how the levels of assurance can best be communicated, seems to be at a lower level than the discussions that are occurring within the accounting profession. Nonetheless, some interesting insights were gleaned from other groups’ approaches to assurance. For example, Information Security Product Evaluation contemplates six levels of assurance (against internationally recognized criteria), while recognizing that not all of these levels will
necessarily be required or appropriate for all market sectors. In terms of reporting on assurance engagements, it appears that in most cases, other professions have chosen the option to use long and detailed reports for assurance engagements.
CHAPTER 4: RESULTS: MODERATE ASSURANCE QUESTIONNAIRE FOR NATIONAL INSTITUTES

4.1 Introduction

The following two chapters specifically address two of the research questions presented in Chapter 1: (1) What can we learn from the various national environments about the determination and communication of levels of assurance other than high?; and (2) Are there innovative reporting practices in the various assurance practices from which we can learn about the determination and communication of levels of assurance other than high? To address these questions, empirical evidence on current practice was collected. This evidence relates to national practices and regulations (Chapter 4) and to audit firm practices (Chapter 5) regarding the determination and communication of assurance levels. While the two areas are somewhat related, the findings are presented in two separate chapters to enable a more detailed analysis of each set of results.

This chapter describes the results of the moderate assurance questionnaires received from the National Institutes of 12 countries. It was agreed that no specific reference to a particular National Institute would be made. The results consequently are presented in such a manner as to maintain anonymity while being as informative as possible. The IAPC contacted the National Institutes of each of the countries and requested them to participate. The questionnaire was structured around two main types of questions: questions relating to the determinants of a moderate level of assurance and questions relating to the communication of a moderate level of assurance. We have received a response from all 12 National Institutes, which gives us a response rate of 100%.

This chapter is structured as follows. A review of the questionnaire methodology will be outlined first and then the results of the questionnaire with respect to the determinants of a moderate level of assurance from the viewpoint of National Institutes are presented. Subsequently the results of the questionnaire with respect to the way in which a moderate level of assurance is communicated, are presented. Finally, conclusions are drawn.

4.2 Steps Undertaken in Designing and Administering the Questionnaire

In order to collect empirical evidence on the current practice in various national environments relating to the determinants and communication of assurance levels, a survey was undertaken. Given the descriptive and exploratory nature of the research, a questionnaire survey was deemed the most appropriate method to address the research questions formulated in the introduction. Our research is classified as exploratory and descriptive since it deals mainly with questions on current practice. The research does not have a theory-testing purpose.

The survey questionnaire was designed around two types of questions: (a) determinants of a moderate level of assurance; and (b) communication of a moderate level of assurance. Both open-ended and closed-ended questions were used. An initial questionnaire proposed by the ISAR research team was pilot-tested by the members of the IAPC sub-committee on moderate assurance. Subsequently, it was discussed with the ISAR research team, adjustments were made, and a consensus was reached on the final version of the questionnaire.

The survey was sent to the National Institutes of twelve countries. The countries chosen provide a wide cross-representation of the various parts of the business world, which was the primary selection criterion.
The second selection criterion was the likelihood of co-operation from the country to which the questionnaire was sent. The questionnaire was completed by and/or under the responsibility of the technical advisors of each of the National Institutes.

### 4.3 Determinants of a Moderate Level of Assurance

This section presents the results from that part of the questionnaire examining the determinants of a moderate level of assurance. The questions relate to: the national definition of a moderate and high level of assurance; national regulations/standards/practice conventions regarding the factors affecting the level of assurance; national regulations/standards/practice conventions that determine which level of assurance should be given in a particular situation; and suggestions for improvement of national regulations/standards/practice conventions.

#### National definition of a moderate level of assurance

**Question: What is the national definition of a moderate level of assurance?**

Most countries do not have a national definition of a moderate level of assurance. Four have adopted (or intend to adopt) the definition of IFAC formulated in ISAE 100 on Assurance Engagements. IFAC defines a moderate level of assurance as follows: “The expression ‘moderate level of assurance’ refers to the professional accountant having obtained sufficient appropriate evidence to be satisfied that the subject matter is plausible in the circumstances” (ISAE 100). In another, the term moderate level of assurance is defined in terms of procedures performed.

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<tr>
<th>Country</th>
<th>National definition of a moderate level of assurance</th>
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<td>I</td>
<td>Notes</td>
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<td></td>
<td>IFAC/Other/None</td>
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<tr>
<td>1</td>
<td>IFAC Intends to issue country-adapted version of ISAE 100 and so will adopt the definition of moderate assurance contained in that document. The only other current references to moderate assurance appears in auxiliary statements where “Review means a service where the auditor’s objective is to provide a moderate level of assurance, being a lower level of assurance than that provided by an audit, through…” Also “A review engagement provides a moderate level of assurance that the information subject to review is free of material misstatement. The report provides this assurance in the form of a “Statement” of negative assurance.” It is anticipated that terminology consistent with ISAE 100 will be used throughout eventually.</td>
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<td>2</td>
<td>None</td>
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<tr>
<td>3</td>
<td>IFAC</td>
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<td>4</td>
<td>None</td>
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<td>None</td>
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In cases of moderate assurance, the auditor’s opinion contains a passage saying that no audit has been performed which indicates that the auditor’s work has been less extensive and therefore with a lower level of assurance than in audit cases.

The conceptual framework of the country does not contain a definition of a “moderate” level of assurance but rather a definition of a review engagement, of which the objective is to provide a “moderate assurance”. A review engagement enables the auditor to provide a lower level of assurance than that resulting from an audit, that the financial information examined does not include significant misstatements. This assurance called “moderate assurance” is expressed under the form of a negative assurance in the auditor’s report.
The Determination and Communication of Levels of Assurance Other than High

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<tr>
<th>Country</th>
<th>National definition of a moderate level of assurance</th>
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<td>6</td>
<td>None Due to the uncertainties surrounding the future contents of ISAE 100 given the research project, the country has not yet incorporated ISAE 100 into its standards. At the present time the country does not prescribe a definition of moderate assurance for reviews of financial statements nor for other assurance engagements. A draft standard proposes that a review engagement represents an assessment of the plausibility of the accounting (defined as the financial statements, the bookkeeping system and the management report) and points out that the reasonable assurance that would have been obtained in an audit is not acquired therewith.</td>
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<td>7</td>
<td>None There is no explicit definition of moderate assurance in the auditing standards. However, an “interim audit” is regarded as providing a lower level of assurance than an audit of financial statements. Although an “interim audit” provides a lower level of assurance than that provided by an audit of financial statements, it is regarded as providing a relatively higher level of assurance than the moderate level of assurance. In other words, the level of assurance provided by an “interim report” lies between the high level of assurance and the moderate level of assurance defined by IFAC.</td>
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<td>8</td>
<td>None A recent exposure draft states: “Reports on attest engagements should be limited only to two different levels of assurance: one, based on an attest risk reduction to an appropriate low level (an “examination”) and the other, based on a reduction of the attest risk to a moderate level (a “review”).”</td>
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<td>9</td>
<td>None The expression moderate level of assurance has not been formally defined in the national standards. However, in specific guidance for auditors the concept is consistent with the IFAC “Framework of International Standards on Auditing” as it existed at that time. In particular, the purpose of an engagement to give a negative assurance conclusion is to express a moderate level of assurance. More recently, in non-mandatory guidance on the review of interim financial information, it was stated that a review provides a moderate level of assurance, i.e., a lower level of assurance than an audit. In order to ensure that the level of assurance provided is properly understood, auditors state in their review report that an audit opinion is not expressed on the financial information.</td>
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<td>10</td>
<td>Other The term “moderate level of assurance” is not defined in the same manner as the IFAC definition. Guidance states that in an attest engagement designed to provide a moderate level of assurance (referred to as a review), the objective is to accumulate sufficient evidence to restrict attestation risk to a moderate level. To accomplish this, the types of procedures performed generally are limited to inquiries and analytical procedures (rather than also including search and verification procedures). Attestation Risk is defined as the risk that the practitioner may unknowingly fail to appropriately modify his or her attest report on the subject matter or an assertion that is materially misstated.</td>
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<td>IFAC</td>
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<td>12</td>
<td>IFAC</td>
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National definition of a high level of assurance

Question: What is the national definition of a high level of assurance?

Four countries are currently working with a national definition that is consistent with IFAC’s definition of a high level of assurance. Seven countries have not developed a national definition of a high level of assurance while one has adopted their own definition. According to the National Institutes of four countries that have not developed their own definition, a high level of assurance comes down to reasonable assurance that the subject matter is free from material misstatements. Clearly, this is very similar to IFAC’s definition. IFAC defines a high level of assurance as follows: “The expression ‘high level of assurance’ refers to the professional accountant having obtained sufficient appropriate evidence to conclude that the subject matter conforms in all material respects with identified suitable criteria” (ISAE 100). In another country, the level of assurance provided by an audit performed in accordance with the relevant Law is deemed to be the same as the high level of assurance defined by IFAC. Whilst in yet another country, the term high level of assurance is defined in terms of procedures performed.
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<th>Country</th>
<th>National definition of a high level of assurance</th>
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<tr>
<td>IFAC/ Other/ None</td>
<td>Notes</td>
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<td>1</td>
<td>IFAC</td>
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<td>2</td>
<td>None</td>
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<td>IFAC</td>
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The expression high level of assurance has not been formally defined in the National Standards. However, guidance provided by the National Institute discussed this concept in a manner consistent with the IFAC Framework. In particular, the purpose of an engagement to give a positive assurance opinion is to express a desired opinion with a high level of assurance. More recently formed, non-mandatory guidance on the review of interim financial information published by listed companies, states: An audit provides a high level of assurance. It is designed to obtain sufficient appropriate audit evidence to provide reasonable assurance that the financial statements are free of material misstatement.

National regulations/standards/practice conventions regarding the factors affecting the level of assurance

Question: Are there any specific national regulations/standards/practice conventions regarding the factors affecting the level of assurance?

Some countries do have national regulations/standards/practice conventions regarding the factors affecting the level of assurance. However, there appears to be no consensus on the factors affecting the level of assurance. One country has adopted an interaction of variables (subject matter, criteria, process, quality and quantity of evidence) approach, while three others relate the level of assurance provided solely to the work effort involved.

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<tr>
<th>Country</th>
<th>National regulations/standards/practice conventions regarding the factors affecting the level of assurance</th>
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<tr>
<td>Yes/No</td>
<td>What do they state?</td>
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<tr>
<td>1</td>
<td>Currently the National Standards distinguish between an audit (high but not absolute assurance) and a review (moderate level assurance). There is an interaction of variables approach (subject matter, criteria, process, quantity and quality of evidence) with some subject matters considered not capable of being given high-level of assurance regardless of the level of work effort performed, generally because adequate benchmarking criteria do not exist. National Standards exist currently primarily (but not solely) with respect to engagements involving financial information. The adaptation of ISAE 100 will see coverage extend more to non-financial information in terms of both high-level and moderate-level assurance.</td>
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<td>Country</td>
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**National regulations/standards/practice conventions that determine which level of assurance should be given in a particular situation**

*Question: Are there any specific national regulations/standards/practice conventions that determine which level of assurance should be given in a particular situation?*

Most countries have developed national regulations/standards/practice conventions that determine which level of assurance should be given in a particular situation. In general, national auditing standards permit a lower (moderate) level of assurance for assurance engagements other than those in relation to financial assets. However, these standards do not typically define moderate and high levels of assurance explicitly, focusing instead on the adequacy of the standards for the conduct of the relevant engagement. Standards defining means of obtaining sufficient relevant and reliable evidence are of particular importance because the practicing accountants express no opinion. The less comprehensive such standards or generally accepted practice, the more that a particular user relies on the skill and judgment of the particular practicing accountants, and the general qualities which underlie their work.

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¹ No, since there is no definition as such of the different levels of assurance provided. The approach with respect to the assurance provided is focused on the definition of the different types of engagements.
statements. One country also noted the possibility of a combination of levels of assurance within a single report for certain engagements. In another country the Standards prohibit a review when providing assurance on prospective financial information, internal control, and compliance with laws and regulations. All of these services need to be delivered with either a high level of assurance or with no assurance at all. Provision of a moderate level of assurance is allowed for attesting pro forma financial information and for attesting management’s discussion and analysis, provided that the related financial statements are audited.
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<th>Country</th>
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<tr>
<td>Yes/No</td>
<td>What do they state?</td>
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<td>1</td>
<td>Yes Some reports prepared by auditors address both levels of assurance within a single document. For instance, the prudential regulator for authorized deposit-taking institutions in the country requires auditors, separately from the annual financial report audit, to provide an opinion on compliance with Prudential Standards and on the reliability of the qualitative and quantitative reporting to the regulator. Audit guidance requires the first of these opinions to be a positive expression of opinion and the latter, a review statement of negative assurance. A standard on prospective information calls for an opinion on historical information and a statement of negative assurance on prospective information.</td>
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<td>2</td>
<td>Yes In recent years, a number of regulators have required from auditors certain comfort in areas beyond the basic financial statements. These include the structure of internal control in general and in some particular areas of the business. For these mandatory reports, the National Institute has developed specific guidelines for each of the situations. In general, although not defined in the literature, the approach is believed to provide a low or moderate level of assurance.</td>
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<td>3</td>
<td>Yes Some legislative audit mandates, and other public sector mandates provide the audit (high) level of assurance only.</td>
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<td>4</td>
<td>Yes Law and standards regulate an audit, review and other assurance engagements. In a lot of cases, these other engagements are prescribed by law. The law, although often vague, gives the objectives of these other engagements: to “attest,” to “check the conformity,” to “verify the fairness,” to “give a conclusion”… From these objectives given by the law, the professional standard developed specifies the type of auditor’s engagement, explains what is required from the auditor, in terms of work and reporting, and states the nature of the assurance provided by the auditor. When the engagement is not prescribed by law, the professional standard defines the nature of the assurance provided.</td>
</tr>
<tr>
<td>5</td>
<td>Yes For statutory audits of financial statements, regulations provide that the audit should be designed such that material misstatements would be detected when applying due professional care. Auditing Standards have interpreted this to mean that the application of due professional care implies that reasonable rather than absolute assurance is required. Otherwise, statutes and regulation remain silent on the issue. Auditing standards currently also require reasonable assurance for assurance engagements other than those in relation to financial statements.</td>
</tr>
<tr>
<td>6</td>
<td>Yes There are auditing standards or practice statements that determine the level of assurance relevant to the following: (a) interim audits, (b) quarterly financial statements of a company listed in the particular capital market and (c) financial statements of merging entities for the particular capital market. The contents of the financial statements in (a) and (b) are intended to be “useful” to readers. The level of assurance given by the auditors’ reports in (b) and (c) is lower than for (a).</td>
</tr>
<tr>
<td>7</td>
<td>Yes Moderate and high levels of assurance are not formally defined and differentiated in the national standards, although they are discussed in guidance statements for users. These documents do not, however, discuss factors affecting the level of assurance, which should be given in a particular situation. In a Briefing Paper the National Institute recognized the publication of ISAE 100 and discussed the factors affecting the levels of assurance that can be provided in these engagements.</td>
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The Determination and Communication of Levels of Assurance Other than High

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Suggestions for improvement of national regulations/standards/practice conventions

**Question:** Do you have suggestions for improvement of your national regulations/standards/practice conventions?

There appears to be a need for a clear definition of and guidance for assurance engagements other than the traditional financial statements and review. Adoption of the ISAs is in this respect considered to be an important step for improvement.

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<th>Country</th>
<th>Suggestions for improvement of national regulations/standards/practice conventions</th>
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<tr>
<td>1</td>
<td>National Institute’s decision to adopt ISAE 100 will result in better guidance than exists currently for engagements that do not involve financial reporting primarily. However, guidance on reporting on non-financial information and well-accepted criteria often do not exist (e.g., environmental reporting). This would improve the situation. The National Institute is moving in this direction.</td>
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<td>3</td>
<td>No, the standards of the country are considered to be well-established and accepted.</td>
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<td>4</td>
<td>Translating ISAs into the local language – a process that has been initiated.</td>
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<td>5</td>
<td>The National Institute considers that the approach and the rationale developed in ISAE 100 is very interesting, especially by the possibility it gives to carry out assurance engagements on a wide range of subject matters, and considers how to transform it into its own standards.</td>
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<tr>
<td>6</td>
<td>The Standard on assurance engagements in relation to the preparation of the financial statements by the public accountant should be clearer as to the level of assurance being obtained and this ought to be reported in the report accompanying the financial statements prepared.</td>
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<tr>
<td>7</td>
<td>Accountants are authorized only to engage in audits of financial statements and other related services under the profession’s rules. There has been no clear definition of an assurance engagement to be conducted. However, in response to various needs for such assurance engagements other than audit, the National Institute is to prepare assurance statements applicable to such needs.</td>
</tr>
<tr>
<td>8</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>A Standard (that was recently issued) is considered to be an important improvement since it represents a comprehensive reconsideration and recodification of the guidance in this area.</td>
</tr>
<tr>
<td>11</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td></td>
</tr>
</tbody>
</table>
4.4 Communication of a Moderate Level of Assurance

This part presents the results relating to the communication of a moderate level of assurance from the National Institutes of the countries under study. In particular, the questions related to: national regulations/standards/practice conventions for the wording of a financial statements review report; national regulations/standards/practice conventions for the wording of a moderate level of assurance report for services other than a review of financial statements; users’ understanding of today’s practice of current reporting on the different levels of assurance; and discussions and/or misunderstandings between professional accountants and users.

National regulations /standards/practice conventions for the wording of a financial statements review report

Question: Are there any national regulations/standards/practice conventions for the wording of a financial statements review report?

Nine of the twelve countries have their own national regulations/standards/practice convention for the wording of a financial statements review report. In most of these countries, the wording of the statement of negative assurance is in line with ISA 910.

National regulations /standards/practice conventions for the wording of a moderate level of assurance report for services other than a review of financial statements

Question: Are there any national regulations/standards/practice conventions for the wording of a moderate level of assurance report for services other than a review of financial statements (e.g., wording of an environmental report providing a moderate level of assurance)?

Six countries have established national regulations/standards/practice conventions for the wording of certain types of moderate level of assurance services other than a review of financial statements. The types of assurance services for which standard wording is suggested are outlined in the table below.

<table>
<thead>
<tr>
<th>Country</th>
<th>National regulations /standards/practice conventions for the wording of a moderate level of assurance report for services other than a review of financial statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Yes</td>
</tr>
<tr>
<td>2</td>
<td>No</td>
</tr>
<tr>
<td>3</td>
<td>Yes</td>
</tr>
<tr>
<td>4</td>
<td>No</td>
</tr>
<tr>
<td>5</td>
<td>No²</td>
</tr>
</tbody>
</table>

² No, since the wording of the conclusion of the assurance engagements other than audit or review, is adapted to the nature of the subject matters examined and to the objectives of the engagements, and is often conditioned by wording of the law which prescribes the engagement. It can thus range from a
The Determination and Communication of Levels of Assurance Other than High

<table>
<thead>
<tr>
<th>Country</th>
<th>National regulations/standards/practice conventions for the wording of a moderate level of assurance report for services other than a review of financial statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>Yes  Preparation of the financial statements with an assessment of the plausibility of the bookkeeping system and the inventory of assets and liabilities (the review is of the bookkeeping system and the inventory of assets and liabilities, not of the financial statements).</td>
</tr>
<tr>
<td>7</td>
<td>No</td>
</tr>
<tr>
<td>8</td>
<td>No</td>
</tr>
<tr>
<td>9</td>
<td>No</td>
</tr>
<tr>
<td>10</td>
<td>Yes  • Attestation Engagement.  • Review of Pro Forma financial information.  • Review of Management’s Discussion and Analysis.</td>
</tr>
<tr>
<td>11</td>
<td>No</td>
</tr>
<tr>
<td>12</td>
<td>Yes  • Comfort letter in connection with an offering.  • Report on examination of a forecast.  • Report on examination of internal control of a service organization.</td>
</tr>
</tbody>
</table>

Users’ understanding of today’s practice of current reporting on the different levels of assurance

Question: To what extent do you believe that users understand today’s practice of current reporting in your country on the different levels of assurance:

(a) provided on financial statements:

There is large variation in the opinion of the National Institutes concerning users’ understanding of today’s practice of current reporting on the different levels of assurance provided on financial statements. In four countries, (two scores of 1, two scores of 2, on a five point scale, where a score of 1 (5) represents that the difference between review and an audit of financial state is poorly (fully) understood by users) it is believed that there are many misunderstandings concerning the difference between a review and an audit of financial statements. There were 3 scores of 3, which indicate that these differences are moderately understood. In contrast, in another five countries (four scores of 4, one score of 5), they do not believe that the difference is generally misunderstood. The remaining three countries are in between. Improvement of users’ understanding is expected from education, greater publicity by the profession, clarification and simplification of the wording of the report.

There was no difference in perceptions of whether there were national regulations/standards/practice conventions regarding the factors affecting the level of assurance in place and users’ understandings. The six countries that responded yes to the earlier question on national regulations recorded an average score of 3.3 for users’ understandings, while the five countries that responded no to the earlier question on national regulations recorded an average score of 3.2 for users’ understandings.

(b) provided on other subject matters:

There is again no consensus among the National Institutes about the extent to which users understand today’s practice of current reporting on the different levels of assurance provided on other subject matters. The scores with regards the level of understanding on different levels of assurance provided on financial statements (part (a) above) and other subject matters were remarkably consistent, with 9 of the 12 conclusion expressed in a negative form worded for example as follows: “based on our work, we have no comment to report on the (indicate the nature of the assurance, for example the consistency) of the subject matter….” to a conclusion expressed in a positive form that confirms (with or without exceptions) that the subject matter (indicate the nature of the assurance, for example the conformity) with the described criteria.
National Institutes recording the same score, 2 countries scoring level of understanding higher, and 1 country scoring it lower. In four countries they do not believe that there are many user misunderstandings. In contrast, in another four, they believe that the different levels of assurance are poorly understood in their countries. The remaining four countries are in between. Suggestions for improvement are education, greater publicity by the profession, clarification and simplification of the wording of the reports. It is also suggested that attempts should be made to involve users in discussions regarding the desired level of assurance. (This suggestion has also been made by the GRI and others in the environmental and social reporting fields.)
(a) provided on financial statements:

<table>
<thead>
<tr>
<th>Country</th>
<th>Users’ understanding of today’s practice of current reporting on the different levels of assurance provided on financial statements</th>
<th>Suggestion for improvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>Explanation</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>4 Certain entities require either a mandatory review or audit of the half-yearly financial report. Because of the cost, most affected entities choose a review. Hence the wording of a review statement compared to an audit opinion in this context has become reasonably familiar and understood. This understanding seems to have evolved with usage of and greater familiarity with the half-yearly versus full-year report wording. However, this does not necessarily mean that the same level of understanding exists for all classes of financial report user or that it extends to other types of engagements. One aspect that does not seem well understood is that one is an “opinion” whilst the other is a “statement”. It is not clear that regulators understand this distinction either.</td>
<td>Current wording in standard seems adequate.</td>
</tr>
<tr>
<td>2</td>
<td>2 By and large, the public believes that any time an auditor is involved with a report the nature of the work is an audit.</td>
<td>Education. However, this is a long process.</td>
</tr>
<tr>
<td>3</td>
<td>5 Country has a long history of providing high and moderate levels of assurance, in both the private and public sectors. When the national assurance standards were developed, they were developed as umbrella standards for existing standards and practice, for both high and moderate levels of assurance.</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>1 • User does not read the auditor’s opinion thoroughly enough. • User lacks insight. • Auditor fails to explain his work adequately.</td>
<td>• Additional information. • Clarification of auditor’s work and liability. • Clarification of the responsibility of the management.</td>
</tr>
<tr>
<td>5</td>
<td>3 The wording of the reports should probably be clarified and simplified to facilitate the understanding by the users of the reports and help them differentiate the level of assurance actually provided.</td>
<td></td>
</tr>
</tbody>
</table>

Score ranked on a 5-point scale, with 1 representing that the difference between a review and an audit of financial is poorly understood and 5 representing that the difference between a review and an audit of financial statements is fully understood by users.
<table>
<thead>
<tr>
<th>Country</th>
<th>Users’ understanding of today’s practice of current reporting on the different levels of assurance provided on financial statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>Explanation</td>
</tr>
<tr>
<td>6</td>
<td>Because users have only very limited experience with reviews of financial statements as opposed to their preparation or audit, the differences tend to be poorly understood. On the other hand, until the year 2000 regulations allowed a “limited audit” of the financial statements for non-statutory purposes that obtains less than “reasonable assurance” without specifying the level of assurance obtained. Based on primarily verbal representations made by the profession, it became apparent that the difference between a full audit and a limited audit was poorly understood and therefore as of 2000 such limited audits are no longer allowed.</td>
</tr>
<tr>
<td></td>
<td>It is important that the differences between preparation, review and audit be clearly conveyed to the public - above all in the reports provided. The profession may need to expend more effort on public relations in these matters as well.</td>
</tr>
<tr>
<td>7</td>
<td>Users do not fully understand differences between the various levels of assurance, between a review and an audit of financial statements for the following reasons: (a) Accountants are authorized only to engage in audits of financial statements and in other related financial services under the relevant Law. Therefore engagements have historically been to a high level of assurance, i.e., an audit of financial statements. (b) Practice statements concerning “Quarterly statements and financial statements of merging entities prepared in conformity with the listing rules of the particular Stock Exchange” were only recently published (in 2000) and have not yet become fully understood.</td>
</tr>
<tr>
<td></td>
<td>It will be improved when reviews of quarterly financial statements and financial statements of merging entities prepared in conformity with the listing rules of the Stock Exchange, are more commonly conducted.</td>
</tr>
<tr>
<td>8</td>
<td>The most common form of assurance engagement on financial statements is the audit. Engagements to provide a moderate level of assurance on financial statements are much less frequent. This, in itself, makes it unlikely that the difference between audit and review of financial statements will be well understood. Moreover, the “negative assurance” statement, which has often been used for reporting on the review of financial statements, relies on the use of a double negative (“nothing has come to our attention to indicate that X is not the case”). This is an obscure and confusing construction that does not clearly convey to the reader the quantity and quality of assurance being provided.</td>
</tr>
<tr>
<td>9</td>
<td>Strawser (1991) has summarized a number of studies that compare financial statement user reactions to information with various forms of assurance. The research indicated that financial statement users are able to distinguish between assurances provided by an audit and by a review (Strawser, J.R., 1991, “The role of accountant reports in users’ decision-making processes: A review of empirical research,” <em>Journal of Accounting Literature</em>, pp.181-207).</td>
</tr>
<tr>
<td>10</td>
<td>Improving users’ understanding of practitioners’ reports is a constant concern of the National Institute. The audit and attest standards incorporate the regulators best thinking to date on this question.</td>
</tr>
<tr>
<td>Country</td>
<td>Users’ understanding of today’s practice of current reporting on the different levels of assurance provided on financial statements</td>
</tr>
<tr>
<td>---------</td>
<td>-----------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>11</td>
<td>Generally, report users are able to discern from the phrases used in the report as to the extent of assurance provided in the report.</td>
</tr>
</tbody>
</table>
| 12      | Given reports containing the two levels, they will be able to tell the difference. However, we believe there will be quite different perceptions in the market as to how “high” and “moderate” level of assurance have to be looked at in terms of the “quantitative” level of “trust” that can be derived from such a report. | 3     | (1) Whenever possible, involve users in the discussions regarding level of assurance.  
(2) Further explain what is not typically done in the context of a review. |
(b) provided on other subject matters:

<table>
<thead>
<tr>
<th>Country</th>
<th>Users’ understanding of today’s practice of current reporting on the different levels of assurance provided on other subject matters</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Score</strong></td>
</tr>
<tr>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>5</td>
<td>3</td>
</tr>
</tbody>
</table>

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4 Score ranked on a 5-point scale, with 1 representing that the difference between a review and an audit of financial is poorly understood and 5 representing that the difference between a review and an audit of financial statements is fully understood by users.
<table>
<thead>
<tr>
<th>Country</th>
<th>Users’ understanding of today’s practice of current reporting on the different levels of assurance provided on other subject matters</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Score</strong></td>
</tr>
<tr>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>7</td>
<td>2</td>
</tr>
<tr>
<td>8</td>
<td>4</td>
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<td>9</td>
<td>3</td>
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<tr>
<td>10</td>
<td>3</td>
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<tr>
<td>11</td>
<td>4</td>
</tr>
<tr>
<td>12</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Discussions and/or misunderstandings between professional accountants and users

Question: Are you aware of any discussions and/or misunderstandings between professional accountants and users:

(a) on the content of a review versus an audit of financial statements?

(b) on the content of moderate level of assurance reports for services other than the review of financial statements?

The results show that about half of the National Institutes surveyed are not aware of discussions and/or misunderstandings between professional accountants and users neither on the content of a review versus an audit of financial statements, nor on the content of a moderate level of assurance report for services other than the review of financial statements.

In one country, the regulator, which holds responsibility for matters in respect of Corporations Law, has expressed some concern at auditor reporting with respect to prospective financial information. This includes concern over pro forma financial statements. An empirical study based on local data has shown that the level of understanding for other than financial report engagements needs to be improved (Roebuck, et al., 2000, which was discussed in detail in Chapter 2 of this study).

Another notes that when regulators require the involvement of an auditor in any area, they generally state that the output of this involvement is “an auditors’ report” when in most cases they are referring to a report with low or moderate level of assurance.

In addition, one National Institute noted that although no formal survey exists, the perception is that an expectation gap exists.

In yet another country, anecdotal evidence and the results of research indicate that the “negative assurance” statement, which has often been used for reporting on the review of financial statements, is commonly regarded as confusing or misunderstood. This is regarded as an obscure and confusing statement that does not clearly convey to the reader the quantity and quality of assurance being provided, thereby encouraging a reader to infer a higher level of assurance than is either intended or justified (this same confusion was identified by the Roebuck, et al. 2000 study). A further point was brought to light in the course of research conducted by the Auditing Practices Board into a possible form of review (“independent professional review”) to replace the audit of financial statements for smaller companies. The findings of field trials indicate that there is some evidence that whilst readers of the financial statements expect the procedures performed in a review will be less extensive than in an audit, they nonetheless expect them to be of the same nature. This conflicts with the view that the procedures in a review are not only less extensive but different in nature.

Finally, the question of whether the users of practitioners’ reports understand the difference between an audit report and a review report, how to clarify current reporting and how to reduce that expectations gap is periodically raised by the relevant National Institute.

4.5 Summary and Conclusions

The results of the National Institutes survey provide important insights into the different national environments and their approach to determining and communicating the provision of moderate levels of assurance. The responses indicate that most countries do not have a national definition of a moderate and high level of assurance. Four countries have adopted IFAC’s definitions formulated in ISAE 100 on
Assurance Engagements. The concept of high level of assurance, although not formally defined in many countries, is interpreted in a way similar to IFAC’s definition. In one country, the terms moderate and high level of assurance are not defined in the same manner as IFAC’s definitions but are defined in terms of procedures performed.

There appears to be no consensus among the countries on the factors affecting the levels of assurance. For example, one country has adopted an interaction of variables approach, while three others consider work effort as the sole determinant of the level of assurance. Most countries have developed national regulations, standards or practice conventions that determine which level of assurance should be given in a particular situation. In general, national auditing standards require a lower level of assurance for assurance engagements other than those in relation to financial statement audits. A combination of levels of assurance within a single report is also a possibility. In one country, regulations prohibit certain attestation services to be delivered with a moderate level of assurance.

Most countries recognize the need of a clear definition of and guidance for assurance engagements, other than the audit of the financial statements and the review. Adoption of the ISAs is in this respect considered by some countries as the way to improve national regulations, standards, and practice conventions.

The results of the survey with respect to the communication of a moderate level of assurance show that most countries have their own national regulations, standards or practice conventions for the wording of a financial statement review report, which at present seems to be the most common service for which a moderate level of assurance is provided. In addition, some countries have already established national regulations, standards or practice conventions for the wording of certain types of moderate level of assurance services other than a review of financial statements. These standards largely relate to some form of assurance on financial information, compliance, or internal controls.

There appears to be no consensus among the countries regarding the extent of users’ understanding of the current reporting on the different levels of assurance provided on both financial statements as well as other subject matters. The National Institutes of five countries do not believe that there are many misunderstandings. In contrast, in four others, the Institutes believe that the different levels of assurance are poorly understood in their countries. Suggested ways for improvement, according to the National Institutes, are education, greater publicity by the profession, clarification and simplification of the wording of the report.

In summary, it appears that while the countries surveyed do not have national definitions of moderate and high levels of assurance, the provision of assurance at levels other than high is accepted in all of these national environments. The subject matter of these engagements is largely some type of financial information, although internal control and compliance are also highlighted as relevant areas. There is no consensus between countries as to the factors giving rise to a lower level of assurance: some countries adopt an interaction of variables view, others see work effort as the primary determinant, with many making regulatory prescriptions as the level of assurance to be provided in particular types of engagement. Similarly, in relation to the communication issue, countries have standard form reports on various types of engagement. Generally, the approach has been to address the matter on a subject by subject basis rather than determining an overall conceptual framework. Thus many countries flag the possibility of adopting ISAs as one way of improving guidance on their overall assurance services framework.
CHAPTER 5: RESULTS: MODERATE ASSURANCE QUESTIONNAIRE FOR AUDIT FIRMS

5.1 Introduction

The previous chapter focused on national practices and regulations regarding the determination and communication of assurance in the 12 countries under study. This chapter concerns empirical evidence regarding audit firm practices in these countries in order to provide insight into the research question stated in Chapter 1, “Are there innovative reporting practices in the various assurance practices from which we can learn about the determination and communication of levels of assurance other than high?”

The following sections describe the results of the moderate assurance questionnaire received from audit firms of the same 12 countries covered by the National Institutes’ survey. IAPC requested the National Institutes of each of these countries to select and contact the Big 5 and 5 other audit firms in their country to participate in the survey. This resulted in a target sample of 120 audit firms. We received usable responses from 56 audit firms, resulting in an overall response rate of 46.6%. The response rate of the sub-sample of Big 5 audit firms is 55%. The response rates of the individual countries are as follows: 0%, 10%, 20%, 30%, 40%, 50%, 60%, 60%, 70%, 70%, and 90% respectively.

Similar to the National Institute questionnaire, the audit firm questionnaire was structured around two main types of questions: questions relating to the determinants of a moderate level of assurance and questions relating to the communication of a moderate level of assurance. The aim was to determine what is occurring in practice in relation to differentiating moderate levels of assurance from high levels. The respondents were also asked to provide examples of moderate assurance reports that were as innovative as possible, in order to identify potentially effective ways of communicating a lower level of assurance.

This chapter is structured as follows. First, the procedures followed in the development of the questionnaire are outlined. Second, the results of the questionnaire with respect to the determinants of a moderate level of assurance are presented. Third, the results of the questionnaire with respect to the way in which a moderate level of assurance is communicated are presented. Finally, conclusions are drawn. Appendix 3 provides examples of alternative ways of expressing moderate assurance other than giving negative assurance. Appendix 4 presents some selected example reports in the major areas in which moderate assurance is currently provided by audit firms.

5.2 Steps Undertaken in Designing and Administering the Questionnaire

Similar to the National Institute survey, a survey was developed for completion by assurance services providers, in order to collect empirical evidence regarding practices with respect to the determinants and communication of assurance levels. The underlying reason for choosing a survey was again the exploratory and descriptive nature of the research.

The design of the questionnaire was similar to the National Institute survey. It was structured around two main types of questions, both open-ended and closed-ended: questions relating to the determinants of a moderate level of assurance and questions relating to the communication of a moderate level of assurance. As mentioned in the introduction, the aim was to determine current practices in differentiating moderate levels of assurance from high levels, and to collect examples of currently provided innovative moderate level of assurance reports.
The initial questionnaire developed by the ISAR research team was also pilot-tested and discussed with the members of the IAPC sub-committee on moderate assurance. The technical advisors participating in the National Institute survey were asked to supervise the audit firm survey and encourage participation. In particular, the technical advisors were asked to contact the partners of the technical departments of 10 audit firms (5 Big five audit firms and 5 Non-Big Five firms) in their country and ask for their cooperation for the audit firm survey. The technical advisors were provided with a cover letter to solicit cooperation of the audit firms and to give instructions for completing the survey. The audit firm surveys were filled out by the technical partners or managers. The technical advisors were also contacted both by IAPC and the ISAR research team for follow-up procedures in case of a low response rate. The follow-up procedures resulted in a substantial increase of the overall response rate.

Users were not contacted given the focus of this research project on the determinants of the level of assurance and the current practices of communicating a moderate level of assurance. However, clear benefit could be gained from undertaking a follow-up study that explores the user perspective.

5.3 Determinants of a Moderate Level of Assurance

This part presents the results relating to the determinants of a moderate level of assurance according to the audit firms of the countries under study. In particular, the questions related to the types of assurance services provided and the corresponding level of assurance; percentage of confidence for a moderate versus a high level of assurance; and the determinants of the level of assurance provided.

5.3.1 Types of Assurance Services and Level of Assurance Provided

The initial question sought to gain descriptive details of the types of assurance services being provided by firms at present. It provides the background on which subsequent questions are based and also indicates the nature and extent of current moderate assurance engagements.

*Question: What type of other assurance services (i.e., services other than financial statement assurance) does your firm provide? Describe the type of assurance service, frequency of provision and level of assurance typically provided for these other assurance services.*

The assurance services were subdivided into the 4 categories as recognized by IAPC (ISAE 100): assurance services with respect to financial data; assurance services with respect to non-financial information; assurance services with respect to systems and processes; and assurance services with respect to behavior. The results are presented in the tables below. The discussion of the results below is based on the criterion number of respondents offering the service and not on the frequency of provision, as the first is a broader indicator.

It appears that with respect to financial data, assurance services that are currently most frequently provided by audit firms are on prospective financial information, due diligence, individual components of the financial statements and budgets. Other services that were mentioned are interim financial statements, a comfort letter, subsidies (grants), an income tax return, a prospectus and an internal audit. Assurance on prospective financial information, due diligence, interim financial statements and a comfort letter are in the majority of cases provided with a moderate level of assurance.

With respect to non-financial information, assurance is most frequently given on environmental performance. Other assurance services relating to non-financial information are provided on performance measures, a value for money audit, intellectual capital, an internal audit, due diligence, a social report and
a prospectus. Assurance on environmental performance, intellectual capital, an internal audit, a social report and a prospectus are mostly moderate assurance engagements.

The results further show that assurance on an internal control system is presently the most frequently provided assurance service with respect to systems and processes. In addition, the following services are provided, though to a lesser extent: assurance on an EDP system, IT system, risk management system, environmental system, WebTrust, internal audit and security system. Typical moderate assurance engagements appear to be assurance on an internal control system, risk management system, environmental system and an internal audit.

Assurance on compliance with laws and regulations is the most frequently provided assurance service with respect to behavior. Corporate governance and forensic audit were also mentioned, which are typically delivered with a moderate level of assurance.

### Assurance services with respect to financial data

<table>
<thead>
<tr>
<th>Description type</th>
<th>Respondents offering service</th>
<th>Frequency of provision</th>
<th>Moderate level of assurance engagement</th>
<th>High level of assurance engagement</th>
<th>Combination moderate &amp; high level of assurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prospective financial information</td>
<td>36</td>
<td>Min: 1&lt;br&gt;Max: 5&lt;br&gt;Mean: 2.83&lt;br&gt;Std.Dev.: 1</td>
<td>Min: 0&lt;br&gt;Max: 1&lt;br&gt;Mean: 0.73&lt;br&gt;Std.Dev.: 0.42</td>
<td>Min: 0&lt;br&gt;Max: 1&lt;br&gt;Mean: 0.11&lt;br&gt;Std.Dev.: 0.30</td>
<td>Min: 0&lt;br&gt;Max: 1&lt;br&gt;Mean: 0.15&lt;br&gt;Std.Dev.: 0.35</td>
</tr>
<tr>
<td>Due Diligence</td>
<td>22</td>
<td>Min: 1&lt;br&gt;Max: 5&lt;br&gt;Mean: 3.57&lt;br&gt;Std.Dev.: 1.22</td>
<td>Min: 0&lt;br&gt;Max: 1&lt;br&gt;Mean: 0.67&lt;br&gt;Std.Dev.: 0.39</td>
<td>Min: 0&lt;br&gt;Max: 1&lt;br&gt;Mean: 0.11&lt;br&gt;Std.Dev.: 0.25</td>
<td>Min: 0&lt;br&gt;Max: 1&lt;br&gt;Mean: 0.20&lt;br&gt;Std.Dev.: 0.33</td>
</tr>
<tr>
<td>Individual components financial statements</td>
<td>19</td>
<td>Min: 1&lt;br&gt;Max: 5&lt;br&gt;Mean: 2.68&lt;br&gt;Std.Dev.: 1.11</td>
<td>Min: 0&lt;br&gt;Max: 1&lt;br&gt;Mean: 0.40&lt;br&gt;Std.Dev.: 0.40</td>
<td>Min: 0&lt;br&gt;Max: 1&lt;br&gt;Mean: 0.47&lt;br&gt;Std.Dev.: 0.42</td>
<td>Min: 0&lt;br&gt;Max: 1&lt;br&gt;Mean: 0.12&lt;br&gt;Std.Dev.: 0.28</td>
</tr>
<tr>
<td>Budget</td>
<td>10</td>
<td>Min: 2&lt;br&gt;Max: 5&lt;br&gt;Mean: 2.70&lt;br&gt;Std.Dev.: 0.95</td>
<td>Min: 0&lt;br&gt;Max: 1&lt;br&gt;Mean: 0.53&lt;br&gt;Std.Dev.: 0.42</td>
<td>Min: 0&lt;br&gt;Max: 1&lt;br&gt;Mean: 0.44&lt;br&gt;Std.Dev.: 0.40</td>
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A low value corresponds with not frequently provided.
# The Determination and Communication of Levels of Assurance Other than High

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### Assurance services with respect to non-financial information

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### Assurance services with respect to systems and processes

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<sup>2</sup> A low value corresponds with not frequently provided.

<sup>3</sup> A low value corresponds with not frequently provided.
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Assurance services with respect to behavior

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5.3.2 Provision of Moderate versus High Level of Assurance

This part of the questionnaire attempted to elicit the major reasons underlying a firm’s decision to provide a level of assurance other than high. Thus the responses give some insight into what audit firms view as the determinants of a moderate level of assurance.

*Question:* For the assurance services where your audit firm provides a moderate level of assurance, what are the most important reasons for not providing a high level of assurance? Do you think that these services can in principle also be provided with a high level of assurance?

**Reasons for not providing a high level of assurance**

The table below presents the reasons given by the respondents for not providing a high level of assurance. As can be seen, the nature of the subject matter and the lack of appropriate criteria or performance standards are the most frequently named reasons for not providing a high level of assurance. In addition, cost/benefit considerations, the lack of appropriate evidence and user needs have an impact on the decision. Note that this question was open-ended, with no specific categories of answers specified.

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<th>Reasons for not providing a high level of assurance</th>
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<td>Appropriate criteria (or performance standards) not established</td>
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<td>Risk exposure (e.g., litigation risk under consideration of the expected distribution of the auditor’s report)</td>
<td>8</td>
</tr>
<tr>
<td>Cost/benefit considerations (moderate assurance can be negotiated and the cost can be adjusted to user needs)</td>
<td>7</td>
</tr>
<tr>
<td>Lack of appropriate evidence</td>
<td>7</td>
</tr>
<tr>
<td>User needs (moderate assurance is sufficient for users’ purposes)</td>
<td>7</td>
</tr>
<tr>
<td>Level of work and resources</td>
<td>5</td>
</tr>
<tr>
<td>Cost of incremental work effort or the scope cannot materially be extended</td>
<td>5</td>
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</table>

¹ A low value corresponds with not frequently provided.
Reasons for not providing a high level of assurance

<table>
<thead>
<tr>
<th>Reason</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory requirements (high level of assurance not required by regulatory authority)</td>
<td>4</td>
</tr>
<tr>
<td>To avoid an expectation gap with the client and/or third parties</td>
<td>2</td>
</tr>
<tr>
<td>Terms of engagement</td>
<td>2</td>
</tr>
<tr>
<td>New assurance services (internal controls and systems are not adequately designed and/or operating)</td>
<td>1</td>
</tr>
<tr>
<td>The results depend on a number of judgmental criteria</td>
<td>1</td>
</tr>
</tbody>
</table>

Can services in principle also be provided with a high level of assurance?

<table>
<thead>
<tr>
<th>High level of assurance always possible?</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>40%</td>
<td>60%</td>
</tr>
</tbody>
</table>

The answer to this question depends to some extent on the type of assurance service provided. On the one hand, most respondents agree that the nature of the subject matter of certain assurance engagements (e.g., future event) prevents them from providing a high level of assurance. The reason being is that for such engagements simply increasing the work effort cannot create a higher level of assurance.

On the other hand, the respondents generally agree that in principle most other assurance engagements could be provided with a high level of assurance. However, this would require some of the following: suitable criteria and professional standards, a higher amount of work effort, effectively operating internal control systems and processes of the client, availability of sufficient quantitative and qualitative data, and a higher fee.

Although these requirements may theoretically be fulfilled, it was widely acknowledged that it may not be practical to do so due to cost/benefit, time and risk considerations.

5.3.3 Percentage of Confidence of Moderate versus High Level of Assurance

Question: What is the percentage of confidence you believe you provide in case of a moderate level of assurance engagement and in case of a high level of assurance engagement?

<table>
<thead>
<tr>
<th>Average percentage of confidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
</tr>
<tr>
<td>----</td>
</tr>
<tr>
<td>Moderate level of assurance engagement</td>
</tr>
<tr>
<td>High level of assurance engagement</td>
</tr>
</tbody>
</table>

The results show that the average percentage of confidence of a moderate level of assurance engagement is 60%. The average percentage of confidence of a high level of assurance engagement is 88%. The different results for high assurance versus moderate assurance are as expected. Perhaps because auditors are less familiar with moderate assurance assessments, both the range and the standard deviation are higher. The higher standard deviation for moderate assurance indicates greater agreement about the meaning of a high level of assurance than about moderate assurance. The distribution of the average percentages of confidence of a moderate assurance engagement is presented in the graph below.
5.3.4 Determinants of the Level of Assurance Provided

Question: The audit firms were asked to provide example reports issued on assurance engagements that offer any level of assurance except absolute or high. They were asked to state on a 5-point scale to what extent the level of assurance provided in the example report was affected by the following factors: subject matter, criteria, work effort, quantity of evidence, quality of evidence, and other factors.

Overall analysis

For each of the potential determinants, firms were asked to make an assessment of their impact on the level of assurance provided, from a low impact (a score of 1) to high impact (a score of 5). As can be seen from the table and graph below, most respondents believe that subject matter, criteria, work effort, quantity and quality of evidence all have an influence on the level of assurance provided.

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subject matter</td>
<td>167</td>
<td>1</td>
<td>5</td>
<td>3.56</td>
<td>1.43</td>
</tr>
<tr>
<td>Criteria</td>
<td>159</td>
<td>1</td>
<td>5</td>
<td>3.42</td>
<td>1.53</td>
</tr>
<tr>
<td>Work effort</td>
<td>164</td>
<td>1</td>
<td>5</td>
<td>3.32</td>
<td>1.47</td>
</tr>
<tr>
<td>Quantity of evidence</td>
<td>159</td>
<td>1</td>
<td>5</td>
<td>2.97</td>
<td>1.42</td>
</tr>
<tr>
<td>Quality of evidence</td>
<td>160</td>
<td>1</td>
<td>5</td>
<td>3.26</td>
<td>1.43</td>
</tr>
</tbody>
</table>

Analysis of specific types of assurance engagements

Similar to the overall analysis, the results show that all factors are perceived to have an influence on the level of assurance provided, irrespective of the type of assurance engagement.
Subject | Work effort | Quantity of evidence | Quality of evidence | Other
--- | --- | --- | --- | ---
Environmental performance | Min:1 | Min:1 | Min:1 | Min:1
Max:5 | Max:5 | Max:5 | Max:5 | Max:5
Mean:3.48 | Mean:3.67 | Mean:2.90 | Mean:3.50 | Mean:3.77
Std.Dev.:1.44 | Std.Dev.:1.60 | Std.Dev.:1.46 | Std.Dev.:1.41 | Std.Dev.:1.40
Internal control | Min:1 | Min:1 | Min:1 | Min:1
Max:5 | Max:5 | Max:5 | Max:5 | Max:5
Mean:3.60 | Mean:3.55 | Mean:2.95 | Mean:3.05 | Mean:4.16
Std.Dev.:1.16 | Std.Dev.:1.51 | Std.Dev.:1.55 | Std.Dev.:1.68 | Std.Dev.:1.54
Prospective financial information | Min:1 | Min:1 | Min:1 | Min:1
Max:5 | Max:5 | Max:5 | Max:5 | Max:5
Mean:4.36 | Mean:3.44 | Mean:3.76 | Mean:4.06 | Mean:3.77
Std.Dev.:0.97 | Std.Dev.:1.20 | Std.Dev.:1.29 | Std.Dev.:1.20 | Std.Dev.:1.34
Compliance | Min:1 | Min:1 | Min:1 | Min:1
Max:5 | Max:5 | Max:5 | Max:5 | Max:5
Mean:4.06 | Mean:3.73 | Mean:3.86 | Mean:3.93 | Mean:3.86
Std.Dev.:1.12 | Std.Dev.:1.31 | Std.Dev.:1.33 | Std.Dev.:1.10 | Std.Dev.:1.22
Corporate governance | Min:1 | Min:1 | Min:1 | Min:1
Max:5 | Max:5 | Max:5 | Max:5 | Max:5
Mean:3.75 | Mean:3.50 | Mean:2.50 | Mean:2.67 | Mean:3.08
Std.Dev.:1.89 | Std.Dev.:1.73 | Std.Dev.:1.41 | Std.Dev.:1.53 | Std.Dev.:1.20

Influence of other factors on level of assurance

<table>
<thead>
<tr>
<th>Influence of other factors</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Influence of other factors</td>
<td>292</td>
<td>1</td>
<td>5</td>
<td>3.92</td>
<td>1.19</td>
</tr>
</tbody>
</table>

Next to subject matter, criteria, work effort, quantity and quality of evidence having an influence on the level of assurance, it appears that other factors are also important determinants of the level of assurance. In particular, the level of assurance is also affected by user needs, litigation risk, lack of standards, distribution of the report, regulatory requirements, adequacy of fees and industry practice.

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>User needs</td>
<td>71</td>
<td>2</td>
<td>5</td>
<td>4.21</td>
<td>0.81</td>
</tr>
<tr>
<td>Litigation risk</td>
<td>51</td>
<td>1</td>
<td>5</td>
<td>3.73</td>
<td>1.38</td>
</tr>
<tr>
<td>Lack of standards</td>
<td>36</td>
<td>1</td>
<td>5</td>
<td>3.86</td>
<td>1.02</td>
</tr>
<tr>
<td>Distribution report</td>
<td>34</td>
<td>1</td>
<td>5</td>
<td>3.68</td>
<td>1.47</td>
</tr>
<tr>
<td>Regulatory requirements</td>
<td>30</td>
<td>1</td>
<td>5</td>
<td>4.09</td>
<td>1.13</td>
</tr>
<tr>
<td>Adequacy of fees</td>
<td>28</td>
<td>1</td>
<td>4</td>
<td>2.95</td>
<td>1.16</td>
</tr>
<tr>
<td>Industry practice</td>
<td>18</td>
<td>1</td>
<td>5</td>
<td>3.69</td>
<td>1.10</td>
</tr>
</tbody>
</table>

Extent of interrelationship of factors

*Question: Please comment on how, if at all, the subject matter, criteria, work effort, available evidence and any other factors you have identified were interrelated in this engagement.*

Note that the sample sizes concern the number of questionnaires filled out for each specific type of assurance engagement. These differ from the sample sizes reported in section 5.2.1, which concern the number of respondents offering a specific type of assurance service.
There is a general consensus of an interrelationship among the factors for most assurance engagements. The subject matter is interrelated with criteria since the subject matter may not be fully measurable in situations where suitable criteria are lacking. The nature of the subject matter can limit the available evidence. A more complex subject matter also demands more work effort. Many respondents suggested that criteria are linked with amount of work effort since criteria can determine the amount of work effort. In the absence of clear criteria, more work effort is often performed to obtain sufficient and appropriate audit evidence.

**Influence of interrelationship of factors on level of assurance**

*Question: Please comment on how, if at all, that interrelationship affected the level of assurance.*

In general, there is a consensus among the respondents that the interrelationship among the factors affects the level of assurance. The following arguments were given:

- The nature of the subject matter and the existence of suitable criteria are commonly considered as the most important factors determining the level of assurance. Both factors are interrelated with work effort and available evidence, which are in turn also linked up to a certain point.

- Other interrelated factors deemed of influence on the level of assurance are user needs, time restrictions, fee level and cost/benefit considerations.

- If there exists insufficiency in one of the factors, it will lower the level of assurance. In other words, in case there exists any insufficiency or deficiency in one or more of the factors and if weaknesses cannot be improved, then the level of assurance could drop depending on the degree of the weaknesses.

In sum, as a result of its nature or the absence of suitable criteria or professional standards, subject matter may be less susceptible to verification. Neither work effort, nor quantity and quality of evidence can always compensate the effects thereof. Indeed, the nature of the subject matter may limit available evidence that cannot be extended simply by providing more work effort. These interrelationships affect the level of assurance besides other factors such as user needs, time restrictions and cost/benefit considerations.

**Change of scope**

*Question: Was the scope of the engagement altered at any stage (either before or after engagement acceptance) because of issues or difficulties associated with the capacity of the subject matter to be reliably measured, the nature of the criteria, the availability of suitable evidence or other matters?*

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change of scope occurred</td>
<td>6%</td>
</tr>
</tbody>
</table>

As expected, it appears that once an engagement was accepted (or even before engagement acceptance), the scope, and therefore the level of assurance, were hardly ever altered. Altering the scope of the engagement at any stage appears to be very uncommon.

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6 Note that one country, where the emphasis is on a work effort view, did not respond to this part of the study.
The Determination and Communication of Levels of Assurance Other than High

Remaining comments on determinants of level of assurance

Question: Do you have any remaining comments or suggestions regarding the determinants of a moderate level of assurance engagement?

An overview of the most interesting remaining comments of the respondents on the determinants of the level of assurance is given below:

One should distinguish theoretical from practical developments. From a theoretical perspective, only the extent of work should affect the level of assurance as is the case in a financial statement audit. However, because of lack of criteria, (legal) requirements and so on in the emerging services arena, some factors like budget available (auditee) and risk management (auditor) seem to be influencing the level of assurance that is achieved and expressed.

The level of work provides defining criteria between positive and negative assurance only when there is established framework/criteria to report against, or these can be specified by the client and the auditor. In many instances we are required by legislation to provide assurance on issues where there are no established criteria. Whilst it would be nice to say that we should provide no assurance in these circumstances, this is not a practical option. In the majority of cases we are actually required to give an audit opinion. However, sometimes we are able to get regulators to accept a review report in these circumstances. In these cases the risks and criteria are the driving factor of the assurance provided.

We are strongly of the view that work effort alone determines the level of confidence provided. If a subject matter cannot be audited it follows that it cannot be reviewed. The susceptibility of a subject matter to evaluation and the existence of suitable criteria are inseparable judgments that do not differ in the face of requests for more or less confidence to be provided.

Although there is debate as to whether the ability of a reporting accountant to give moderate or high assurance relates to the nature of the subject matter or the work effort, I believe that either factor can influence the degree of assurance that the auditor can give. Clearly, the work effort can vary and the degree of assurance must vary with it. However, there are certain subject matters for which the objective evidence will necessarily not be available to give the high degree of assurance that is required. One approach to this problem is to restrict the matters on which the accountant is reporting, such that the report is confined to matters on which high assurance can be given. Another approach is to move to an agreed upon procedures engagement. Finally, the third approach, which will often be regarded as the least desirable is to give an opinion which would be regarded as giving a moderate level of assurance.

The level of assurance should be determined at the outset and the engagement planned and conducted accordingly. The subject matter and criteria should be the same regardless of the level of assurance to be provided. The resources available will dictate the work done. Given our mandate and circumstances we are more likely to either narrow the subject matter or obtain sufficient expertise to allow the expression of high level of assurance rather than provide moderate assurance. If it is important to our client, we will seek the necessary resources to provide a high level of assurance on the subject matter of interest to them. This is particularly true for special assignments they request us to carry out.

Higher assurance leads to increased effort and costs. It will also, inevitably, lead to a reduction of assurance coverage, and scope.

Guidance is required on the following elements of assurance engagements: scope, limitations, methodology, timing, personnel, assurance level.

Any report with a moderate level of assurance should be issued only for companies that have been previously audited by the same independent auditors.

We expect that IFAC will issue standards for Moderate Level Assurance since the practice varies from country to country.
5.4 Communication of a Moderate Level of Assurance

This part presents the results associated with the communication of a moderate level of assurance, based on the responses of the audit firms of the countries under study. In particular, the questions related to: alternative ways of expressing moderate assurance other than giving negative assurance; client’s and third parties’ understanding of the different levels of confidence provided on financial statements and other subject matters; issues of discussion with the client regarding the wording of a moderate level of assurance report; and modified opinions issued on moderate assurance engagements.

5.4.1 Alternative Wording for Moderate Assurance Other than Negative Assurance

Negative assurance is a common way of expressing a moderate level of assurance. For example, it is widely used in reporting on review engagements. The first question of this section was aimed at identifying alternative ways for communicating a moderate level of assurance.

Question: Has your firm used any ways of expressing moderate assurance other than giving negative assurance?

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alternative wording for moderate assurance other than negative assurance</td>
<td>46%</td>
<td>54%</td>
</tr>
</tbody>
</table>

Nearly half of the respondents have used ways of expressing moderate assurance other than giving negative assurance. Two examples of these alternative wordings for moderate assurance are given in appendix 3. The first example is an independent verification report on environmental performance. The report states that:

“We have been asked to provide an opinion on:

(a) The process used to identify ABC’s significant environmental impacts and to define the scope of the environmental data included in the Report; and

(b) Key aspects of the data collection and reporting processes used to compile this Report.

“We have not been asked to provide verification of the data in the Report and therefore cannot comment specifically on the reliability of that data.

“There are no generally accepted international standards for reporting or verifying environmental data. We have adopted a verification approach that reflects emerging practices and guidance.

…

“On the basis of the above work, we found that ABC has:

(a) Adopted a systematic process to identify the significant environmental impacts related to its manufacturing operations, products and services and to define the scope of the environmental data included in the Report;

(b) Designed and implemented appropriate and reliable data collection and reporting processes at ABC Group to compile the Report, including:…”

The second example is a verifier’s report on intellectual capital. The report states that:

“The review conducted is not as comprehensive as an audit, and therefore it does not ensure that the user of the accounts is given the same degree of detail and completeness of the statement and presentation of information in the intellectual capital accounts.

…”
The status and nature of information vary, which means that not all the information can be verified. Thus, the intellectual capital accounts include information with varying degrees of reliability, ranging from purely subjective interpretation to objectively verifiable information.

“In our opinion, the intellectual capital accounts of xxx for the year ended xx/yy 2000:

• Are based on reliable data and information presented as stated under ‘Accounting Policies,’
• Correlate with the activities of the Company in the period as described and defined under ‘Accounting Policies.’”

5.4.2 Client and Third Parties’ Understanding of Communication

Communication relating to moderate assurance is an issue in so far as users of assurance services may not perceive the differences in assurance between engagements providing high and moderate levels of assurance. This section of the questionnaire aimed to gauge audit firm opinions of user understandings, given that as assurance providers, they would have experience with both clients and third parties and be in a position to provide such an opinion. The first issue examined is whether users would understand the difference between an audit and a review (both being common examples of high and moderate level assurance engagements, respectively), while the second is a broader issue, concerning whether users understand the difference between high and moderate levels of assurance.

Client understanding of difference between review and audit

Question: To what extent do you think clients understand different levels of confidence provided on financial statements?

<table>
<thead>
<tr>
<th>Level of understanding</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client understanding of difference, review vs. audit</td>
<td>53</td>
<td>1</td>
<td>5</td>
<td>3.24</td>
<td>1.05</td>
</tr>
</tbody>
</table>

Score on a 5-point Likert scale, with 1 representing a poor understanding and 5 a full understanding.

It appears that the difference between a review and an audit is moderately understood by the client. Clearly, a score of 5 is desirable from the perspective of the profession and the IAPC. A mean score of just over 3 should be a cause for concern.

The level of understanding varies depending on client features (e.g., client size). The following arguments were given to explain a high level of understanding:

• Clients understand the difference due to the difference in costs of the engagements;
• Established distinctive forms of reporting should make the difference between an audit and a review of financial statements evident;
• The level of assurance is agreed with the client in the terms of the engagement letter;
• Regulatory requirements make the difference clear; and
• The existence of objective criteria enhance client understanding.

A poor client understanding of the difference between a review and an audit is explained as follows:

• A signature of an auditor provides high assurance in the perception of the client, without reading the report and its findings;
• The form and nature of the report is not clear;
• Clients are not familiar with the terms;
• Clients perceive that a moderate level of assurance represents a limited work, but they do not differentiate the level of comfort they receive with the conclusion;
• The absence of objective criteria or professional standards result in a poor understanding of the difference;
• The experts vocabulary and style of writing are not fully accessible by the client; and
• Clients generally expect a high level of assurance for engagements involving external auditors (“expectation gap”).

**Third parties’ understanding of difference between review and audit**

*Question: To what extent do you think third parties understand different levels of confidence provided on financial statements?*

<table>
<thead>
<tr>
<th>Level of understanding</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Third parties’ understanding difference review vs. audit</td>
<td>53</td>
<td>1</td>
<td>5</td>
<td>2.40</td>
<td>0.98</td>
</tr>
</tbody>
</table>

Score on a 5-point Likert scale, with 1 representing a poor understanding and 5 a full understanding.

The difference between a review and an audit is not perceived to be well-understood by third parties generally, and third parties compared to clients. The level of understanding depends on who the third parties are (e.g., professional financial analysts and institutional investors should have a better understanding than ordinary individuals). A clear understanding of the reporting framework is also necessary to appreciate the difference. Factors enhancing third parties’ understanding of the difference are the existence of objective criteria and established distinctive reporting, which should make the difference evident if the report is read carefully.

The lack of understanding is explained as follows:

• The absence of objective criteria or professional standards result in a poor understanding of the difference;
• Third parties often rely on the opinion of the auditor without a severe study of the wording of the opinion in all due aspects;
• Third parties are not focused on the level of assurance;
• Third parties tend to associate any report issued by an accounting firm with a high level of assurance and also expect it;
• Third parties are not involved in the negotiation and communication with management and do not know the explanation of the differences in the engagement letter; and
• The expert’s technical vocabulary and style of writing are not fully accessible by the public.
Client understanding of difference between moderate versus high level of assurance

Question: To what extent do you think clients understand different levels of confidence provided on other subject matters?

<table>
<thead>
<tr>
<th>Level of understanding</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client understanding difference moderate vs. high level of assurance</td>
<td>51</td>
<td>1</td>
<td>4</td>
<td>2.66</td>
<td>1.13</td>
</tr>
</tbody>
</table>

Score on a 5-point Likert scale, with 1 representing a poor understanding and 5 a full understanding.

Client’s understanding of the difference between a moderate and a high level of assurance is lower than their understanding of the difference between a review and an audit. The level of understanding depends to some extent on the subject matter and the clarity of the opinion rendered. If the level of assurance is driven by the client or discussed with the client, this should enhance the understanding. In addition, the level of understanding is enhanced if the level of assurance provided is explained in the engagement letter and/or in the introduction paragraph of the report as well as the subject matter and the objectives of the engagement.

Factors contributing to a poor understanding are the following:

- Clients have had little exposure to new moderate level of assurance engagements and the auditor’s experience is still developing;
- Clients generally expect a high level of assurance for engagements involving external auditors;
- The lack of objective criteria and professional standards reduce the client’s understanding;
- The wording is not understandable for people with no accounting experience;
- Users lack a benchmark to perform a cost/benefit analysis;
- The use of the words “In my opinion” in the report will usually trigger the thought that a high level of assurance is being provided; and
- Due to the lack of a standardized wording for opinions, there is a real possibility of confusion, especially when the user is not financially sophisticated.

Third parties’ understanding of difference between moderate versus high level of assurance

Question: To what extent do you think third parties understand different levels of confidence provided on other subject matters?

<table>
<thead>
<tr>
<th>Level of understanding</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Third parties’ understanding difference moderate vs. high level of assurance</td>
<td>49</td>
<td>1</td>
<td>5</td>
<td>2.16</td>
<td>1.06</td>
</tr>
</tbody>
</table>

Score on a 5-point Likert scale, with 1 representing a poor understanding and 5 a full understanding.

Third parties’ understanding of the difference between a moderate and a high level of assurance is assessed to be low. As argued above, the level of understanding depends on who the third parties are: the distinction should be familiar to trained accountants and financial professionals, but not so much to the layperson. Third parties would be able to identify this difference if the wording is used in the report in
such a manner that they can understand the difference. If the wording is used in a vague or complicated manner, third parties may have difficulty understanding the difference. The existence of objective criteria is considered to enhance third parties’ understanding.

The lack of understanding is explained as follows:

• Third parties have insufficient experience with new moderate assurance engagements;
• The use of technical language in the report;
• Third parties are focused on whether the auditor has provided a statement, not on the level of assurance;
• Third parties tend to associate any report issued by an audit firm with a high level of assurance and also expect it;
• Third parties have no negotiation involvement in the engagement process;
• The absence of applicable regulations; and
• Due to the lack of standardized wording for opinions, there is a real possibility of confusion especially when the user is not financially sophisticated.

5.4.3 Modified Opinion

Question: Has your firm expressed a modified opinion (qualified, disclaimer or adverse) for an assurance engagement on a subject matter other than financial statements?

<table>
<thead>
<tr>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>52%</td>
<td>48%</td>
</tr>
</tbody>
</table>

More than half of the respondents have already issued a modified opinion on an assurance engagement other than financial statements.

5.4.4 Issues of Discussion Concerning Wording

Question: What type of issues do you discuss with your clients regarding the wording of a moderate level of assurance report?

The audit firms mentioned the following issues that have been discussed with their clients regarding the wording of a moderate level of assurance report:

• Extent of detailed work involved or work effort;
• Inherent limitations;
• Clients prefer positive assurance instead of negative assurance;
• Description of type and extent of qualifications;
• Discussion of circumstances that make it unable to provide a high level of assurance (e.g. control and procedural weaknesses, adequacy of the accounting resources, cost of providing the service);
• Explanation of differences between moderate and high level of assurance;
• Scope of responsibility;
• Content of the subject matter (e.g., discussion of the subjective content);
• Appropriate sentences which would not cause misunderstandings;
• Not an opinion but a statement is issued;
• Clients prefer long form reports with detail (including benefit of professional expertise in recommendations) rather than standard wording;
• Auditing standards and criteria; and
• The extent to which undetected errors may remain.

5.4.5 Remaining Comments/Suggestions Regarding Communication Moderate Level of Assurance

Question: Do you have any remaining comments or suggestions regarding the communication of a moderate level of assurance?

An overview of the most interesting remaining comments of the respondents on the communication of a moderate level of assurance is given below:

In my opinion it is very difficult to provide a moderate assurance. In my experience as a student on high school, my teacher for English provided moderate assurance for my skills and knowledge on this subject matter (grade 6 on a scale between 1 and 10). What does this mean? 60 % is enough to pass to the next level, but 40% is not enough to make myself understandable in England. This means that providing “a level of assurance” is not enough to rely upon for the user. Instead of providing a level of assurance, the auditor should provide verbal descriptions of important characteristics of the subject matter, in terms of strengths and weaknesses (i.e., for my example, the number of words known, the pronunciation etc.).

A level of assurance an accounting firm can take responsibility for would highly depend on the firms policy. In other words, a more aggressive firm would be willing to take more risk.

What is needed is to develop a report without negative assurance wording explaining the difference between high and moderate level.

In our opinion, IFAC’s definitions of moderate and high level of assurance are not discriminating enough. It would be advisable to send a similar questionnaire to different groups of stakeholders. For assurance services not referring to financial statements we prefer a long form report (see ISAE 100 paragraph 69). In our opinion the difference between direct reporting and attest reporting is artificial. In our opinion agreed upon procedures should not be excluded from assurance services, since they can provide a high level of assurance.

The lack of understanding by third parties (users/stakeholders) of different levels of assurance is a problem. This makes it difficult to communicate an improvement in the periodic assurance engagement, because in the view of the users a verification report is always the same. Obviously, this is an obstacle for the legitimating of higher fees and consequently the further development of assurance services in this area. It may be more appropriate to focus on the communication and to enhance transparency around “what is not done” instead of just “what is done” - to develop an understanding of the possibilities for further improvement of the assurance.

Although firms are providing increased assurance services, the IAPC framework seems to be applying artificial labels and measures to these engagements. Clients require meaningful communication of findings with recommendations based on professional expertise. In particular they want a report of findings which can be actioned, rather than a level of assurance which describes the status quo.

Clarity is of crucial importance.

One of the objectives of this project must be to try to ensure that any report issued more explicitly conveys the level of assurance previously only inherent in the report, whether high or moderate, without expanding the report to the extent that it becomes too verbose.

There is a need to educate non-professionals on the difference between moderate and high levels of assurance. This communication should be at an industry level — not only on a one to one basis.
It is our view that altering the scope of engagement would not be appropriate either before or after engagement acceptance. We need to come up with some better or alternative wording to communicate a moderate level of assurance other than our “negative assurance” wording which is generally only understood by accountants.

The more complex the subject matter the more important it is to be clear and descriptive about what has been done, observed and concluded. Readers also need to fully understand any limitations being placed on the assurance provided.

There is clearly a significant expectation gap between clients/third parties and auditors. This is also linked into themes such as limited liability of auditors.

Our experience would indicate that there appears to be little demand, if any, for the provision of moderate level of assurance, other than as allowed under Sections 8100, 8200, 8500 and 8600 of the CICA Handbook. We have also received requests for provision of a high level of assurance where, because of either the lack of appropriate criteria and/or the nature of the subject matter being outside our professional competencies, we refused such engagements. In our view, moderate level assurance reports are not being issued because of the current lack of standards and guidance for such reports in Canada. Section 5025 of the Handbook provides only a limited conceptual framework and there are no suitable standards or guidance.

We are looking forward to seeing the results of this survey very soon.

5.4.6 Example Reports Given by Respondents

The table below gives an overview of the example reports given by the respondents, and the number of countries, providing a moderate level of assurance. Appendix 4 provides a selection of 12 of the more innovative example reports in different areas.

<table>
<thead>
<tr>
<th>Area in which a moderate level of assurance is provided</th>
<th>Number of audit firms offering the service</th>
<th>Number of countries offering the service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental performance</td>
<td>24</td>
<td>9</td>
</tr>
<tr>
<td>Internal control</td>
<td>21</td>
<td>10</td>
</tr>
<tr>
<td>Prospective financial information</td>
<td>20</td>
<td>9</td>
</tr>
<tr>
<td>Compliance</td>
<td>17</td>
<td>9</td>
</tr>
<tr>
<td>Interim reporting</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>Due diligence</td>
<td>9</td>
<td>4</td>
</tr>
<tr>
<td>Individual components financial statements</td>
<td>6</td>
<td>2</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Intellectual capital reporting</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Comfort letter</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Income tax return</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Performance measures</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Subsidies (grants)</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Budgeting</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Forensic audit</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

5.5 Summary and Conclusions

The results of the survey with respect to the types of assurance services currently provided by audit firms have shown the following. First, assurance on financial data other than financial statements is currently provided mostly on prospective financial information, due diligence, individual components of financial statements and budgets. Prospective financial information and due diligence are mostly delivered with a moderate level of assurance. Second, assurance on environmental performance is the most frequently
provided service with respect to non-financial information and is also commonly given with a moderate level of assurance. Third, with respect to systems and processes, assurance on the internal control system is currently the most frequently provided service and has typically been provided at a moderate level of assurance. Fourth, assurance on compliance with laws and regulations is presently the most frequently delivered service with respect to behavior.

The nature of the subject matter and the lack of appropriate criteria or performance standards are the most frequently cited reasons for not providing a high level of assurance. In addition, cost/benefit considerations, the lack of appropriate evidence and user needs play a role. The possibility of providing a high level of assurance depends to some extent on the type of assurance service provided. On the one hand, the nature of the subject matter of certain assurance engagements (e.g., estimation, future event) hinders the provision of a high level of assurance. For such engagements, simply increasing the work effort cannot create a higher level of assurance. On the other hand, in principle most other assurance engagements could be provided with a high level of assurance. However, this would require suitable criteria and professional standards, a higher amount of work effort, effectively operating internal control systems and processes of the client, availability of sufficient quantitative and qualitative data, and a higher fee. Although these requirements may theoretically be fulfilled, it was widely acknowledged that it may not be practical to do so due to cost/benefit, time and risk considerations.

The average percentage of confidence of a moderate level of assurance engagement appears to be 60%. Interestingly, the average percentage of a high level of assurance turned out to be 88%. The range and standard deviation for moderate assurance was high, as is expected given that auditors are less familiar with this assurance level.

The results of the survey further provide evidence that subject matter, criteria, work effort, quantity and quality of evidence all have an influence on the level of assurance, irrespective of the type of assurance engagement. In addition, other factors appear to have an important impact on the level of assurance. In particular, the level of assurance is determined by user needs, litigation risk, lack of standards, distribution of the report, regulatory requirements, adequacy of fees and industry practice. There is a general consensus that there is a strong interrelationship among the factors for most assurance engagements. The subject matter is interrelated with criteria since the subject matter may be difficult to verify in case suitable criteria are lacking. The nature of the subject matter can limit the available evidence. A more complex subject matter also demands more work effort. Criteria are linked with amount of work effort since criteria can determine the amount of work effort. In the absence of clear criteria, more work effort is often performed to obtain sufficient and appropriate audit evidence. Furthermore, there is consensus on the fact that the interrelationship among the factors affects the level of assurance. In particular, it was argued that the subject matter might be difficult to verify due to the absence of suitable criteria or professional standards. Neither work effort, nor quantity and quality of evidence can always compensate this. Indeed, the nature of the subject matter may limit available evidence that cannot be extended simply by providing more work effort. These interrelationships affect the level of assurance besides other factors such as user needs, time restrictions and cost/benefit considerations. Altering the scope of the engagement appears to be very uncommon.

The results of the survey with respect to the communication of a moderate level of assurance have shown that nearly half of the respondents use alternative wording to negative assurance for describing moderate assurance.

The difference between a review and an audit is assessed as being only fairly understood by clients, and even less so by third parties. The level of understanding depends on the type of client and third party. It is commonly agreed that a clear understanding of the reporting framework is necessary to appreciate the
difference. The existence of objective criteria and established distinctive reporting should enhance the level of understanding.

The difference between a moderate and a high level of assurance is not well understood by clients, and even less so by third parties. The level of understanding depends to some extent on the subject matter and the clarity of the opinion rendered. If the wording is used in a vague or complicated manner, it is difficult to appreciate the difference. Our respondents also believe that an explanation of the level of assurance provided in the engagement letter or in the introductory paragraph of the report, as well as a description of the subject matter and the objectives of the engagement, enhance the level of understanding. The current lack of objective criteria and professional standards is commonly considered as an important explanatory factor of the low level of understanding.

More than half of the respondents have already expressed a modified opinion for an assurance engagement on a subject matter other than financial statements.

Finally, the results show that audit firms often discuss with their clients the wording of a moderate level of assurance report. In particular, there is discussion about issues like work effort, inherent limitations, positive versus negative assurance, moderate versus high level of assurance, circumstances that make it unable to provide a high level of assurance, qualifications, and scope of responsibility.
CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS

This study was commissioned by the International Auditing Practices Committee (IAPC) to conduct research on the determination and communication of levels of assurance other than high. The approach used was to review relevant sources of information that may contribute to knowledge on the determinants of assurance at levels other than high, and how best to communicate this level of assurance. In addition, the National Institutes of 12 countries were surveyed along with assurance providers from these countries from which 56 responses were received.

The conclusions regarding the determination of assurance will be presented in section 6.1. The conclusions regarding the communication issue will be presented in section 6.2. The final section summarizes this chapter.

6.1 Determinants of a Level of Assurance Other than High

The two competing views proposed by the IAPC were the “interaction of variables view” and the “work effort view.” The research undertaken in this study shows that there is evidence to support the view that there are distinguishing factors beyond work effort in determining the level of assurance. This therefore discounts the strict “work effort” view. In this study there are at least four sources of evidence supporting the interaction of variables view. First, even in countries that support the work effort view, distinctions are drawn on the basis of subject matter. It is found that on the basis of subject matter, different engagement rules and communication reports have been recommended. Second, subject matter, in the form of historical versus prospective information, has also been examined systematically in an empirical study, and it has been found that users do draw distinctions between different subject matters as to the level of assurance that they attach to engagements, holding work effort constant. While no one disputes work effort as a determinant of assurance, it has been found that current methods of communicating work effort may not be effective in communicating different levels of assurance. No factors other than subject matter and work effort have to date been empirically tested in a systematic way. Third, admittedly the determination of assurance has received very limited attention outside the accounting profession. However, in those cases where other professions deal with the determinants of assurance, they recognize an effect of subject matter on assurance level (e.g., the GRI). Finally, the responses of audit firms surveyed strongly support an interaction of variables view. Respondents indicate that the two most important reasons for not giving a high level of assurance are subject matter and criteria.

In this section we will discuss our findings for each of the possible determinants of level of assurance.

Does work effort affect the level of assurance provided and communicated?

There is widespread agreement, with no dissent, that variations in work effort will have a significant effect on the level of assurance. It is primarily through a continuum of work effort (from moderate to high) that a continuum of assurance (from moderate to high) is provided.

The standards set what could be regarded as a lower level for work effort — the level that is currently associated with review reports. The procedures are not necessarily described in the suggested forms of communication, except to say that they are less comprehensive than audits, and involve analytical procedures and discussions with management (or the equivalent for the engagement). The procedures expected for audit describe work effort providing high assurance.

Research indicates that at this moment the profession is not effective in communicating levels of work effort. However, this view of ineffective communication may not be universal, as two countries indicate...
that they have evidence that suggests the current forms of review reports and audit reports are well-accepted and understood. Such evidence is not generally available, and may come from private research. One country refers to a study by Strawser (1991) as evidence of effective communication. This study is primarily aimed at qualifications, and concludes that for limited assurance engagements “users may not understand the message communicated.”

Even at the extremes (audit versus review), research suggests that users do not ascribe differences in levels of assurance with the current wordings that are suggested. The suggested wordings to describe differences in work effort do need to be reconsidered.

In some forms of assurance services (e.g., performance audits), work effort is described in greater detail. It may be that this is an appropriate form for special purpose assurance reports, where the intended audience is confined and their ability to identify the level of assurance contained in a description of proceedings can be assessed. It is not so clear that such a detailed approach is appropriate for general-purpose assurance reports, where the intended audience is much broader.

As shown by our review of communication theory, effective communication is usually achieved through symbolic representation. The symbols that are currently being recommended by the profession for the two levels of assurance are remarkably quite similar. Thus as symbolic representations, it is not surprising that these forms of communication fail to differentiate between levels of assurance.

It is also identified that negative form of assurance reports are used or recommended for all circumstances where level of assurance is less than high. As a symbolic representation it may be that the profession desires to limit the negative form of reporting to the minimum levels of evidence collected. This will depend on whether it is determined that assurance at a lower level should be restricted to a specific level or permitted over a range.

**Does subject matter affect the level of assurance provided and communicated?**

It is apparent that subject matter affects the level of assurance that can be provided and communicated. The concept of “subject matter” has been defined in different ways. In some cases it has been used to refer to broad categories of engagements, such as reporting on internal controls, environmental reporting, or reporting on prospective information. In other instances “subject matter” has been used to refer to sub-components within these broad categories. One example of this has been within the broad category of internal control where the subject matter of the assurance engagement has been defined as the systems producing the information, or the final results produced from this system.

Support for the view of subject matter as a determinant of the level of assurance that can be offered can be seen where national bodies have found it necessary to provide guidance on particular types of assurance engagements. It may be appropriate to do this in order to communicate particular requirements or evidence gathering procedures. Further evidence suggesting that subject matter affects the level of assurance provided, includes changes in the suggested form of communication for a particular subject matter. This may be a restriction on the level of assurance offered (only high, or only less than high). Alternatively, it may be suggestions of inclusions in the report: for example, in assurance reports on internal controls, an inherent limitation is included as a separate paragraph, whereas there is no such paragraph for other subject matters.

On what dimensions are these distinctions in subject matter drawn? A major distinction is between historical versus forward-looking subject matter. This can also be drawn on other bases, such as the suitability of criteria, which may be highly correlated with subject matter. This can be seen in the fact that
The Determination and Communication of Levels of Assurance Other than High

in certain jurisdictions, future oriented (prospective) information is not seen as an appropriate basis on which to issue a positive form of assurance report. For example, in the Global Reporting Initiative’s (GRI) guidelines, forward-looking information about strategy, plans and targets is seen to differ from backward-looking information about past results and events. This seems to be a theoretically supported dimension, in that the persuasiveness (or reliability) of the available evidence is expected to be less in forward-looking engagements.

A further distinction can be drawn on the quantitative versus qualitative nature of the subject matter. Information about management policies, systems, practices and processes (typically qualitative in nature) differs from information about events, incidents, operations and performance (which is typically quantitative in nature). The extent to which qualitative subject matter (or suitability of criteria or persuasiveness of evidence) can be turned into quantitative subject matter without limiting the relevance of the engagement, will be a determinant of the level of assurance that can be provided.

This view of the importance of subject matter as a determinant gives rise to two (not necessarily mutually exclusive) suggestions. Firstly, in any general guidance issued by the profession on reporting the appropriate level of assurance, one of the important considerations appears to be subject matter. Second, in order to provide adequate guidance on reporting it is necessary that guidelines be issued on a subject matter by subject matter basis. Guidance that is effective for one subject matter may not necessarily work for another subject matter.

Do suitable criteria affect the communicated level of assurance?

Suitable criteria are possibly the most contentious determinant of the level of assurance. We found support for the view that the suitability of criteria affected the level of assurance. A number of National Institute responses indicated that the lack of criteria (e.g., lack of guidelines on reporting on a particular subject matter) is one of the primary reasons for not providing a high level of assurance on a particular engagement. In addition, as stated earlier, the audit firm respondents indicated that criteria were the second most important reason for not providing a high level of assurance.

Based on the available evidence highlighted in the discussion above, we believe that there is general agreement that suitability of criteria affects the level of assurance. The difference lies in the approach suggested in incorporating this factor into the assurance level provided. In some countries it is argued that suitable criteria are of such importance that the service should not be provided in the absence of suitable criteria (that is, it is a dichotomous variable — suitable or not suitable). In other countries, it is argued that the suitability of criteria lies on a continuum, and the position on this continuum is the determining factor. For an international standard setting body aiming to position the profession as a high quality provider of assurance services, it is desirable that it provides guidance as to what constitutes suitable criteria, and encourages the use of international best practice criteria. One of the assurances services that was examined in detail in this study was the issuing of assurance on environmental and sustainability reports. This service is of particular interest because it is possible to trace the evolution of suitable criteria for these types of engagement. Even though the criteria to date may not meet the standard of “suitable” (in some eyes), there are emerging guidelines that are commonly regarded as world best practice. The tracing of this service highlights one of the dilemmas for the IAPC. This is the dilemma between creating the right environment to encourage the development of innovative assurance practices, and the control and maintenance of the reputation of the profession.

The other issue highlighted by the review of this assurance service is that the profession should be careful in using the term “suitable criteria,” especially in the context of being either suitable or not suitable. For a
profession that wants to be at the forefront of providing high quality assurance, it appears that the criteria that the profession should encourage their members to use are best practice criteria. If criteria that were suitable (or best practice) and were used last year have been superseded this year, the current best practice guidelines should be the criteria that members are encouraged to use.

Many of the developments in assurance services undertaken by the profession have had to do with creating and developing the acceptance of suitable criteria. This study views criteria not as a dichotomous variable but as lying on a continuum. The criteria for specific assurance engagements evolve over time. This evolutionary perspective is a requirement for the development of new assurance services. While the subject matter for financial statement auditing is set, the specific criteria have been evolving, and would be considered superior to what they were, say, 20 years ago. The same could be said today for many newly developed assurance services. The criteria for environmental and sustainability reporting are evolving, and at some stage these criteria will meet the condition of “suitable.”

Finally, the criteria that should be encouraged are those which are best practices, which are those that, for a given level of work effort, result in the highest level of assurance permitted for that subject matter. The dimensions driving this will include relevance and reliability of evidence. Consideration should also be given to its effectiveness in communications, dimensions that will include its general acceptance and the level of understandability by the intended users of the report.

**Quantity and Quality of Evidence**

The fourth dimension discussed within the interaction of variables approach is the quantity and quality of evidence. It is argued that the reliability of the evidence itself can impact the overall levels of assurance provided, but only in conjunction with the nature and form of the subject matter, criteria and procedures. We found little theoretically to support the view that this should be a separate determining factor in the level of assurance. We do believe that there will be variation in the quantity and quality of the evidence, but this will be a function of (and not a separate dimension to) the subject matter, suitability of criteria, and work effort. Within the constraints imposed by the first two dimensions listed, work effort becomes the major determinant of the quantity and quality of evidence.

From our review of practice contained in Chapter 5 we do see that quantity and quality of evidence were included as ranked dimensions of levels of assurance, although they ranked fourth and fifth behind the other three dimensions outlined (quality of evidence was just below work effort).

**Do other factors affect the level of assurance provided and communicated?**

There was no theoretical framework identified that included any other factors affecting the level of assurance other than those identified to date.

Another method of identifying potential determinants was the survey of practice. This survey found a number of other factors that appear to have an important impact on the level of assurance. In particular, the level of assurance is determined by user needs, litigation risk, lack of standards, distribution of the report, regulatory requirements, adequacy of fees and industry practice.

One dimension that could be argued as worthy of incorporation in a theoretical framework for levels of assurance at less than high is user needs. Specified user needs should be a major determinant of level of assurance to be provided in assurance engagements. The determinants that are then considered are the

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1 Included in the questionnaire as separate dimensions.
The Determination and Communication of Levels of Assurance Other than High

factors driving the assurance provider’s response. For a particular engagement (involving assessment of subject matter and suitability of criteria), the assurance provider will respond to differences in user needs by altering work effort.

It was not viewed as necessary to consider the other dimensions in a theoretical framework of determinants of levels of assurance. Litigation risk is generally not referred to in auditing standards on the basis that this is a practice consideration rather than a policy consideration. Lack of standards, regulatory requirements, and industry practice will be covered by the subject matter and the suitability of criteria. Distribution of the report will generally be covered by general-purpose versus special-purpose reporting considerations. Adequacy of fees should be related to acceptance of the engagement (practice consideration), user needs and work effort. Thus these suggestions of determinants from assurance providers, although relevant considerations, generally do not produce any further determinants that are considered necessary for consideration by the IAPC.

Form of relationship between determinants of level of assurance

There is a general consensus of a strong interrelationship among the determining factors for most assurance engagements. The subject matter is generally regarded as interrelated with suitable criteria since suitable criteria may be lacking in specific engagements, in particular for forward-looking or less quantitative engagements. The nature of the subject matter can limit the reliability of the evidence, although as outlined before, it is hard to see these as separate dimensions. Furthermore, there is consensus on the fact that the interrelationship among the factors affects the level of assurance. In particular, it was argued that the nature of subject matter might not be fully measurable in itself or due to the absence of suitable criteria or professional standards. Neither work effort, nor quantity and quality of evidence can always compensate for this. Indeed, the nature of the subject matter may limit available evidence, in which case it cannot be extended simply by providing more work effort. These interrelationships affect the level of assurance in addition to other factors such as user needs, time restrictions and cost/benefit considerations.

In short, the form of the relationship is that the three factors (subject matter, criteria and work effort) will all directly and separately impact on determining the level of assurance. The most difficult components to conceptualize separately are subject matter and suitable criteria, as these will run hand-in-hand. As an example, however, it would be possible to have forward-looking engagements with criteria that meet the definition of suitable, yet only provide a level of assurance other than high. As well as impacting as separate components, subject matter and suitable criteria will correlate, with specific types of engagements being less prone to generating suitable criteria. These cannot be compensated by work effort with the implication that for such engagements it may be difficult to provide a high level of assurance.

6.2 Communication of a Level of Assurance Other than High

When considering assurance at levels other than high it must be remembered that issues of determinants and communication are interrelated. That is, the reporting associated with a particular engagement will depend on the specific subject matter, criteria and work effort. What has been identified from the research is that there is no easy solution as to how to report levels of assurance other than high. This should not be seen as a surprising finding, because if there was an easy, globally acceptable solution, one of the many groups that have examined this area would have presented it by now. There are a number of competing models and suggestions that have been put forward by the many groups that have been examined in this

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2 For example, assurance reports on internal control contain an inherent limitations paragraph.
research project. It is also recognized that groups have put forward and argued for the superiority of certain models over other competing views. These views are consistently applied across some national standard-setting jurisdictions, but it must be remembered that they are contingent on the identified determinants of assurance.

The current system of communication that is widely used and advocated is a relatively standardized positive form of assurance report for high assurance, and negative form of assurance report for levels of assurance less than high. The major justification for this system is that it is simple, widely accepted and thus should minimize any differences in expectation between the preparer and the user. However, our review of the available evidence from around the world finds that while the positive form of assurance report is generally well-understood, there are problems with the negative form of assurance communication. It is appreciated that this raises difficulties, as if such a relatively simple two-form system leads to difficulties, any suggestion with increased reporting options may increase these difficulties.

One of the difficulties of advocating any suggested form of communication device for communicating various levels of assurance, is that the intended user may use factors other than those suggested in section 6.1 to derive a level of assurance. This study has found that the user commonly uses general referents for quality, such as Big Five, or assurance providers known as specialists in the industry, to assume a level of assurance. While extant research has been on high assurance engagements, there is no reason to presume that it will be different for assurance engagements at levels less than high. It may be however, with the reporting process much less developed for such assurance engagements, that an assurance provider can communicate various levels of assurance within an acceptable range, through the description of the determinants such as work effort, subject matter, or criteria, or the form of the opinion.

During this study we have identified different reporting initiatives, some of which are specific to a particular form or group of assurance services. One form that is commonly used is a less standardized, more descriptive, form of report. Another form is the use of an inherent limitations section paragraph, especially for forward-looking or less quantified subject matter. The advantage of these forms of communications, and others identified are considered below.

**What can we learn from our review of the initiatives of the various National Institutes?**

The approach that is advocated by the National Institutes is the negative form of reporting for reporting assurance at levels other than high (“nothing has come to my attention”). Comments vary upon how well this type of reporting is understood. While some respondents appear to believe this form is generally now well-accepted, the publicly available research and many other respondents believe that that this form of reporting is poorly understood. It is possible that in some nations, for specific types of user groups, the level of assurance communicated with this method is well understood. However, our review of assurance providers shows that this form of report is used for various levels of work-effort, and to portray a relatively wide range of assurance. We believe that use of this type of report is directly informed by communication theory, and thus its use, and suggested enhancements, are discussed further under this section.

One of the major ways in which the current negative form report attempts to distinguish itself from the positive form, is with the description of work effort. The research however suggests that the suggested descriptions fail to adequately convey the intended differences in work effort. Thus current descriptions should be reconsidered to see whether descriptions more fitting of the work effort actually undertaken can be identified. In particular, descriptions such as “less intensive than those undertaken in an audit” are not seen to be sufficiently informative, and require knowledge of the base audit procedures to be accurately judged.
We also see a common suggestion from National Institutes, that is widely used in practice, is that where the subject matter is less quantified, or is forward looking, an inherent limitations section is included. An example of this is reporting on internal control, where an inherent limitations section paragraph on the nature of the internal control service in the body of the report is suggested. There appears to be little thought given to the communication issues associated with this approach. In particular, do users subscribe a lower level of assurance to this report because of the inclusion of such a paragraph? While this appears to be a widely regarded way of reporting and effectively communicating the nature of this service, there is currently little evidence on the effectiveness of this method of communication.

Are there innovative reporting methods in the various assurance practices from which we can learn about the communication of levels of assurance other than high?

Our review of innovative practices from assurance services providers indicates that this is an area where high levels of innovation are not present. This seems strange, given that in the past standards-setters have not been able to agree on the most appropriate approach, practice has tended to lead the way. At present, it appears that communication relating to engagements providing other than high levels of assurance are being pigeonholed into familiar reporting forms, such as the negative assurance provided by reviews, the high level of assurance provided by audit (perhaps with inherent limitations paragraphs), or agreed-upon procedures. This pigeonholing approach appears to be associated with the fact that there is no guiding framework (a comment that is frequently observed in the survey responses).

While much of the reporting examined was closely related to existing communications associated with audit and review engagements, there were observed instances of innovative reporting. An example of this was the Shell sustainability report where the assurance report was provided in a standardized way at the front of the report and then symbols were used throughout the report to indicate whether suitable criteria were significantly departed from. The innovation is in two ways. First, the content of the assurance report is not restricted to the assurance report itself, but is distributed throughout the subject matter. This clearly identifies particular assurances or concerns with particular subject matter. As a method of communication this is possibly an effective approach, as readability studies suggest that the current form of assurance report is not widely read. This lack of readership is consistent with it being more of a symbol of a particular level of assurance, rather than providing additional information content. The second innovation of this style of reporting is the disaggregation opportunities that it offers. One of the most difficult tasks for assurance providers is to try to pull all the evidence gathered together in order to provide an overall conclusion on the subject matter of the engagement. This also involves determining whether the assurance provider’s concerns overall are material or significant. Being able to provide assurance on sub-components can be a more effective communication device.

Another aspect of innovation the profession may consider is the use of laymen’s terms in the assurance report. The International Standards Organization reporting framework essentially recommends such an approach. The use of everyday language may be more understandable to the average user, but may increase the risk of professional liability.

What can we learn from other professions about the determination and communication of levels of assurance other than high?

A review was undertaken of the initiatives undertaken by groups of assurance providers and standards setters outside the accounting profession. This included the International Standards Organization, the Internal Auditors Association, various public sector groups, and other organizations. It is true to say that the discussion of the determinants of assurance, and how the levels of assurance can best be
communicated, seems to be at a lower level than the discussions that are occurring within the accounting profession. However, a fairly consistent finding regarding how different levels of assurance are reported is that members of these other professions have chosen the option to use long and detailed reports for assurance engagements. The reporting guidance provided by these other professional groups to their members is usually limited, and the members appear unconcerned about issuing descriptive and non-standardized reports. There is no research that we are aware of about these reports being a more effective communication device, in that the level of assurance intended is that which is extracted from the report by the users. The accounting profession has been worried about encouraging non-standardized reports, primarily for stated reasons of litigation and lack of comparability. It may however be, that in innovative, new assurance services, such reporting is the most effective at communicating the intended level of assurance.

**What can we learn from communication theory about communicating levels of assurance other than high?**

As outlined earlier, it is commonly recognized that there are difficulties in communicating the appropriate level of assurance. If viewed in terms of communication theory, it could be argued that the profession and the National Institutes have tended to go for a semiotic solution to this issue, where they have attempted to create symbols of audit and review and attach to these a particular level of assurance. Thus in practice, as illustrated by current IAPC standards, the approach has been to emphasize a communication system which involves two levels of assurance, high (audit) and moderate (review). The suggested wording of these reports has been used as the major mechanism to distinguish between these two levels of assurance. A form of positive wording has been associated with the high level of assurance, and a form of negative wording (“nothing has come to my attention”) has been associated with the moderate level of assurance. This framework has a great deal of support from particular standard-setters, as well as support from the semiotic view of communications theory. Wording is, however, only one of the methods by which symbols of particular levels of assurance can be effectively communicated.

Is there evidence that this method of communication is successful? As outlined earlier, the evidence suggests that the term “audit” is a well-understood, and not generally misinterpreted term. For auditors it is associated with a particular set of evidence gathering procedures. The word has become part of the everyday language (although there are many examples of its abuse in the everyday use). The evidence for the term “review” or “moderate level of assurance” is nowhere near as clear. The term has not been in existence in this particular context as long as has the term “audit”. While most of the current standards try to portray “review” as a particular set of evidence gathering procedures, it is not always used by the standard setting bodies or the assurance services providers in association with these procedures. It appears that in practice it has become widely used for providing an assurance anywhere below high on the level of assurance continuum. Thus it is being used to communicate a range of assurance levels, rather than a point estimate (moderate). It also appears that the level of assurance provided by a review engagement is not always well-understood by the intended users of the assurance services report. It may be that the term review and the associated concept of negative assurance have not been in existence for a sufficient period of time. The standard words that are contained in these review reports are not interpreted as conveying a significantly different level of assurance to that level contained in an audit report. The review report, when thought of as a symbol of moderate level of assurance, also looks very similar to the symbol of the audit report. The suggested structure of these reports are very similar, with differences in wording which may be considered too subtle for any other than a well-informed user. Thus, as well as the assurance services providers using the review report for different purposes, there is evidence that the users do not attribute a significantly different level of assurance to that contained in the review report.
Do communication issues appear to differ for special purpose assurance reports compared with general purpose assurance reports?

It may be argued that the symbolic representation of levels of assurance provided by review and audit reports is suitable for general purpose reports. Special purpose reports, where the assurance provider can more easily judge the intended recipient’s ability to adequately interpret the intended message, can be considered a less standard form of communication device. Longer form reports, for example where work effort is described in more detail, may be informative to this class of intended user. Thus it may be that any guidance also has to draw the distinction between whether the report is intended as a special purpose or general purpose report.

The use of disclaimers is also widely associated with special purpose reports. While these disclaimers are not necessarily intended to reduce the amount of assurance to be provided to the intended user, it may be that an intended user reading a report containing a disclaimer (even if the disclaimer is limiting only the groups that may rely on the report), may draw a lower level of assurance compared to that which would be read by the same user from a report not containing such a disclaimer.

6.3 Summary and Conclusions

Regarding the determinants of the level of assurance, this study supports an interaction of variables approach for determining a given level of assurance. The three main variables are subject matter, specific criteria and work effort. These factors are seen to impact directly on the level of assurance, and interact to cause the level of assurance. The work effort view is not necessarily seen to be inconsistent with this approach. The work effort view has been to date undertaken primarily on a subject matter by subject matter approach. This is an acknowledgement that subject matter is a determining factor in the level of assurance. The major ways in which subject matter has been divided, is on a historical versus future-orientation, and quantitative versus qualitative basis.

We also believe that there is general agreement that suitability of criteria affects the level of assurance, although we understand that this is contentious. The major difference appears to be not on whether suitability of criteria has an impact on the level of assurance offered, but on whether the suitability of criteria is a continuum or a discrete concept (suitable/unsuitable). In some countries it is argued that suitable criteria are such an important dimension that the service should not be provided without suitable criteria (it is a 0 or 1 variable). In other countries it is argued that the suitability of criteria is on a continuum and its position on this continuum will be a determining factor of the level of assurance that can be provided on any engagement. This study views criteria not as a dichotomous variable but as lying on a continuum. The criteria for specific assurance engagements evolve over time. This evolutionary perspective is a requirement for the development of new assurance services.

In terms of how best to communicate the level of assurance, the first point to be noted is that the determinants and effective communication relating to assurance engagements at levels other than high are interrelated. We have argued in this study that the assurance associated with a particular engagement will depend on the specific subject matter, criteria and work effort. Each of these determinants needs to be properly addressed in the report. Describing the determinants of a particular level of assurance will improve user understanding of the particular assurance level the assurance provider wishes to communicate. The communication issue can only be satisfactorily addressed once there is consensus on an appropriate framework for the determinants of a moderate level of assurance.

There are a number of possible communication frameworks suggested by our evaluation. One possible approach is to limit the forms of communication to two: audit and review. This is effectively the current
situation. Audit would be communicated in the positive form and review in the negative form. Audit would be used for high level of assurance and review for anything other than high level of assurance. This would solve the problem of identifying forms of effective communication for levels of assurance other than high. However, it does mean that review reports would be used to capture a wide range of assurance levels. Thus a problem would remain: what level of assurance is to be associated with a particular review report? Our review suggests that in current practice, this range is very broad, with a mean of about 60%.

It is argued that the profession should consider initiatives that will provide a greater differentiation of the form of the review report from the current audit report. One of the potential problems is that these forms of reports closely resemble each other, and that with the use of standardized terminology, users are failing to adequately distinguish between the reports. Even headings, for example of high assurance report and moderate assurance report, rather than “independent audit report” and “independent review report,” can help distinguish these forms of engagements. It has also been identified that the standardized descriptions of work effort that are suggested fail to adequately communicate different levels of assurance. It is suggested that greater detail be provided for audit procedures, and review procedures be described without the referent to audit procedures.

An alternative communication framework to the above is that the profession attempts to only associate the review (negative assurance) report with a particular set of minimum evidence-gathering procedures and a minimum level of assurance. Many, but not all, current review engagements are associated with a particular set of evidence-gathering procedures, these predominantly being analytical procedures and discussions with management (or variants of these for particular engagements). These are deemed as providing a moderate level of assurance, and would in most circumstances provide a minimum level of evidence-gathering procedures for any assurance engagement. Thus it would be possible to connect the review report format to a specific set of evidence-gathering procedures and a minimum level of assurance. If it is supposed to be symbolic of this minimum (but still moderate) level of assurance provided by the profession, then the profession should consider whether as a symbol it should in appearance be similar to the high assurance (audit) report. Such a report would then provide a lower base, or anchor, for reporting.

If it is accepted that there should be symbols for audit and review at both the lower and upper ends of an acceptable continuum of assurance, the question remains as to how to report the level of assurance for engagements between these acceptable levels. The review of the responses of the National Institutes and the participating assurance firms does not reveal high levels of innovation in practice. It may be necessary to encourage novel reporting practices in assurance providers in order to promote development in this area. However, it is not clear that individual assurance providers would be willing to innovate, as shown by the fact that most firms seem hesitant to move too far from suggested standard form audit reports. Perhaps under this approach the IAPC could suggest various reporting strategies where the level of assurance is something less than high (for which the audit report is used) and somewhere above moderate (for which the negative form of assurance report is used). More research on the alternative types of reports, the intended levels of assurance, and the received levels of assurance, is encouraged in order to provide greater insights to policy makers considering the reporting issue.

A final communication framework that should not be discounted is to encourage longer form reports, or to encourage innovation of members in their forms of reporting. Longer form reports are commonly used in other professions, although there is little evidence of the effectiveness of these forms of communication. In innovative areas, until the profession gains general acceptance as the natural assurance provider, it may be best to leave members unconstrained by reporting requirements.
APPENDIX 1: INTERNATIONAL STANDARD ON ASSURANCE ENGAGEMENTS (ISAE 100)

As of May 2002

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Preface

This International Standard on Assurance Engagements (ISAE) provides an overall framework for assurance engagements intended to provide either a high or moderate level of assurance.

It establishes the basic principles and essential procedures for professional accountants in public practice for the performance of engagements intended to provide a high level of assurance. This ISAE does not, however, provide basic principles and essential procedures for engagements intended to provide a moderate level of assurance. IAPC is developing further guidance on such engagements.
Introduction

1. This International Standard on Assurance Engagements has three purposes:
   (a) to describe the objectives and elements of assurance engagements intended to provide either a high or moderate level of assurance (paragraphs 4-30);
   (b) to establish standards for and provide guidance to professional accountants in public practice for the performance of engagements intended to provide a high level of assurance (paragraphs 31-74); and
   (c) to act as a framework for the development by the IAPC of specific standards for particular types of assurance engagements.

2. When a professional accountant is engaged to perform an assurance engagement for which specific standards exist, those standards apply; if no specific standards exist for an assurance engagement, this document applies. Where a professional accountant in public practice performs an engagement intended to provide a high level of assurance for which no specific standards exist, the standards and principles set out in paragraphs 31-74 are to be followed.

3. This Standard does not supersede the existing International Standards on Auditing (ISAs). For example, it does not apply to an audit or review of financial statements.

OBJECTIVE AND ELEMENTS OF AN ASSURANCE ENGAGEMENT

Objective of an Assurance Engagement

4. The objective of an assurance engagement is for a professional accountant to evaluate or measure a subject matter that is the responsibility of another party against identified suitable criteria, and to express a conclusion that provides the intended user with a level of assurance about that subject matter. Assurance engagements performed by professional accountants are intended to enhance the credibility of information about a subject matter by evaluating whether the subject matter conforms in all material respects with suitable criteria, thereby improving the likelihood that the information will meet the needs of an intended user. In this regard, the level of assurance provided by the professional accountant’s conclusion conveys the degree of confidence that the intended user may place in the credibility of the subject matter.

5. There is a broad range of assurance engagements, which includes any combination of the following.
   • engagements to report on a broad range of subject matters covering financial and non-financial information.
   • engagements intended to provide high or moderate levels of assurance.
   • attest and direct reporting engagements.
   • engagements to report internally and externally.
• engagements in the private and public sector.

6. Not all engagements performed by professional accountants are assurance engagements. This does not mean that professional accountants do not undertake such engagements, only that these engagements are not covered by this Standard. Other engagements frequently performed by professional accountants that are not assurance engagements include the following.

• Agreed-upon procedures.
• Compilation of financial or other information.
• Preparation of tax returns where no conclusion is expressed, and tax consulting.
• Management consulting.
• Other advisory services.

7. An agreed-upon procedures engagement, in which the party engaging the professional accountant or the intended user determines the procedures to be performed and the professional accountant provides a report of factual findings as a result of undertaking those procedures, is not an assurance engagement. While the intended user of the report may derive some assurance from the report of factual findings, the engagement is not intended to provide, nor does the professional accountant express, a conclusion that provides a level of assurance. Rather, the intended user assesses the procedures and findings and draws his or her own conclusions. However, a professional accountant may undertake an engagement that is similar to an agreed-upon procedures engagement but which does result in the expression of a conclusion that provides a level of assurance. Where, in the judgment of the professional accountant, the procedures agreed to be performed are appropriate to support the expression of a conclusion that provides a level of assurance on the subject matter, and the professional accountant intends to do so, then such an engagement becomes an assurance engagement governed by this standard.

Elements of an Assurance Engagement
8. Whether a particular engagement is an assurance engagement will depend upon whether it exhibits all the following elements.

(a) a three party relationship involving:
   (i) a professional accountant;
   (ii) a responsible party; and
   (iii) an intended user;
(b) a subject matter;
(c) suitable criteria;
(d) an engagement process; and
(e) a conclusion.

Three Party Relationship
9. Assurance engagements involve three separate parties: a professional accountant, a responsible party and an intended user. The professional accountant provides assurance to the intended user about a subject matter that is the responsibility of another party.
10. The responsible party and the intended user will often be from separate organizations but need not be. A responsible party and an intended user may both be within the same organization, for example, a governing body may seek assurance about information provided by a component of that organization. The relationship between the responsible party and the intended user needs to be viewed within the context of a specific engagement and may supersede more traditionally defined responsibility lines.

Professional Accountant

11. The IFAC “Code of Ethics for Professional Accountants” (the Code) defines professional accountants as those persons who are members of an IFAC member body, whether they be in public practice (as a sole practitioner, partnership or corporate body), industry, commerce, the public sector or education. The term “professional accountant” in this Standard includes the term “auditor” but also recognizes that assurance engagements deal with a broader range of subject matter and reporting arrangements than the issue of an audit opinion by external auditors on financial statements.

12. The fundamental principles that the professional accountant has to observe are:

   (a) integrity;
   (b) objectivity;
   (c) professional competence and due care;
   (d) confidentiality;
   (e) professional behavior; and
   (f) application of technical standards.

13. The requirement relating to the “objectivity” principle is of particular importance in an assurance engagement in ensuring that the conclusion of the professional accountant has value to the intended user. The intended user needs to have confidence that the professional accountant has no interest that creates an unacceptable risk of bias with respect to the subject matter.

14. Professional accountants in public practice also have to observe the requirements of Part B of the Code, which includes a requirement to be independent when conducting an assurance engagement.

15. Professional accountants may be requested to perform an assurance engagement on a wide range of subject matters. However, professional accountants will not agree to perform an assurance engagement which they are not competent to carry out, unless competent advice and assistance is obtained so as to enable them to satisfactorily perform such services. If a professional accountant does not have the competence to perform a specific part of the assurance engagement, technical advice will be sought from experts.

Responsible Party

16. The responsible party is the person or persons, either as individuals or representatives of an entity, responsible for the subject matter. For example, management is responsible for the preparation of financial statements or the implementation and operation of internal control. The responsible party
may or may not be the party who engages the professional accountant. The professional accountant may be engaged by management or by other parties.

**Intended User**

17. The intended user is the person or class of persons for whom the professional accountant prepares the report for a specific use or purpose. The intended user may be established by agreement between the professional accountant and the responsible party or those engaging or employing the professional accountant. In some circumstances the intended user may be established by law. The responsible party may also be one of the intended users. Often the intended user will be the addressee of the professional accountant’s report but there may be circumstances where there will be intended users other than the addressee. There may also be situations where the responsible party will be the addressee, but will make the report available to the intended users.

18. Some intended users (for example, bankers and regulators) may impose a requirement on, or may request the responsible party to arrange for an assurance engagement to be carried out on a particular subject matter. However, other intended users may have no direct involvement in defining the arrangements for an assurance engagement.

19. In circumstances where the engagement is for a special purpose, the professional accountant may consider restricting the report to specific intended users, and indicating in a restriction in the report that others not identified as users may not rely on it.

**Subject Matter**

20. The subject matter of an assurance engagement may take many forms, such as the following:

- Data (for example, historical or prospective financial information, statistical information, performance indicators).
- Systems and processes (for example, internal controls).
- Behavior (for example, corporate governance, compliance with regulation, human resource practices).

The subject matter may be presented as at a point in time or covering a period of time.

21. The subject matter of an assurance engagement is to be identifiable, capable of consistent evaluation or measurement against suitable criteria and in a form that can be subjected to procedures for gathering evidence to support that evaluation or measurement.

**Criteria**

22. Criteria are the standards or benchmarks used to evaluate or measure the subject matter of an assurance engagement. Criteria are important in the reporting of a conclusion by a professional accountant as they establish and inform the intended user of the basis against which the subject matter has been evaluated or measured in forming the conclusion. Without this frame of reference any conclusion is open to individual interpretation and misunderstanding. Criteria in an assurance engagement need to be suitable to enable reasonably consistent evaluation or measurement of the subject matter within the context of professional judgment. Suitable criteria are context-sensitive, that is, relevant to the engagement circumstances.
23. For example, in the preparation of financial statements the criteria may be International Accounting Standards or International Public Sector Accounting Standards, which are intended to provide a range of users with relevant and consistent information about an entity’s financial position, results of operations and cash flows. In an audit of financial statements, the auditor provides assurance as to whether the financial statements give a true and fair view of (or present fairly, in all material respects), an entity’s financial position, results of operations and cash flows by using the accounting framework to evaluate the preparation and presentation of the subject matter. When reporting on the way in which an entity is organized or managed, or the extent to which its objectives have been achieved, generally accepted criteria for a particular industry may be used. When reporting on internal control, the criteria may be an established internal control framework or stated internal control criteria. When reporting on compliance, the criteria may be the applicable law, regulation or contract. Criteria may also be developed for specific users, for example, a party to a contract who wants assurance that other parties to the same contract are complying with the contract terms.

Engagement Process

24. The engagement process for an assurance engagement is a systematic methodology requiring a specialized knowledge and skill base, and techniques for evidence gathering and evaluation and measurement to support a conclusion, irrespective of the nature of the engagement subject matter. The process involves the professional accountant and those who engage the professional accountant agreeing to the terms of the engagement. Within that context, the professional accountant considers materiality and the relevant components of engagement risk when planning and conducting the engagement. An assurance engagement involves the professional accountant planning and conducting the engagement to obtain sufficient appropriate evidence and applying professional judgment in order to express a conclusion.

Conclusion

25. The professional accountant expresses a conclusion that provides a level of assurance as to whether the subject matter conforms in all material respects with the identified suitable criteria.

26. In an attest engagement, the professional accountant’s conclusion relates to an assertion by the responsible party. The assertion is the responsible party’s conclusion about the subject matter based on identified suitable criteria. The professional accountant can either express a conclusion about the assertion by the responsible party, or provide a conclusion about the subject matter in a form similar to the assertion made by the responsible party. In the latter case the assurance is provided because the professional accountant’s conclusion on the subject matter supports the assertion by the responsible party.

27. In a direct reporting engagement, the professional accountant expresses a conclusion on the subject matter based on suitable criteria, regardless of whether the responsible party has made a written assertion on the subject matter.

28. The professional accountant’s conclusion provides a level of assurance about the subject matter. In theory, it is possible to provide an infinite range of assurance from a very low level of assurance to an absolute level of assurance. In practice, it is not ordinarily practicable to design an engagement to provide such fine graduations of assurance or to communicate the level of assurance in a clear and unambiguous manner. In addition, absolute assurance is generally not attainable as a result of such factors as the use of selective testing, the inherent limitations of control systems, the fact that
much of the evidence available to the professional accountant is persuasive rather than conclusive, and the use of judgment in gathering evidence and drawing conclusions based on that evidence. Therefore, professional accountants ordinarily undertake engagements to provide one of only two distinct levels: a high level and a moderate level. These engagements are affected by various elements, for example, the degree of precision associated with the subject matter, the nature timing and extent of procedures, and the sufficiency and appropriateness of the evidence available to support a conclusion.

29. The expression “high level of assurance” refers to the professional accountant having obtained sufficient appropriate evidence to conclude that the subject matter conforms in all material respects with identified suitable criteria. In rare circumstances, the professional accountant may be able to provide absolute assurance, for example, where the evidence available is conclusive and reliable because the subject matter is determinate, the criteria definitive and the process applied comprehensive. However, because of the limitations of the engagement process, a high level of assurance is ordinarily less than absolute. The professional accountant designs the engagement to reduce to a low level the risk of an inappropriate conclusion that the subject matter conforms in all material respects with identified suitable criteria.

30. The expression “moderate level of assurance” refers to the professional accountant having obtained sufficient appropriate evidence to be satisfied that the subject matter is plausible in the circumstances. The professional accountant designs the engagement to reduce to a moderate level the risk of an inappropriate conclusion. The professional accountant designs the report to convey a moderate level of assurance regarding the conformity of the subject matter with identified suitable criteria.

The following section contains the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material for high level assurance engagements performed by professional accountants in public practice where no specific standards exist. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provide guidance for their application.

To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the Standard, including explanatory and other material contained therein, not just that text which is black lettered.

In exceptional circumstances, a professional accountant may judge it necessary to depart from this Standard in order to more effectively achieve the objective of the engagement. When such a situation arises, the professional accountant should be prepared to justify the departure.

This Standard need only be applied to material aspects of the subject matter.

The Public Sector Perspective (PSP) issued by the Public Sector Committee of the International Federation of Accountants is set out at the end of a standard. Where no PSP is added, the standard is applicable in all material respects to the public sector.
HIGH-LEVEL ASSURANCE ENGAGEMENTS

Scope of Standard

31. The objective of a high level assurance engagement is for a professional accountant in public practice to evaluate or measure a subject matter that is the responsibility of another party against identified suitable criteria, and to express a conclusion that provides the intended user with a high level of assurance about that subject matter. The term “practitioner” is used hereafter to refer to a professional accountant in public practice.

32. The term “high level assurance engagement” is used to describe any assurance engagement intended to provide a high, but not absolute, level of assurance. The practitioner designs the engagement process so that the risk of expressing an inappropriate conclusion that the subject matter conforms in all material respects with suitable criteria, is reduced to a low level. The practitioner obtains sufficient appropriate evidence through procedures such as inspection, observation, inquiry, confirmation, computation and analysis.

Ethical Requirements

33. The practitioner should comply with the requirements of the IFAC Code of Ethics for Professional Accountants (The Code).

34. A practitioner who performs an assurance engagement should be independent. Section 8 of The Code indicates some of the situations which, because of the actual or apparent lack of independence, would give a reasonable observer grounds for doubting the independence of a practitioner.

Accepting the Engagement

35. The practitioner should accept an engagement only if the subject matter is the responsibility of another party. Acknowledgement by the responsible party provides evidence that the appropriate relationship exists and also establishes a basis for a common understanding of the responsibility of each party. Obtaining this acknowledgement in writing provides the most appropriate form of documentation of the responsible party’s acknowledgement, but, recognizing the broad range of assurance engagements, this is not always practical. There may be other sources of evidence that indicate responsibility for the subject matter; for example, it may be clearly established in legislation, or contract. When the practitioner has other evidence that the responsibility exists, acknowledgement of responsibility for the subject matter may be obtained at other points in the engagement such as through discussions on the criteria or the level of assurance.

36. The practitioner should accept the engagement only if the subject matter is identifiable and in a form that can be subjected to evidence gathering procedures, and the practitioner is not aware of any reason for believing that a conclusion expressing a high level of assurance about the subject matter based on suitable criteria cannot be expressed. The practitioner may accept the engagement only if, as a result of initial discussions with one or more of the parties associated with the engagement, and on the basis of a preliminary knowledge of the engagement circumstances, nothing comes to the attention of the practitioner to indicate that the requirements of this Standard will not be satisfied. The practitioner also needs to have a reasonable basis for believing that a conclusion with a high level of assurance concerning the subject matter can be
provided and that the conclusion can be meaningful to the intended user of the report of the practitioner.

37. **The practitioner should be satisfied that those performing the engagement possess collectively the necessary professional expertise to perform the engagement.** Some subject matters may require specialist skills and knowledge beyond those practitioners ordinarily possess. In such cases the practitioner ensures that those persons carrying out the engagement as a team possess the requisite skills and knowledge.

**Agreeing the Terms of the Engagement**

38. **The practitioner should agree on the terms of the assurance engagement with the party who engages the practitioner.** As a means of reducing uncertainty, it is recommended that the agreed terms be recorded in an engagement letter or other suitable form of contract. In some cases the engagement objective, subject matter and time period are prescribed by a party or parties other than the one that appoints the practitioner, for example, by legislation. Where the assurance engagement mandate is legislated, acknowledgement of the legislative mandate meets this requirement.

39. A practitioner who, before the completion of the engagement, is requested to change the engagement from one that provides a high level of assurance to a different engagement, considers the appropriateness of doing so, and cannot agree to a change where there is no reasonable justification for the change.

**Quality Control**

40. **The practitioner should implement quality control policies and procedures designed to ensure that all assurance engagements are conducted in accordance with applicable standards issued by the International Federation of Accountants.** Quality control policies and procedures apply at two levels, and relate to the overall policies and procedures for all assurance engagements and also to the direction, supervision and review of work delegated to personnel involved in a specific assurance engagement. ISA 220 “Quality Control for Audit Work” sets out the current applicable standards.

**Planning and Conduct**

41. **The practitioner should plan and conduct the assurance engagement in an effective manner to meet the objective of the engagement.** Planning consists of developing a general strategy and a detailed approach to the assurance engagement, and assists the proper assignment and supervision of work. The following are examples of the main matters that need to be considered.

- The engagement objective.
- The criteria to be used.
- The engagement process and possible sources of evidence.
- Preliminary judgments about materiality and engagement risk.
- Personnel and expertise requirements, including the nature and extent of the involvement of the experts.
Planning and supervision are continuous throughout the engagement, and plans may need to be changed as the engagement progresses.

42. **The practitioner should plan and conduct an assurance service engagement with an attitude of professional skepticism.** The practitioner neither assumes that the responsible party is dishonest nor assumes unquestioned honesty. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of evidence. Without an attitude of professional skepticism, the practitioner may not be alert to circumstances that lead to a suspicion, and may draw inappropriate conclusions from the evidence obtained.

43. **The practitioner should have or obtain knowledge of the engagement circumstances sufficient to identify and understand the events, transactions and practices that may have a significant effect on the subject matter and engagement.** Such knowledge is used by the practitioner in assessing the suitability of the criteria, engagement risk and in determining the nature, timing and extent of engagement procedures.

44. **The practitioner should assess whether the criteria are suitable to evaluate the subject matter.** Criteria can be either established or specifically developed. Established criteria are those embodied in laws or regulations, or issued by recognized bodies of experts that follow due process. Specifically developed criteria are those identified for the purpose of the engagement and which are consistent with the engagement objective. The source of the criteria will affect the amount of work the practitioner will need to carry out in order to assess suitability for a particular engagement. In addition, those engaging the practitioner and the practitioner agree on the criteria. The practitioner may also discuss the criteria to be used with the responsible party or the intended user.

45. The decision as to whether the criteria are suitable involves considering whether the subject matter is capable of reasonably consistent evaluation against or measurement using such criteria. The characteristics for determining whether criteria are suitable are as follows:

   (a) Relevance: relevant criteria contribute to conclusions that meet the objectives of the engagement, and have value in terms of improving the quality of the subject matter, or its content, so as to assist decision making by intended users;

   (b) Reliability: reliable criteria result in reasonably consistent evaluation or measurement and, where relevant, presentation of the subject matter and conclusions when used in similar circumstances by similarly qualified professional accountants;

   (c) Neutrality: neutral criteria are free from bias. Criteria are not neutral if they cause the practitioner’s conclusion to mislead report users;

   (d) Understandability: understandable criteria are clear and comprehensive and are not subject to significantly different interpretation; and

   (e) Completeness: complete criteria exist when all the criteria that could affect the conclusions are identified or developed, and used.

46. The assessment of whether criteria are suitable involves weighing the relative importance of each characteristic and is a matter of judgment in light of the specific objective of the engagement. Irrespective of whether the subject matter is quantitative or qualitative, the criteria are to be suitable. In applying the guidance in paragraph 45, it is recognized that while suitable criteria are to possess each of the characteristics, the evidence available to support some of those characteristics for a particular subject matter will be less conclusive. If any of the characteristics
are not met, the criteria are unsuitable. In emerging types of assurance engagements it is less likely that there will be established criteria, and therefore criteria will need to be specifically developed.

47. The practitioner ordinarily concludes that established criteria are suitable when the criteria are consistent with the engagement objective, unless an identifiable limited group of users has agreed to other criteria. In such cases, the practitioner’s report indicates that the report is intended only for the use of the identified users. For example, International Accounting Standards are established criteria for the preparation and presentation of financial statements, but a particular user may specify an alternative basis of accounting that meets the user’s specific information needs. The practitioner needs to be satisfied that specifically developed criteria do not result in a report that is misleading to intended users. The practitioner attempts to obtain from the intended users, those engaging the practitioner, or the responsible party, acknowledgement that specifically developed criteria are sufficient for the intended users’ purposes. When such acknowledgement cannot be obtained, the practitioner considers the effect of this on the nature and extent of work required to be satisfied as to the suitability of the criteria and on the information provided about the criteria in the report of the practitioner.

48. The practitioner should consider materiality and engagement risk when planning and conducting an assurance engagement in order to reduce the risk of expressing an inappropriate conclusion that the subject matter conforms in all material respects with suitable criteria. When considering materiality, the practitioner needs to understand and assess what factors might influence the decisions of the intended users. Materiality can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and extent of the effect of these factors on the subject matter and the expressed interests of intended users. The assessment of materiality and the relative importance of quantitative and qualitative factors in a particular engagement are matters for the practitioner’s judgment.

49. Engagement risk is the risk that the practitioner will express an inappropriate conclusion that the subject matter conforms in all material respects with suitable criteria. The practitioner plans and performs the engagement so as to reduce to an acceptable level the risk of expressing an inappropriate conclusion. In general, engagement risk can be represented by the following components:

(a) inherent risk: the risks associated with the nature of the subject matter;

(b) control risk: the risk that the responsible party’s controls over the subject matter will not prevent, or detect and correct on a timely basis, matters that could affect the subject matter; and

(c) detection risk: the risk that the practitioner’s procedures will not detect material matters that could affect the subject matter.

50. considered by the practitioner in all engagements, not all components of the engagement risk model will be significant for all assurance engagements. The extent to which the practitioner considers the relevant components of engagement risk will be affected by the engagement circumstances, for example the nature of the subject matter.

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1 In addition to engagement risk, the professional accountant is exposed to a business risk through loss or injury from litigation, adverse publicity, or other event arising in connection with a subject matter reported on. Business risk is not part of engagement risk and does not affect the application of this International Standard on Assurance Engagements.
51. Engagement risk is influenced by the risks associated with:
   (a) the nature and form of the subject matter;
   (b) the nature and form of the criteria applied to the subject matter;
   (c) the nature and extent of the process used to collect and evaluate evidence; and
   (d) the sufficiency and appropriateness of the evidence likely to be available.

Evidence

52. The practitioner should obtain sufficient appropriate evidence on which to base the conclusion.

53. The concepts of sufficiency and appropriateness of evidence are interrelated, and include considering the reliability of evidence. Sufficiency is the measure of the quantity of evidence obtained and appropriateness is the measure of its quality, including its relevance to the subject matter. The decision as to whether sufficient evidence has been obtained will be influenced by its quality. The quality of evidence available to the practitioner will be affected by the nature of the subject matter and the quality of the criteria, and also by the nature and extent of the procedures applied by the practitioner. A determination as to the sufficiency and appropriateness of evidence is a matter of professional judgment.

54. The practitioner collects and evaluates evidence to evaluate whether the subject matter is in conformity with the identified criteria. The reliability of evidence is influenced by its source: internal or external, and by its nature: visual, documentary or oral. While the reliability of evidence is dependent on individual circumstances, the following generalizations will help in assessing the reliability of evidence:
   (a) evidence from external sources is more reliable than that generated internally;
   (b) evidence generated internally is more reliable when subject to appropriate controls within the entity;
   (c) evidence obtained directly by the practitioner is more likely to be reliable than that obtained from the entity; and
   (d) evidence in the form of documents and written representation is more likely to be reliable than oral representations.

55. Evidence is more persuasive when items of evidence from different sources or of a different nature are consistent. In these circumstances, the practitioner may obtain a cumulative degree of confidence higher than that obtained from items of evidence considered individually. Conversely, when evidence obtained from one source is inconsistent with that obtained from another, the practitioner determines what additional procedures are necessary to resolve the inconsistency.

56. In terms of obtaining sufficient appropriate evidence, it is generally more difficult to provide assurance on subject matter covering a period of time than subject matter covering a point in time. In addition, conclusions provided on processes are generally limited to the period covered by the engagement and do not extend to providing any assurance that the process will continue in the future.
Documentation

57. The practitioner should document matters that are important in providing evidence to support the conclusion expressed in the practitioner’s report, and in providing evidence that the assurance engagement was performed in accordance with applicable standards.

58. Documentation includes a record of the practitioner’s reasoning on all significant matters that require the exercise of judgment, together with the practitioner’s conclusion thereon. In areas involving difficult questions of principle or judgment, the documentation will include the relevant facts that were known by the practitioner at the time the conclusion was reached.

59. The extent of documentation is a matter of professional judgment since it is neither necessary nor practical to document every matter the practitioner considers. In assessing the extent of documentation to be prepared and retained, it may be useful for the practitioner to consider what is necessary to provide another professional accountant who has no previous experience with the engagement with an understanding of the work performed and the basis of the principal decisions taken, but not the detailed aspects of the engagement. However, even then, that other professional accountant may only be able to obtain an understanding of detailed aspects of the engagement by discussing them with the practitioner who prepared the documentation.

Subsequent Events

60. The practitioner should consider the effect of subsequent events up to the date of the practitioner’s report. When the practitioner becomes aware of events that materially affect the subject matter and the practitioner’s conclusion, the practitioner should consider whether the subject matter reflects those events properly or whether those events are addressed properly in the practitioner’s report. The extent of any consideration of subsequent events depends on the potential for such events to affect the subject matter and to affect the appropriateness of the practitioner’s conclusions. For some assurance engagements the nature of the subject matter may be such that consideration of subsequent events is not relevant to the conclusion. For example, when the engagement is to provide a conclusion about the accuracy of a statistical return at a point in time, events occurring after that point in time, but before the date of the practitioner’s report, may not affect the conclusion.

Using the Work of an Expert

61. When an expert is used in the collection and evaluation of evidence, the practitioner and the expert should, on a combined basis, possess adequate knowledge of the subject matter and have adequate proficiency in the subject matter for the practitioner to determine that sufficient appropriate evidence has been obtained.

62. The subject matter and related criteria of some assurance engagements may be composed of a number of elements requiring specialized knowledge and skills in the collection and evaluation of evidence. In these situations, the practitioner may decide to use the work of persons from other professional disciplines, referred to as experts, who have the required skills and knowledge of the relevant aspects of the subject matter or criteria. This Standard does not provide guidance on engagements where there is joint responsibility and reporting by a practitioner and one or more experts.

63. Due care is a required professional quality for all individuals, including experts, involved in an assurance engagement. Persons involved in assurance engagements will have varying
responsibilities assigned to them. The extent of proficiency required in performing those engagements will vary with the nature of their responsibilities. While experts do not require the same proficiency as the practitioner in performing all the components of an assurance engagement, the practitioner determines that the experts have a sufficient understanding of this Standard to enable them to relate the work assigned to them to the engagement objective.

64. The exercise of due care requires that all persons involved in an assurance engagement comply with these Assurance Standards, including any subject matter experts who are not professional accountants. The quality control procedures adopted by the practitioner will address the responsibility of each person performing the assurance engagement to comply with this Standard in the context of their responsibilities in the engagement process.

65. **When an expert is involved, the practitioner should have a level of involvement in the engagement and an understanding of the aspects of the subject matter for which the expert has been used, sufficient to enable the practitioner to accept responsibility for expressing a conclusion on the subject matter.** The practitioner considers the extent to which the practitioner will rely on the work of an expert in forming a conclusion on the subject matter.

66. The practitioner is not expected to possess the same specialized knowledge and skills as the expert. However, the practitioner needs to have a reasonable understanding to:

(a) define the objectives of the work assigned to the expert and how this work relates to the objective of the engagement;

(b) consider the reasonableness of the assumptions, methods and source data used by the expert; and

(c) consider the reasonableness of the findings of the expert in relation to the objective of the engagement.

67. **When an expert is involved, the practitioner should obtain sufficient appropriate evidence that the work of the expert is adequate for the purposes of the assurance engagement.** The practitioner evaluates the sufficiency and appropriateness of the evidence provided by the expert by considering and assessing:

(a) the professional competence, experience and objectivity of the expert;

(b) the reasonableness of the assumptions, methods and source data used by the expert; and

(c) the reasonableness and significance of the expert’s findings in relation to the objective of the engagement and the conclusion on the subject matter.

**Reporting**

68. **The report should express a conclusion that conveys a high level of assurance about the subject matter, based on the results of the work performed.** The practitioner’s report should contain a clear expression of the practitioner’s opinion about a subject matter based on the identified suitable criteria and the evidence obtained in the course of the assurance engagement. The report can take various forms, such as written (in hard copy or electronic form), oral, or by symbolic representation. However, a written report is generally the most effective form for adequately presenting the detail required and evidencing the conclusions provided. Oral and other forms of expressing the conclusion are open to misunderstanding without the support of a
The Determination and Communication of Levels of Assurance Other than High

written report. For this reason, the practitioner will not ordinarily report orally without also providing a definitive written report.

69. This Standard does not require a standardized format for reporting on all assurance engagements but rather identifies the minimum information required to be included in the report. These minimum requirements may be tailored to the specific engagement circumstances. For certain assurance engagements, the practitioner may choose to adopt a flexible approach using a narrative (or “long form”) style of reporting rather than a standardized (or “short form”) format. This will result in more engagement-specific reports to facilitate effective communication to the intended user of the conclusion expressed.

70. The form of conclusion to be expressed by the practitioner is determined by the nature of the subject matter and the agreed objective of the engagement and is designed to meet the needs of the intended user of the report of the practitioner.

Report Content

71. The practitioner’s report should include:

(a) title: an appropriate title helps to identify the nature of the assurance engagement being provided, the nature of the report and to distinguish the practitioner’s report from reports issued by others such as those who do not have to abide by the same ethical requirements as the practitioner;

(b) an addressee: an addressee identifies the party or parties to whom the report is directed;

(c) a description of the engagement and identification of the subject matter: the description includes the engagement objective, the subject matter, and (when appropriate) the time period covered;

(d) a statement to identify the responsible party and describe the practitioner’s responsibilities: this informs the reader that the responsible party is responsible for the subject matter and that the practitioner’s role is to express a conclusion about the subject matter;

(e) when the report is for a restricted purpose, identification of the parties to whom the report is restricted and for what purpose it was prepared: while the practitioner cannot control the distribution of the report, this will inform readers of the party or parties to whom the report is restricted and for what purpose, and provides a caution to readers other than those identified that the report is intended only for the purposes specified;

(f) identification of the standards under which the engagement was conducted: when a practitioner performs an engagement for which specific standards exist, the report identifies those specific standards. When specific standards do not exist, the report states that the engagement was performed in accordance with this Standard. The report includes a description of the engagement process and identifies the nature and extent of procedures applied;

(g) identification of the criteria: the report identifies the criteria against which the subject matter was evaluated or measured so that readers can understand the basis for the practitioner’s conclusions. The criteria may either be described in the practitioner’s report or simply be referred to if they are set out in an assertion prepared by the responsible party or exist in a readily accessible source. Disclosure of the source of the criteria and whether or not the criteria are generally accepted in the context of the purpose of the engagement and the nature of the subject matter is important in understanding the conclusions expressed;
(h) the practitioner’s conclusion, including any reservations or denial of a conclusion: the report informs users of the practitioner’s conclusion about the subject matter evaluated against the criteria and conveys a high level of assurance expressed in the form of an opinion. Where the engagement has more than one objective, a conclusion on each objective is expressed. Where the practitioner expresses a reservation or denial of conclusion, the report contains a clear description of all the reasons;

(i) the report date: the date informs users that the practitioner has considered the effect on the subject matter of material events of which the practitioner became aware up to that date; and

(j) the name of the firm or the practitioner and the place of issue of the report: the name informs the readers of the individual or firm assuming responsibility for the engagement;

72. The practitioner may expand the report to include other information and explanations not intended as a reservation. Other examples include findings relating to particular aspects of the engagement and recommendations of the practitioner or references to the inherent limitations of the subject matter. When considering whether to include any such information, the practitioner assesses the significance of that information in the context of the objective of the engagement. Additional information is not to be worded in such a manner to affect the conclusion of the practitioner. The practitioner considers the use of appropriate headings to identify the principal sections of the report as a means of improving communication.

Reservation or Denial of Conclusion

73. The conclusion should clearly express circumstances where:

(a) the practitioner is of the view that one, some or all aspects of the subject matter do not conform to the identified criteria;

(b) the assertion prepared by the responsible party is inappropriate in terms of the identified criteria; or

(c) the practitioner is unable to obtain sufficient appropriate evidence to evaluate one or more aspects of the subject matter’s conformity with the identified criteria.

Where the practitioner expresses a reservation about the subject matter, the nature and expression of that reservation is determined by the materiality of the matter giving rise to the reservation, for example, whether it relates to some or all aspects of the subject matter not conforming to the criteria (disagreement), or the inability of the practitioner to obtain sufficient appropriate evidence on some or all aspects of the subject matter (limitation of scope). When the practitioner expresses a reservation of conclusion or a denial of conclusion, the report discloses all significant facts and reasons relating to the reservation or denial.

Effective Date

74. This ISAE is effective for assurance engagements intended to provide a high level of assurance where the report is dated on or after December 31, 2001. Earlier application is encouraged.

Public Sector Perspective

1. The Public Sector Committee (PSC) considers and makes use of the pronouncements issued by the International Auditing Practices Committee for their application in the public sector. “Public sector” refers to national governments, regional (state, provincial, territorial) governments, local
(city, town) governments and related governmental entities (agencies, boards, commissions and enterprises).

2. Irrespective of whether an assurance engagement is being conducted in the private or public sectors, the basic principles remain the same. However, the application of the principles may need to be clarified or supplemented to accommodate the public sector circumstances and perspective of individual jurisdictions. The nature of potential matters for clarification and supplementation is identified in the “Public Sector Perspective (PSP)” included at the end of each International Standard on Assurance Engagements (International Standard) when required.

3. If no PSP is included at the end of an International Standard, then the International Standard is applicable in all material respects to an assurance engagement in the public sector.

Assurance Engagements in the Public Sector — Specific considerations

4. Professional accountants appointed to perform an assurance engagement in the public sector need to take account of the specific requirements of any relevant regulations, ordinances or ministerial directives that affect the mandate, or any special requirements. The mandate and requirements may affect certain aspects of the assurance engagement, such as, the extent of the professional accountant’s discretion in establishing materiality, and in the form of the report. In particular, legislation and regulations often specify requirements relating to the subject matter and the reporting of certain assurance engagements in the public sector.

5. While the standards on high level assurance engagements are limited to professional accountants in public practice (practitioners), the basic principles are also applicable to professional accountants undertaking such engagements in the public sector, such as public sector auditors.

Subject Matter

6. The mandate and legal requirements affecting professional accountants often encompass a wide range of objectives and subject matter. For example, professional accountants may be required to report on the reliability and appropriateness of performance indicators included in a public sector entity’s annual report, relating to such matters as productivity levels, quality and volume of service and the extent to which particular service delivery objectives have been achieved. In addition, professional accountants may be required to report on:

- compliance with legislative or regulatory requirements and related authorities;
- adequacy of accounting and control systems; and
- economy, efficiency and effectiveness of programs, projects and activities.

7. In these engagements, the professional accountant may attest to a report or assertion regarding the subject matter, or may directly report their evaluation of the subject matter. Professional accountants may be required to report not only on the reliability of a performance report of a government program, but also on the relevance of performance measures to the objectives of that program.
Appendix 1: International Standard on Assurance Engagements (ISAE 100)

Reporting

8. Professional accountants often undertake direct reporting assignment, since the responsible party may not have prepared a written assertion. While the reports generally should contain the elements described in paragraph 71, such reports are often long-form, describing in more detail the objective of the engagement, the criteria, the findings and conclusions. Professional accountants may also include recommendations in their reports.

9. Some mandates may require professional accountants to report instances of non-compliance, or instances where management has not handled matters with due regard to economy, efficiency and effectiveness. It should nevertheless be recognized that the framework contemplates that the report will contain a clear expression of the professional accountant’s conclusion about the subject matter.
APPENDIX

Relationship with Existing ISAs

The diagram below indicates the relationship between this ISAE and the IAPC’s existing ISAs and IAPSs.
Appendix 1: International Standard on Assurance Engagements (ISAE 100)

International Auditing Practices Committee


Chronology

1. In August 1997, the IAPC issued an exposure draft “Reporting on the Credibility of Information”. This initiative recognized the increasing demand for information on a broad range of subject matters to meet the needs of decision-makers, and the consequent need in both the private and public sectors for services that enhance the credibility of that information. The exposure draft introduced the concept of a continuum of levels of assurance that could be provided, with the level of assurance provided in a particular engagement being dependant upon the interrelationship of four variables.

2. The IAPC received strong support for the aims of the 1997 exposure draft. The vast majority of respondents agreed with the concept of a continuum of levels of assurance. However, many respondents believed that the concept would be difficult to apply in practice, and in particular that it would be difficult to ensure that any report would convey the level of assurance with the necessary precision.

3. In order to address the concerns expressed by respondents, the IAPC concluded that significant changes needed to be made to the 1997 exposure draft and, as a result, issued a second exposure draft “Assurance Engagements” in March 1999. This kept the concept of the continuum, but restricted the levels of assurance being provided to two levels: a high level and a moderate level.

4. The exposure period for the 1999 exposure draft ended in July 1999, and the IAPC has examined the issues raised in those responses. The responses to the 1999 exposure draft continued to support the underlying concepts in the document. There was agreement on how the concepts would be applied to assurance engagements intended to provide a high level of assurance. However, there was disagreement as to how the concepts would be applied to assurance engagements intended to provide a moderate level of assurance. A number of respondents believed that the model did not provide sufficient guidance as it did not explain adequately the interaction of the variables and how they result in a moderate level of assurance. In addition, there was not consensus on how the moderate level of assurance is best communicated. Two alternative models for the moderate level of assurance were identified: one based in the interaction of the variables and the other based on work effort.

5. Respondents agreed that the concepts could be applied in assurance engagements conducted by all professional accountants. However, many respondents questioned whether professional accountants not in public practice should be required to use any standard derived from those concepts, and whether such requirement could be enforced.

6. In June 2000 the IAPC issued an International Standard on Assurance Engagements (ISAE) taking into account the comments received on the 1999 exposure draft. In view of the support that the framework received, and the fact that there was agreement on the requirements for a high level assurance engagement, the ISAE provides a framework for all assurance engagements — both moderate level and high level assurance engagements — and sets standards and provides guidance for the performance of engagements intended to provide a high level of assurance. The IAPC decided that the standards and guidance should apply only to those assurance engagements
conducted by professional accountants in public practice, but would not prohibit other professional accountants from applying the ISAE should they be able to do so.

7. In view of the lack of agreement on standards for engagements intended to provide a moderate level of assurance, the IAPC has decided not to proceed at this time with a standard on moderate level assurance engagements. However, in developing new standards for assurance engagements on specific subjects, the IAPC will consider whether it can develop standards for moderate-level assurance engagements where it believes it appropriate.

8. IAPC intends to conduct research with the objective of identifying the determinants of moderate level of assurance and their interaction, and the ways in which that level of assurance can be expressed.

Two Views of Moderate Assurance

9. As indicated in paragraph 4 there were two views expressed as to how professional accountants determine whether a particular engagement can be conducted to provide a moderate level of assurance. These are the interaction of variables view (as expressed in the 1997 and 1999 exposure drafts), and the work effort view.

Interaction of Variables View

10. The determination of the level of assurance that can be provided involves consideration of the inter-relationship between the following:

   (a) Subject Matter

   Some subject matter is inherently more capable of reliable measurement and support by relatively conclusive evidence. All else being equal, a higher level of assurance can be provided about an historical and quantitative subject matter (for example, historical financial statements) than about a more subjective and qualitative subject matter (for example, ethical behavior or a financial forecast).

   (b) Criteria

   While all criteria need to be suitable, depending on the nature of the subject matter some criteria provide a means for more reliable measurement of the subject matter. A lower level of assurance will be provided when the criteria are qualitative rather than quantitative, for example criteria addressing standards of ethical conduct will be subjective and qualitative.

   (c) Process

   A major determinant of the level of assurance that can be provided is the nature, timing, and extent of the procedures adopted by the professional accountant to gather evidence on which to base the conclusion. The professional accountant determines the nature, timing and extent of the process to be applied to achieve the engagement objective. The higher the level of assurance to be provided, the more comprehensive must be the procedures performed.

   (d) Quantity and Quality of Evidence

   The professional accountant will, through the application of appropriate procedures, seek to obtain sufficient appropriate evidence as the basis for the provision of the level of assurance. The professional accountant evaluates the reliability of the evidence obtained. Ordinarily, the
Appendix 1: International Standard on Assurance Engagements (ISAE 100)

11. The level of assurance is determined by the nature of the subject matter, criteria and by both the quantity and quality of evidence obtained. The professional accountant uses professional judgment to determine the appropriate level of assurance taking into account the interrelationship of the four variables. The following two situations illustrate the inter-relationship of these variables that result in a moderate level of assurance:

(a) Subject matter capable of reliable measurement using objective criteria.

The professional accountant applies procedures of a different nature or less extensive procedures than in an audit. The resulting evidence, while lower in quantity or quality than would be required for audit, may be sufficient to support a moderate level of assurance.

(b) Subject matter measurement less reliable because suitable criteria are less objective.

In some situations the subjectivity of the criteria may cause the measurement of the subject matter to be less reliable. This may, regardless of the procedures performed, result in an inability to obtain sufficient and appropriate evidence to support a high level of assurance. However, the professional accountant may be able to plan and perform appropriate procedures to obtain the evidence necessary to support a moderate level of assurance.

12. To differentiate the levels of assurance described above and to assist users of the professional accountant’s report to understand the level of assurance being provided, the report includes additional explanatory language reflecting the influence, in the particular engagement, of the factors identified in paragraph 10. The conclusion and explanatory language will facilitate the communication to report users and limit the potential for these users to take a level of assurance beyond that which is intended, and what is reasonable in the circumstances.

Work Effort View

13. The level of assurance provided by the professional accountant is determined based, in the first instance, on the users’ needs (including cost considerations) and, secondly, by the procedures performed to obtain sufficient appropriate evidence. The criteria and subject matter are viewed as prerequisites to the engagement. Both are considered when deciding whether or not the professional accountant is able to accept the engagement. Once the professional accountant determines that the criteria and subject matter support an assurance engagement, it is the work effort (the nature, timing and extent of the procedures performed) that determines the level of assurance. Consequently, if the professional accountant concludes that the professional accountant is unable to perform a high-level assurance engagement because of concerns regarding the criteria or the subject matter, the professional accountant would also be unable to perform a moderate-level assurance engagement.

14. Criteria are such a critical element of an assurance engagement that they must conclusively meet all of the characteristics of suitability to support providing any level of assurance. Thus, either the criteria have the characteristics of suitable criteria or they do not. For example, it is not possible for criteria to be only somewhat relevant and reliable and, therefore, while not suitable for a high level of assurance engagement, still be considered adequate for a moderate-level assurance engagement. If criteria were not suitable in this regard, then they would not meet all of the
characteristics of suitability defined in paragraph 22 of the International Standard for Assurance Engagements.

15. The subject matter of an assurance engagement needs to be identifiable, capable of consistent evaluation or measurement against suitable criteria, and in a form that can be subjected to procedures for gathering evidence to support that evaluation or measurement. Once again, therefore, consideration of the subject matter is an engagement acceptance decision that the professional accountant considers when deciding whether or not it is possible to perform an assurance engagement either at a high level or a moderate level of assurance.

16. When the subject matter is not capable of consistent measurement, or when the criteria do not meet one or more of the characteristics of suitable criteria, the professional accountant is unable to perform an assurance engagement as defined in the ISAE.

17. Since suitable criteria and the subject matter are engagement acceptance decisions, it is the work effort that determines the level of assurance provided. Professional judgment would be applied in determining the nature, timing and extent of procedures that would be performed in any particular engagement. Nevertheless, this model results in a high level of consistency in its application by different professional accountants in similar circumstances, and in the understanding by users of the level of assurance conveyed in the report.

18. In the professional accountant’s report, in addition to the conclusion that expresses the level of assurance (either high or moderate, depending on the objective of the engagement), the professional accountant might consider including additional explanatory language regarding the degree of precision of the subject matter, or its inherent limitations, to help readers of the report put the professional accountant’s conclusion in appropriate context. The explanatory language is not a reservation of the auditor’s conclusion.

19. The model is necessarily rigorous to ensure that professional accountants are able to reach consistent conclusions, given the same set of circumstances, as to the level of assurance that can be provided. In situations when the criteria have not been adequately developed, the professional accountant would not be able to perform an assurance engagement, but would be able to perform special purpose engagements, or agreed-upon procedures engagements, to meet users’ specific needs.

Further Research

20. As referred to in paragraph 8, the IAPC is conducting research to help resolve the above issue. Those who wish to provide comments to assist the research may do so through the IFAC secretariat.
# APPENDIX 2 : ENVIRONMENTAL AND SUSTAINABILITY REPORTS AND ASSURERS'/AUDITORS’ OPINIONS

<table>
<thead>
<tr>
<th>Firm Name and URL</th>
<th>Country</th>
<th>Verifier</th>
<th>Name of Report &amp; Date</th>
<th>Title of verification</th>
<th>Summary of Audit Assessment opinion</th>
</tr>
</thead>
</table>
| British Airways            | U.K.       | CSR Network Ltd., U.K.                        | British Airways Social and Environmental Report 2000 | Verifier's statement     | • We have investigated … and found them to present an **accurate account** of British Airways actions.  
• We have reviewed the system … we have found the system to be **robust**.  
• Review evidence suggests that the underlying trends identified by performance data are **substantially correct**. |
| http://www.british-airways.com |           |                                               |                             |                          |                                     |
| 2. ING                     | The Netherlands | KPMG                                         | 1999 Environmental Annual Report | Statement KPMG Environmental Consulting | • ING Group has established … a **comprehensive system** for the reporting of …  
• The 1999 data for … are **free of material misstatement**;  
• The other reported data … are **in accordance with** the data in the …  
• The report **fairly presents** the activities of ING … |
| http://new.ing.com         |           |                                               |                             |                          |                                     |
| http://www.novartis.com    |           |                                               |                             |                          |                                     |
| 4. Norsk Hydro             | Norway     | Deloitte & Touche AS                         | 1999 Environmental Report  | Independent Accountants Report | In all material respects:  
• The report is based on the **Guidelines Section of the GRI draft guidelines** …  
• The Eco-Efficiency Indicators were identified, defined and calculated **in accordance with** … |
| http://www.hydro.com       |           |                                               |                             |                          |                                     |
| 5. Statoil                 | Norway     | Ernst & Young AS                             | Statoil 1999 HES Accounting | Report from Ernst & Young AS | • We can confirm that the group has established a management system for …  
• We can also confirm that the … information specified on HES accounting is based on consistent measuring methods, and is in accordance with the figures reported to … |
<p>| <a href="http://www.statoil.com">http://www.statoil.com</a>     |           |                                               |                             |                          |                                     |
| 6. Body Shop               | U.K.       | New Economics Foundation                     | Values Report 1997         | Social audit verification statement | New Economics is <strong>satisfied</strong> that the social elements of The Body Shop Values Report for 1995/97 provide a <strong>reasonable basis</strong> for |
| <a href="http://www.bodyshop.com">http://www.bodyshop.com</a>    |           |                                               |                             |                          |                                     |</p>
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<th>Summary of Audit Assessment opinion</th>
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<tr>
<td>Novo Nordisk</td>
<td>Denmark</td>
<td>1. Deloitte &amp; Touche</td>
<td>Novo Nordisk</td>
<td>Statement from Deloitte &amp; Touche</td>
<td>understanding the key aspects of the company’s behavior and social impact in relation to those stakeholders considered for the period in question.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2. Dr. Simon Zadek</td>
<td>Environmental and Social Report 1999</td>
<td>Statement from Simon Zadek</td>
<td>1. Based upon … it is our opinion that the Company has applied detailed data collection procedures for the purpose of collecting figures from …</td>
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<td></td>
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<td></td>
<td></td>
<td>• The figures reported for 1998 and 1999, … are appropriately reflected in the Report.</td>
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<td>• We find the company has made reasonable endeavors at corporate level to verify the figures collected from …</td>
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<td>• Submitted figures are consistent with the source documentation presented to us.</td>
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<td>• The figures on … are consistent with the source documentation presented to us …</td>
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<td>2. Novo Group…has integrated classical good practice with innovations…</td>
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<td></td>
<td></td>
<td>• The Novo Group’s accounting and reporting has advanced significantly</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• The report complies with the main GRU reporting recommendations</td>
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<tr>
<td>Bayer AG</td>
<td>Germany</td>
<td>Arthur D. Little</td>
<td>1999 Responsible Care Report</td>
<td>Statement by the independent reviewer Arthur D. Little</td>
<td>• Bayer has incorporated several improvements since the last environmental report.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Bayer has begun including additional environmentally relevant parameters in line with guidelines published by CEFIC (the European Council of Chemical Industry Federations) in order to give the Responsible Care Report even greater credibility.</td>
</tr>
<tr>
<td>CLP Power</td>
<td>Hong Kong</td>
<td>Enviros Hong Kong Limited</td>
<td>Environmental, Health and Safety Review 2000</td>
<td>Verifier’s Statement</td>
<td>• We have investigated the following aspects of the main report text and found they present an accurate account of CLP Power’s actions and performance.</td>
</tr>
<tr>
<td>Firm Name and URL</td>
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<tr>
<td>10. Elec &amp; Eltek Co. Ltd. <a href="http://www.eleceltek.com">http://www.eleceltek.com</a></td>
<td>Hong Kong</td>
<td>The Hong Kong Productivity Council (HKPC)</td>
<td>Environmental Performance Report 1998</td>
<td>Validation Statement</td>
<td>Based on the extent of our investigations, the report is a true and accurate account of Elec &amp; Eltek’s operations and performance.</td>
</tr>
<tr>
<td>11. BHP <a href="http://www.bhp.com">http://www.bhp.com</a></td>
<td>Australia</td>
<td>Dame &amp; Moore Group</td>
<td>1999 BHP Environmental and Community Report</td>
<td>Auditors’ verification statement</td>
<td>Based on our involvement in selection of the sites to be visited and … we are satisfied that BHP is making progress in improving its data quality and other performance.</td>
</tr>
</tbody>
</table>
| 12. Homestake Mining Co. [http://www.homestake.com](http://www.homestake.com) | Australia | Arthur D. Little | 1999 Environmental, Health & Safety Report | Independent evaluation of Homestake Mining Company’s Environmental, Health and Safety Audit Program | • In our opinion, Homestake’s EHS Audit Program is designed and implemented in a manner that is generally consistent with, and in some instances exceeds, prevailing EHS auditing standards.  
• It provides a high level of assurance that all operations, including … have implemented and are continuing to improve EHS management systems, consistent with the state-of-the-art in multinational industrial companies. |
| 13. Rio Tinto [http://www.riotinto.com](http://www.riotinto.com) | Australia | Arthur D. Little | Social and environment report 1999 | Verification statement | Based on our review of a sample of the quantitative HSE data, we can confirm that the information in the report presents a fair and accurate representation of the Group performance. The survey tool used to collect information from the sites is clear and encourages comprehensive reporting. |
| 14. WMC Limited [http://www.wmc.com.au](http://www.wmc.com.au) | Australia | Price waterhouse Coopers | Environment Progress Report 1999 | Price waterhouse Coopers independent verification statement | Based on the findings from our verification, we believe that in all material respects the:  
1. Report and selected site reports present a fair view of WMC’s environmental management and issues …  
2. Data … constitute a complete and accurate statement of performance  
3. Qualitative and quantitative statements … are complete and |
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<tr>
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<tr>
<td>Pasminco</td>
<td>Australia</td>
<td>Dames &amp; Moore</td>
<td>Pasminco Annual Environment Report 1999</td>
<td>Verification from Dames &amp; Moore</td>
<td>A high level of awareness of the environmental issues and impacts has been gained and is demonstrated at each site.</td>
</tr>
<tr>
<td>Normandy Mining Limited</td>
<td>Australia</td>
<td>Dames &amp; Moore</td>
<td>1999 Environment Report</td>
<td>Verification statement</td>
<td>Our review of … indicates that the data are <em>valid and supported by an acceptable level</em> of quality control …</td>
</tr>
<tr>
<td>Ontario Power Generation</td>
<td>Canada</td>
<td>Ernst &amp; Young LLP</td>
<td>1999 Progress Report Towards Sustainable Development</td>
<td>Independent external verification</td>
<td>The reported 1999 data <em>has been properly collated</em> at the corporate office from the data provided by the business units, Comparative information <em>has been properly transcribed, aggregated and consistently presented</em> from year to year.</td>
</tr>
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</table>

The information reported … is *consistent with* the information reported in Appendix B …

The business units employed a *systematic approach* in environmental data collection.
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</tr>
</thead>
<tbody>
<tr>
<td>18. Baxter <a href="http://www.baxter.com">http://www.baxter.com</a></td>
<td>U.S.</td>
<td>ERM certification and Verification Services</td>
<td>1999 Sustainability Report</td>
<td>Auditor’s Verification Statement for Environmental, Health and Safety Data</td>
<td>It is our opinion that the data presented in this report address Baxter’s key EHS aspects, are a valid representation of Baxter’s EHS performance over the period covered by this report, and are presented in a manner which substantively conforms with the Good EHS Reporting Principles.</td>
</tr>
</tbody>
</table>
APPENDIX 3: ALTERNATIVE WAYS OF EXPRESSING MODERATE ASSURANCE OTHER THAN NEGATIVE ASSURANCE

Example 1: Environmental performance

Independent Verification Report
To Chairman and CEO, ABC Corporation
President and COO, ABC Corporation

The ABC Corporation (“ABC”) Environmental Report 2000 (“the Report”) covers ABC Group’s global operations. ABC prepared and is responsible for the Report. We have been asked to provide an opinion on:

(a) The process used to identify ABC’s significant environmental impacts and to define the scope of the environmental data included in the Report; and

(b) Key aspects of the data collection and reporting processes used to compile this Report.

We have not been asked to provide verification of the data in the Report and therefore cannot comment specifically on the reliability of that data.

Basis of opinion
There are no generally accepted international standards for reporting or verifying environmental data. We have adopted a verification approach that reflects emerging practices and guidance. To reach our opinion we conducted the following tasks:

(a) Assessed the processes ABC used to identify its significant environmental impacts and to define the scope of the environmental data in the Report;

(b) Assessed the process used to define, collect and report environmental information concerning those impacts;
   • At the corporate level, by inspecting the processes used to manage, aggregate and compile the data reported from each site, reviewing associated documents and interviewing management;
   • At the site level, by inspecting collection and reporting processes, reviewing documents and interviewing management at twelve ABC sites around the world; and,

(c) Evaluated the consistency of the reported data with processes we assessed.

Opinion
On the basis of the above work, we found that ABC has:

(a) Adopted a systematic process to identify the significant environmental impacts related to its manufacturing operations, products and services and to define the scope of the environmental data included in the Report;

(b) Designed and implemented appropriate and reliable data collection and reporting processes at ABC Group to compile the Report, including:
   • Common terms and definitions;
   • Standard data collection methods;
• A requirement for supporting documentation and controls on the data reported; and
• Independent confirmation of the reliability of certain data.

Comments
During the verification process, we made a number of recommendations and observations about ABC’s environmental management at the ABC Group and site levels which have been reported to ABC management. Our main observations were:

(1) Data Gathering and Reporting System
   (detail omitted)

(2) Environmental Accounting System
   (detail omitted)

(3) Criteria of Sites Selected for Verification

The Report includes information related to the global operations of ABC Group around the world. Therefore, we have selected 12 sites for the verification across nations and geographic areas. In the course of the selection process, we have considered the following points in consultation with ABC:

• Significance of environmental impacts caused by the site;
• Financial level of the site;
• Geographical diversity; and
• Business diversity.
Example 2: Intellectual capital

VERIFIERS’ REPORT

According to agreement, we have reviewed the intellectual capital accounts, prepared by the Board of Directors and the Management, of xxx A/S for the year ended xx/yy 2000.

Objective and scope of the review

We planned and conducted our review in accordance with assurance standards generally accepted in Denmark and with the objective of assessing:

• Whether data and information are reliable and are presented in accordance with the accounting policies applied (transparency, substance, gross measurement and comparability),

• Whether data and information correlate with the activities of the Company in the period under review.

The review conducted is not as comprehensive as an audit, and therefore it does not ensure that the user of the accounts is given the same degree of detail and completeness of the statement and presentation of information in the intellectual capital accounts.

Based on an evaluation of materiality and risk, we have tested the basis and documentation for the data and information included in the intellectual capital accounts. Our review includes analyses, inquiries, review of data, information and underlying documentation material as well as tests on a sample basis of whether the accounting policies were complied with and correlate with the activities of the Company in the period. In areas where it was possible, we made an analytical review of the correlation with the financial annual accounts. Finally, we made a separate assessment of external providers of analyses incorporated into the intellectual capital accounts, including a review of the objective, delimitation and completion of the analyses.

The status and nature of information vary, which means that not all the information can be verified. Thus, the intellectual capital accounts include information with varying degrees of reliability, ranging from purely subjective interpretation to objectively verifiable information.

Opinion

In our opinion, the intellectual capital accounts of xxx for the year ended xx/yy 2000:

• Are based on reliable data and information presented as stated under “Accounting Policies,”

• Correlate with the activities of the Company in the period as described and defined under “Accounting Policies.”
APPENDIX 4: EXAMPLE REPORTS

Example 1: Individual components financial statements

REPORT OF FACTUAL FINDINGS IN CONNECTION
WITH ATTENDING STOCKTAKE AND REVIEWING VALUATION
OF STOCK AS AT 30 SEPTEMBER 2000

To Management of ABC

Scope
We have performed the procedures agreed with you as per our engagement letter dated 5th October 2000.

Our engagement was undertaken in accordance with Australian Auditing Standards applicable to agreed-upon procedures engagements. The responsibility for determining the adequacy or otherwise of the procedures agreed to be performed is that of the Management of ABC. The procedures were performed solely to facilitate the current due diligence review being undertaken by PricewaterhouseCoopers and are summarized as follows:

(a) We attended the 30 September stocktake at the Sunshine Warehouse, and the Myer Concession stores located at Chadstone and Melbourne Bourke Street Mall;
(b) We reviewed the results of the stocktake to ensure they were accurately reflected in the company’s perpetual inventory system for the aforementioned locations;
(c) We assessed the appropriateness and consistency of the basis used to value inventory as at 30 September 2000;
(d) We assessed the appropriateness and consistency of the basis used to determine the provision for stock obsolescence; and
(e) To report to you any significant factual findings arising from our procedures.

The above procedures do not constitute either an audit in accordance with Australian Auditing Standards or a review in accordance with Australian Auditing Standards applicable to review engagements. We do not express any assurance regarding the adequacy of the stocktake procedures; accuracy of inventory record maintenance; valuation methodology of stock; and the adequacy of the Provision for obsolescence as at 30 September 2000.

Had we performed additional procedures or had we performed an audit in accordance with Australian Auditing Standards or a review in accordance with Australian Auditing Standards applicable to review engagements, other matters might have come to our attention that would have been reported to you.

Findings
We report as follows:

(a) With respect to (a) above we attended the stocktake at the Sunshine Warehouse and the Myer Concession stores located at Chadstone and Melbourne Street Mall and the stockcounts were performed in accordance with the procedures established prior to the count.
(b) With respect to (b) above we found the stocktake results are accurately reflected in the company’s perpetual inventory system for the aforementioned locations, as at 30 September 2000.

(c) With respect to (c) above we found that the basis used to value inventory as at 30 September 2000 was consistently applied to those in operation at the 30 June 2000, and is a basis acceptable under Australian Accounting Standards.

(d) With respect to (d) above we found that the basis used to determine the provision for stock obsolescence as at 30 September 2000 was consistent with that applied as at 30 June 2000. We were of the view that the provision could be increased by $127,000 based on the holding and disposal costs associated with prior season stock.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose or distributed to any other party. This report relates only to the accounts and items specified above and does not extend to any financial report of ABC, taken as a whole.

**Example 2: Prospective financial information**

We have not observed any item which could put into question the hypotheses taken into consideration for the establishment of the prospective financial accounts, being specified that we cannot give the assurance on their achievement.

We have no comments to make on the figure translation of these hypotheses, on the observance of the principles of establishment and presentation applying to the prospective accounts, on the conformity of the accounting methods used with those used for the establishment of the annual accounts (and/or consolidated) as of …

However, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material.

**Example 3: Budgeting**

**Auditor’s statement**

As agreed we have reviewed the budget for 20xx of ABC, represented by DEF, as has been drawn up by the Board of Directors and the Board of Management.

**Basis of statement**

We have planned and conducted our work in accordance with generally accepted budget reviewing standards as applied in Denmark. Our review included an assessment of the budget assumptions and accounting policies applied, and we have verified that the budget has been drawn up in accordance therewith. In addition, we have checked the consistency of figures in the budget.

**Statement**

It is our opinion that the budget has been drawn up on the basis of the assumptions described, that the assumptions appear valid, and that it gives a reliable description of the Board of Directors’ and the Board of Management’s expectations for the results and financial position of the company.
Example 4: Environmental performance

ENVIRONMENTAL MANAGEMENT -
A SURVEY OF GOVERNMENT PRACTICES

Background

4.1 There are significant potential environmental impacts associated with many of the activities of government. Examples include Department of Agriculture and Marketing’s advice relating to land use and pesticides, Department of Natural Resources’ development of a sustainable forestry, and Department of Transportation and Public Works’ building of highways and other construction projects.

4.2 A new Environment Act came into effect January 1, 1995; effectively updating the environmental laws of Nova Scotia and consolidating 16 pieces of existing environmental legislation. The Act is just as relevant to Provincial government operations as private-sector activities, as it specifically binds “Her Majesty’s corporations, agents, administrators, servants and employees and Government agencies.” It addresses important environmental issues such as pollution, dangerous goods and pesticides, contaminated sites, water-resources, waste-resource and air quality. The Act is extensive and provides significant powers of enforcement. In addition, regulations were developed by government to help clarify the requirements of the Act. The only acceptable legal defense available under the Act is “due diligence or reasonably and honestly (believing) in the existence of facts that, if true, would render the conduct of that person innocent.”

4.3 One effective means of ensuring good environmental stewardship and displaying “due diligence” is to establish and maintain an environmental management system (EMS) wherever significant impacts on the environment are a possibility. The Canadian Standards Association defines an EMS as the organizational structure, responsibilities, practices, procedures, processes and resources for implementing environmental management. Such systems, if comprehensive and operating effectively, should ensure environmental risks and liabilities are properly identified, minimized and managed; as well as ensure entities comply with environmental laws.

4.4 An EMS will not necessarily exist as a discrete system, but may consist of policies, procedures and accountabilities integrated into an existing management framework. The complexity and size of the system should depend on the nature of the environmental responsibilities of the organization. Ideally, an EMS should contribute to the integration of environmental concerns into all levels of decision making.

4.5 In the fall of 1998, we surveyed various government departments to obtain an understanding of the systems and practices government uses to fulfil its responsibilities under the Environment Act.

Scope Of Survey

4.6 The objectives of this assignment were to:

- Survey the government-wide policy framework for environmental management; and
- Gain an understanding of the policies, systems and practices used at the departmental level to fulfil environmental responsibilities.
4.7 For purposes of our survey of departmental practices, we selected a sample of five departments with operations that have a significant potential of impacting the environment. The five departments included in our survey were:

- Agriculture and Marketing
- Environment
- Fisheries and Aquaculture
- Natural Resources
- Transportation and Public Works

4.8 We interviewed senior managers who have responsibility for environmental issues in their department. Because this was not an audit, we relied on the representations made by each department in producing this Chapter. Our assignment did not include testing or other verification to ensure systems functioned as described, though we did review some supporting documentation to help us better understand the practices and issues involved.

4.9 Our interviews were guided by a questionnaire which we developed from our research. It focused on five key areas of environmental management: definition of responsibilities, availability of resources, risk identification, management control and performance reporting. After a description of the government-wide policy framework for environmental management, the Chapter summarizes the results of our survey using the format of our questionnaire. Because of the nature of this assignment, our descriptions of environmental management are generalized and do not indicate the specific practices of individual departments surveyed.

Principal Findings

Government-wide Policy Framework

4.10 Government By Design, the government’s annual planning document, indicates that the government’s agenda is based on four pillars of public policy: social responsibility, economic growth, responsive government and fiscal stability. In the 1997-98 plan, under the pillar of social responsibility, protecting the environment and ensuring resources are managed for sustainability were stated as priorities. In the 1998-99 plan, under the pillar of economic growth, the government stated its commitment to securing a lasting future for the industries that capitalize on the Province’s natural resources. Under the pillar of responsive government, the government expressed its commitment to protecting the environment. As such, the government’s commitment to environmental stewardship has been integrated into its highest-level planning activities.

4.11 There is no government-wide policy framework for environmental management at this time. In 1997 a policy was implemented to outline environment-friendly purchasing practices for government, but there is no comprehensive guide to help departments manage all of their environmental responsibilities. In 1992 the Nova Scotia Round Table on Environment and Economy developed a policy paper on a strategy for sustainable development for Nova Scotia. The strategy addressed issues such as the state of the atmosphere, water management and biological diversity. It also proposed sustainable goals in a number of economic sectors, such as agriculture, forestry, fishing and aquaculture, and tourism and recreation. It was intended to apply to government operations, as well as to establish a framework for government’s encouragement of the private sector to adopt sustainable development practices. However, the strategy was never
formally adopted by government and has not led to the development of central policy for environmental stewardship.

4.12 Later, in 1993, an Environmental Self-Assessment policy was approved by government and announced by the Department of the Environment. It required all departments, agencies, boards and commissions to conduct environmental self-assessments on significant new policy and economic development initiatives. The policy also highlighted five practices of good environmental management. In addition, there was now a requirement that a summary statement on environmental implications accompany all requests for approval from central government. However, no mechanisms were developed to encourage and monitor departments’ self-assessment practices. Compliance by departments with the reporting requirement has not been regular, and there is little information with respect to the degree of compliance with the requirement for self-assessments.

4.13 Although the Nova Scotia Round Table on Environment and Economy was created by government in 1988, the 1995 Environment Act formally established it as an advisory body to government on sustainable development planning in Nova Scotia. Its mandate was formalized to include:

- Researching and analyzing issues relating to sustainable development;
- Advising government on the incorporating of environmental and economic considerations into its decision-making processes, and sustainable development principles and practices into its activities and undertakings;
- Increasing public awareness of the cultural, social, economic and policy changes required to attain sustainable development; and
- Assisting the government to overcome barriers to sustainable development.

4.14 The Round Table has since been active in advising on various environmental issues, including accountability and environmental self-assessment. However, in the past year, the Round Table’s ability to function has been hampered by membership vacancies and legislative delays in filling those vacancies.

4.15 In lieu of government-wide policy, departments develop their own environmental policies, strategies and plans, and look to the Environment Act and its regulations for a comprehensive description of their environmental responsibilities. All of the departments we surveyed had an opportunity to advise on the writing of the legislation, and thus were well versed in it. The Department of the Environment has the lead role in overseeing and enforcing the Act, both with respect to private sector as well as government activities. We observed that, with respect to environmental issues, there is considerable communication and collaboration between the Department of the Environment and the other departments we surveyed.

**Responsibility for Environmental Management**

4.16 One characteristic of a well-functioning environmental management system is that environmental responsibilities are clearly defined. This can be achieved through an environmental policy that outlines the commitment to meeting environmental responsibilities and assigns roles and accountability for its achievement. Senior management commitment and leadership in implementing an organization’s environmental management function are essential.
4.17 The five departments in our survey demonstrated an understanding of their responsibilities under the Environment Act. While only one department had a distinct environmental policy, all five departments included statements of their commitment to the environment in their annual business plans. The statements ranged from a broad, high-level commitment set out in the mission statement, to strategic goals of sustainability and environmentally responsible management, to specific operational priorities and objectives for the year ahead. Two departments have a division or branch with specific environmental management responsibilities, while the other three have a more decentralized form of environmental management. All five departments made environmental management a key responsibility of their senior management teams, but each also held the view that operating in a manner that is responsible to the environment is the duty of all departmental staff.

**Availability of Resources**

4.18 The availability of adequate resources in terms of knowledge, experience and funding is a requirement for effective management of environmental responsibilities.

4.19 In terms of knowledge and experience, management in all five departments indicated that they had adequate resources, either within their departments or available to them from other departments and outside sources. In three of the departments it was indicated that management of certain operational aspects of their environmental responsibilities was constrained by limitations in funding.

**Risk Identification**

4.20 The identification of environmental risks and liabilities inherent in an organization’s operations is an important aspect of environmental management. It helps management understand the organization’s potential for environmental impact, and to focus attention and resources on higher priority issues.

4.21 From our interviews we determined that none of the five departments have performed a formal, department-wide environmental risk analysis. Management of each department indicated that it has developed a good awareness of the environmental risks and liabilities inherent in its operations through its regular activities and through contacts with other departments and agencies. One department has completed a review of its legislation for potential conflicts with the Environment Act and two other departments have reviewed and prioritized certain risk sites. Management in all five departments noted that some of the work of the occupational health and safety committees helped identify environmental risks; for example, through the development of hazardous material identification and monitoring systems.

4.22 A comprehensive review of the Environment Act and its regulations, to be initiated within five years of its enactment, is a requirement under the Act. The Department of the Environment has begun planning for the review process and is developing approaches to provide opportunity for input from all stakeholders. Such a review process will likely help identify environmental risk factors relating to government’s activities.

**Environmental Management**

4.23 Environmental management should include practices and controls such as planning, coordinating, monitoring, reporting and auditing to help ensure environmental responsibilities are met.
Environmental management should be integrated with other areas of management and, as a result, environmental considerations should be included in all senior-level decision-making.

4.24 All five departments incorporated a variety of the above-noted elements in their management of environmental responsibilities. Although the elements were more apparent in the two departments with environmental service divisions, the three departments with more decentralized environmental management also demonstrated environmental practices and controls.

4.25 Each of the five departments had goals and outcome measures relating to the environmental impact of their operations, which were included in their annual business plans. The departments have also established a number of policies, guidelines and practices on conducting operations in a manner responsible to the environment. One department has developed a handbook for its private sector clients to guide them through the environmental regulations. Another department has implemented a pollution prevention program to promote improvement in operational practices. A third department is developing natural resource databases for better land-use planning and management. Three of the departments have undertaken initiatives to encourage good environmental practices in the workplace.

4.26 Annual performance appraisals are part of the management regime at all five departments, but are used to varying degrees as a means of establishing accountability for environmental responsibilities. At four of the departments, environmental responsibilities are included in annual performance goals to some degree, and achievement of these goals is subsequently evaluated. Of these four, annual performance appraisals are performed for all staff at two of the departments, and primarily with management personnel at the other two. In the one remaining department, environmental responsibilities are tied into performance goals to a much more limited extent.

4.27 Contractors and consultants hired by the departments are required to follow environmental regulations and guidelines. Environmental conditions are often specified in the contracts that govern their services. The departments monitor to ensure compliance with contract terms and conditions.

4.28 All five departments carry out inspections to ensure regulatory compliance by their clients, and inspectors generally prepare reports or letters to document their inspections. Internal reporting on environmental responsibilities is generally informal; usually through meetings, memos and briefings.

4.29 None of the departments have undergone an audit of their environmental management practices to provide assurance on proper implementation and effectiveness in achieving environmental objectives. There are also no established mechanisms for such audits.

Environmental Reporting

4.30 Under the Environment Act, the government is committed to reporting on the state of the environment in the Province. The first report was released in July 1998 and called The State of the Nova Scotia Environment 1998. This report gives an overview of environmental issues, concerns and actions related to air, water and waste management. Subsequent reports will cover land resources, biota, and coastal and marine ecosystems. The report focuses on the major responsibilities of the Department of the Environment, but also contains references to three of the other departments included in our survey. Even though the report claims that it is not
comprehensive and that data gaps have been identified, we commend this effort to document the progress the Province has made in protecting the environment.

4.31 Each of the five departments reported performance results for 1997-98 in *Nova Scotia Counts*. This document reports on government’s level of achievement of performance goals developed and reported in *Government By Design*. Thus, *Nova Scotia Counts* serves as a reporting mechanism on environmental responsibilities only to the extent that those responsibilities were included in performance targets in the departments’ business plans and in *Government By Design*. We noted that three of the departments had details on their environmental responsibilities included in *Government By Design*. We also noted that one department released a progress report in relation to an environmental strategy it developed, and another department plans to implement a regular reporting mechanism for one of its environmental responsibilities.

Concluding Remarks

4.32 The importance of environmental stewardship has been recognized in government’s top-level planning, but there is no formal government-wide policy framework for managing the Province’s environmental responsibilities. Departments are responsible for meeting the requirements of the Environment Act and regulations, and for developing the policies and systems that are most appropriate for their individual requirements.

4.33 There is no generally accepted model of an environmental management system and the focus of our survey was on the embodiment of sound environmental management principles, rather than on specific techniques and procedures. We also recognize that each department’s environmental management needs are specific to that department. Practices must be allowed to vary to fit a department’s business and management style, and evolve to reflect changes in a department’s organization and business.

4.34 The departments in our survey were aware of their environmental responsibilities and had developed systems, policies and procedures to manage them. None of the departments have implemented a comprehensive environmental management system, but most have implemented a number of the component elements of a formal EMS and are actively developing others to meet environmental challenges. We support and encourage their continual improvement of environmental management and accountability.

Example 5: Corporate governance

Audit Objective And Scope
The objective of our audit was to assess the extent to which the Ministry’s accountability framework for university funding promotes the achievement of objectives including:

- Program quality;
- Access;
- Responsiveness to changing educational needs;
- Cost effectiveness in the delivery of programs and services; and
- Sound financial management.
Our audit of the Ministry was performed in accordance with the standards for assurance engagements, encompassing value for money and compliance, established by the Canadian Institute of Chartered Accountants, and accordingly included such tests and other procedures as we considered necessary in the circumstances. Our assessment was based on the following audit criteria, to which the Ministry agreed:

- The Ministry should have objectives for university grants and measurable goals to determine whether its objectives have been achieved.
- The Ministry should ensure that satisfactory governance and accountability frameworks are in place at the universities.
- The Ministry should ensure that: there are appropriate quality standards for publicly-funded programs; objective, reliable procedures exist to verify that program quality standards have been met; and appropriate corrective action is taken where deficiencies have been noted.
- The funding process should include clearly defined eligibility criteria for grants and should support the achievement of the Ministry’s goals and objectives.
- The Ministry should obtain reliable financial and performance information, and perform the analyses required to determine whether: the university system is efficient and effective; institutions have the financial capacity to fulfill their commitments to stakeholders; its goals and objectives are being achieved; and its grant conditions have been fulfilled. It should take appropriate, timely action where deficiencies are detected.

Our audit focused on the activities of the Universities Branch. We reviewed recent work that had been completed by the Ministry’s Audit Services Branch regarding financial controls over grants paid to universities and were able to rely upon it to reduce the extent of our audit.

The Audit Act does not provide the Provincial Auditor with access to the information necessary to perform value for money audits of universities. Instead, we requested the universities’ cooperation in conducting a more limited review of their governance and accountability processes in connection with our audit of the Ministry. The presidents and boards of governors of five universities allowed us access to information beyond their accounting records and all but one of the remaining universities completed a questionnaire about their governance and accountability processes. The governors, senators, senior managers and faculty we interviewed were open and cooperative during our visits and provided all the information we requested.

We were also permitted to review the program quality assurance processes performed through the Council of Ontario Universities (COU). The COU is composed of the presidents of the province’s universities and is funded by the universities.

As our work at the universities and COU was not an audit and consisted only of inquiry and discussion, and analysis of documentation and survey responses, we cannot provide a high level of assurance that the systems, policies and procedures described to us were working as intended. We also cannot provide any assurance that the results of our visits to the five volunteer universities are indicative of all Ontario universities.

Our work was conducted from September 1998 to June 1999.

**Overall Audit Conclusions**

Although the Ministry has recently set some measurable objectives for postsecondary education and begun to collect some related performance information, these initial steps are not sufficient for the
Ministry to determine how well the university system is meeting provincial needs and contributing to the achievement of postsecondary education objectives. We also concluded that the existing accountability framework for university funding did not yet meet certain aspects of the Management Board of Cabinet requirements for transfer payment accountability and that the Ministry had not linked funding to the achievement of provincial postsecondary education objectives.

In order for the Ministry to fully comply with Management Board of Cabinet’s requirements for accountability and to better ensure that Ontario universities are meeting provincial needs and objectives, the Ministry needed:

• To establish expectations for university governance and accountability and encourage universities to report publicly on their key governance and accountability processes, including those aimed at ensuring program quality;

• To work with the university community to strengthen the processes established for objectively assessing the quality of programs;

• To obtain more and better information about the extent to which universities are meeting student and provincial needs, including trends and achievements in delivering programs in ways that reduce student need for financial assistance;

• To establish procedures to effectively monitor the financial condition of universities at risk; and

• To encourage and monitor improvements in universities’ efforts to report publicly on their performances.

The five universities we visited had made a number of changes and improvements in recent years largely in response to the recommendations of the Task Force on University Accountability, provincial funding cuts and other changes. Significant improvements included: greater focus on strategic plans and priorities based on assessments of strengths, weaknesses and opportunities; better quality, clarity and analysis of the financial information provided to the governing bodies and the public; establishment of internal and external undergraduate program quality assurance processes; and the development and publication of institution-specific performance measures.

However, for the Ministry and other stakeholders to have confidence that universities are meeting provincial and institutional objectives cost effectively, university governing boards need:

• To set measurable objectives and targets, and report publicly on their achievement;

• To formally evaluate their presidents’ performances against established objectives and ensure that other senior managers are similarly evaluated; and

• To better ensure that they are governing effectively by periodically evaluating board members and functions and by formalizing board member orientation, including the use of COU orientation material.

Example 6: Compliance

Compliance with financial covenants

The Directors
ABC Limited [client]
[address]

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Dear Sirs:

**ABC Limited - Compliance with financial covenants**

This report is produced in accordance with the terms of our engagement letter dated [date].

The directors of ABC Limited ("the Company") are responsible for ensuring that the Company complies with the terms of the Company’s financing facility agreement with DEF Bank dated [date] ("the Agreement") and in particular the financial covenants specified in Clause Y of the Agreement. It is also their responsibility to extract relevant financial information from the Company's accounting records, to make the calculations specified in Clause Y, and to provide relevant financial information to DEF Bank.

For the purpose of preparing our report we have been provided by the directors of the Company with a schedule ("the Schedule") prepared in accordance with clause X of the Agreement, which shows the [Interest Cover and Debt to Equity ratio] for the Company for the year ended [date] in accordance with clause Y of the Agreement. This Schedule, for which the directors are solely responsible, is attached in Appendix 1.

In our opinion, the amounts shown in the Schedule have been accurately extracted from the accounting records of the Company as at [the year end date] and the [Interest Cover and Debt to Equity Ratio] have been correctly calculated in accordance with clause Y of the Agreement [with the following exceptions: (list exceptions)].

Our procedures, as stated in our engagement letter, do not constitute an examination made in accordance with generally accepted auditing standards, the objective of which would be the expression of an opinion on the truth and fairness of the Schedule. Accordingly, we do not express such an opinion.

This report is solely for your use in connection with the financial covenants in the Agreement as set out in our engagement letter; it is not to be used for any other purpose or to be distributed to any other parties. We will not accept any liability/responsibility to any third party to whom our report is shown or into whose hands it may come.

**Example 7: Due diligence**

Mr. President
South America Inc

Dear Mr. President,

We have performed the procedures set out in our letter of March xx, xxxx, which were agreed to by the management of South America Inc (the specified users), solely to assist you with respect to your proposed acquisition of companies A, B and C in Brazil. The sufficiency of the procedures is solely the
responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose. The work carried out and our findings thereon are set in the various sections of this report which are summarized below:

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- Executive summary
- Exhibit I -
Appendices
- Exhibit II -
- Exhibit III -
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We were not engaged to, and did not, perform an audit, the objective of which would be to express an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of the specified users listed above and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes.

Yours very truly,

**Example 8: Forensic audit (fraud investigation)**

**Management Summary**

I. Mr. xxxxx

Mr. xxxxx was sole general manager of XXX a privately-held corporation and responsible for:

- The re-factoring to the economic advantages for particular customers, e.g., company XXX and company XXX performed for years. This led to enormous damage. In some cases he was directly involved or informed.

- Unauthorized provision of advertising subsidies to the detriment of xxxx. The investigation revealed that he was informed of the practices of the sales departments subject to his authority and in some cases was directly involved.

- For non-compliance with the instruction that manual goods return vouchers were no longer to be used. This meant that the correct processing of returned goods could be overridden, which in fact occurred.

- In particular cases the manipulation of charts.

Moreover, Mr. xxxxx failed to exercise his incumbent control and supervisory duties with respect to employees subject to his authority. Although he was aware of the business links between Mr. XXX and XXX and XXX, he exercised no control whether Mr. XXX was engaged by these companies to the detriment of XXXX.

Only upon occasion of the special audit he allegedly have himself informed locally.

Beyond that for years, Mr. XXXX, against better knowledge, did nothing to make sure that the returned goods processing which he knew to be problematic and detrimental to XXX was securely and transparently organized.
Appendix 4: Example Reports

II. Mr. XXXX
Was directly responsible for all activities in the sales division. Mr. XXXX used his position to:

• personally perform re-factoring to the economic advantage of particular customers, e.g., XXX, XXX and XXX for years. XXX incurred sustained damage thereby.

• provide unauthorized advertising subsidies to the detriment of XXX. XXX incurred thereby substantial financial damage.

• actively manipulate charts.

Mr. XXX is collaterally responsible for

• the continued use of manual returned goods vouchers which allowed the correct processing of returned goods to be overridden.

• rebates in-kind, or free deliveries illicitly introduced in part using the catalog number XXX and thereby concealed.

Beyond that Mr. XXXX failed to exercise his incumbent control and supervisory duties with respect to employees subject to his authority. Although he was aware of the business links between Mr. XXXX and XXX and XXX, he exercised no control whether Mr. XXX was engaged by these companies to the detriment of XXX.

Only upon occasion of the special audit did he allegedly have himself informed locally.

Moreover, for years, Mr. XXXX, against better knowledge, did nothing to make sure that the returned goods processing which he knew to be problematic and detrimental to XXX was securely and transparently organized.

III. Mr. XXXX
Mr. XXXX was in constant violation of his obligations pursuant to his employment contract.

Despite prohibition, he continued to work for the companies XXX and XXX.

He used his position in sales to divert business intended for XXX to his own company.

IV. Organizational structure
As a result of the audit, we found the following additional weaknesses:

• By dissolution of the internal audit department in 2000, the management had no further means to audit the correct execution of its business processes.

• By lacking a central controlling department to steer the activities of the individual companies, XXX lost an important information and control instrument;

• Because of the decentralized responsibilities for EDP, which was in no way subordinated to a higher function, the definition and implementation of an integrated information processing system was continually impeded.

Example 9: Intellectual capital
As agreed with the management, we have reviewed the 20xx intellectual capital accounts for company xx.
Purpose and scope of the review
We have planned and performed our review in accordance with generally accepted auditing practices with a view to assessing whether:

- Data and information are documented and in accordance with generally accepted accounting practices;
- Data and information are related to the company’s activities in the period in question; and
- Measuring, monitoring and reporting procedures have been planned in an expedient way.

The review is not as comprehensive as an actual audit, and thus, it does not provide the user with the same degree of certainty with regard to the precision and completeness of the statement and the presentation of the information in the intellectual capital accounts. An audit requires the existence of generally accepted practices for the preparation and presentation of intellectual capital accounts. At present, such practices are not available.

In our review, we have checked the basis and documentation of the amounts disclosed in the intellectual capital accounts on the basis of an assessment of materiality and risk. Our review included analyses, enquiries, reviews of data and underlying documentation as well as random checks. Furthermore, we have reviewed the measuring and reporting procedures applied as well as the internal control system.

Opinion of the review
In our opinion, the 20xx intellectual capital accounts for the company xx are:

- Related to the company’s activities in the period in question, as described and defined under Accounting Policies;
- Based on documented information that has been processed in accordance with the guidelines set out under Accounting Policies; and
- Based on measuring, monitoring and reporting procedures that have been planned in an expedient way.

Example 10: Comfort letter
ABC Corporation
President and Representative Director

XYZ Securities
President and Representative Director

ChuoAoyama Audit Corporation
Representative Engagement Partner
Certified Public Accountant

Engagement Partner
Certified Public Accountant
Appendix 4: Example Reports

By the request of XYZ Securities (the “Manager”), we report in this letter on the Securities Registration Statements (the “SRS”) that ABC Corporation (the “Company”) has filed with the Director of Finance Bureau on XX XX 2000, together with an amendment to the SRS filed on XX XX 2000,

(1) We have audited the consolidated and non-consolidated financial statements of the Company included in the SRS for each of the two years ended 31 March 1999 and 2000. Our reports with respect thereto are included in the SRS. As at the date of this letter, we are not aware of any item that modifies the financial statements as of the date of our audit report.

(2) Since we have not performed an audit on the consolidated and non-consolidated financial statements for the year ending 31 March 2001, we are unable to express any opinion on any consolidated or non-consolidated financial statements as of any date or for any period subsequent to 1 April 2000.

(3) For the purpose of this letter, we have read the following, set forth in the SRS. (detail omitted)

(4) For the purpose of this letter, we have performed the following procedures, which were applied as indicated with respect to the items enumerated in 3 above. (detail omitted)

(5) For purpose of this letter, we have performed the following procedures with respect to the period from the 1 April 2000 to 30 June 2000.

(a) We have read the minutes of the shareholders’ and the Board of Directors’ meetings of the Company, Mr. XX, Senior Executive Director of the Company, having advised us that all such meetings between such dates were set forth in the minute book.

(b) We have read the monthly non-consolidated financial statements of the parent company as of 31 June 1999 and 2000. We have been advised by Mr. YYY (title) of the Company that the monthly consolidated financial statements were prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the non-consolidated financial statements as of 31 March 1999 and 2000, respectively, except for the accounting for pension obligations.

(c) We made enquiries of Mr. YYY (title) of the Company as to whether there were any decreases in operating revenue for the period from 1 April 2000 to 30 June 2000, in each case as compared with the corresponding period of the preceding year.

(d) We made enquiries of Mr. YYY (title) of the Company as to whether there were any decreases in profit before taxes for the period from 1 April 2000 to 30 June 2000, in each case as compared with the corresponding period of the preceding year.

(e) We made enquiries of Mr. YYY (title) of the Company as to whether there were any decreases in shareholders’ equity as of 30 June 2000 as compared with the amount of shareholders’ equity as of 31 March 2000 (less ¥ XXX million of dividends approved at the Company’s shareholders meeting as of XX June 2000).

(6) Except as noted below, nothing came to our attention as a result of the procedures described in 5. above, that caused us to believe that:

(a) for the three-month period from 1 April 2000 to 31 June 2000, there were any decreases in operating revenue, in each case as compared with the corresponding three-month period of the preceding year;
(b) for the three-month period from 1 April 2000 to 31 June 2000, there were any decreases in profit before taxes, in each case as compared with the corresponding three-month period of the preceding year;

(c) at 30 June 2000, there had been any decrease in shareholders’ equity as compared with an amount shown in the consolidated balance sheet as of 31 March 2000;

(Thousands of yen)

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<th></th>
<th>Operating Revenue</th>
<th>Profit before Taxes</th>
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<td>From April 1, 2000 to June 30, 2000</td>
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<td>Corresponding period of the preceding year</td>
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<td>Net</td>
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(7) We conduct our audit, on a test basis, applying customary auditing procedures in order to express an opinion as to whether the consolidated or non-consolidated financial statements present fairly the company’s financial position, the results of its operations and its cash flows. In addition, we conducted our interim audit, on a test basis, applying customary auditing procedures in order to express an opinion as to whether the interim consolidated or non-consolidated financial statements present useful information. Consequently we do not intend to express an opinion on the validity of each individual account, its detailed analysis, related quantities and amounts or ratios. The procedures enumerated in 4. and 5. above are not those in conformity with generally accepted auditing standards or generally accepted interim auditing standards. Therefore we do not express any opinion either as to whether those procedures met Management’s purposes or on the validity of each individual account, its detailed analysis, related quantities and amounts or ratios included in the SRS. Furthermore, we do not intend to express an opinion as to questions of legal interpretation, the sufficiency of disclosure in the SRS, or as to whether any material fact is not disclosed.

(8) This letter is solely for the information of, and assistance to Manager in conducting their investigation of the affairs of the Company in connection with the new share issues covered by the SRS. Therefore this letter is not to be used for any other purposes, e.g. sale of securities, nor is it to be referred to in whole or in part in the SRS or any other document.

(9) There is no relationship between the Company and our audit corporation which is required to be disclosed in accordance with Japanese CPA law.

Example 11: Subsidies (grants)

Grants for covering the carbon dioxide tax

Auditor’s report

We have audited the accounts on grants provided to cover carbon dioxide tax for 20xx which have been presented by the Board of Directors and the Board of Management of ABC, reference no 123.
Basis of opinion
We have planned and conducted our audit in accordance with generally accepted auditing standards as applied in Denmark to obtain reasonable assurance that the accounts are free from material misstatements. We have followed the audit instructions of January 1999 from the Danish Energy Agency’s Department 15 governing audits of accounts of business enterprises with major energy consumption that have received a total annual grant of more than DKK 200,000 under the Danish Act on state grants to cover expenses of carbon dioxide tax. In our audit we have tested the basis and documentation for the amounts and other disclosures in the accounts. We have based our audit on an evaluation of materiality and risk, and on the invoices disclosing energy purchased and tax. We have reviewed the accounts with a view to verifying accurate data transfers, accurate allocation of energy on room heating, light processing and heavy processing as well as accurate calculation of taxes and grants. In addition, we have verified the joint basis of calculation of CO2 grants and ordinary refunding of CO2 taxes.

Opinion
A total state grant of DKK XX has been paid to ABC to cover carbon dioxide taxes in the period YX to YXX. Payment was effected after the Danish Energy Agency’s commitment of grants that was made in connection with the energy efficiency enhancement agreement of DEF. We declare that:

- [Apart from the above qualification] the company has calculated the basis of grants correctly according to the commitment given and applicable rules, i.e., taking into account the company’s business procedures and registration systems for allocation of energy consumed on room heating, light processing and heavy processing

- Following this allocation of energy, at the time of measurement a statement on correct installation and placement of meters is available from an approved energy supervisor who has attended a training course on CO2 taxes as well as on principles for installation and placement of meters that has been approved by the Danish Central Customs and Tax Administration. In cases where energy is allocated through other legal means than measurement, the energy supervisor has submitted a statement that the relevant means of calculation is correct.

- The central business registration number (CVR-nr.) to which the grant was paid in the period YX to YXX is the same as the one disclosed in the company’s commitment of grant. Said central business registration number covers the processes and related quantities of energy that form the basis for calculation of the grant and the energy efficiency enhancement agreement and that are used in the Central Customs and Tax Administration’s refunding of energy taxes.

- The Danish Energy Agency’s audit instructions of January 1999 which include requirements relating to auditors’ statements on state grants to cover expenses of carbon dioxide tax, have been complied with.

Example 12: Education
Auditor’s statement
We have audited the ABC university report for the first quarter of 20xx as has been prepared by the business school.
Basis of statement
We have planned and conducted our audit in accordance with generally accepted auditing standards as applied in Denmark and Executive Order No 1007 of 14 December 1995 on auditing of business schools etc to obtain reasonable assurance that the report is free from material misstatements. Based on an evaluation of materiality and risk, we have in our audit tested the basis and documentation for the disclosures in the report.

Additional information
Course no. 123 was only advertised on the business school’s home page on the Internet.

Statement
In our opinion the overall report is in accordance with the business school’s actual number of full-school-year students.
BIBLIOGRAPHY


