

### **TOPIC 3**

#### **ISA 100: ASSURANCE ENGAGEMENT**

- This is where a practitioner is engaged to measure a given subject matter that was the responsibility of another party against suitable criteria and express an opinion meant to provide the intended user with a level of assurance regarding the information content of the subject matter.

#### **Elements of assurance engagement. (MAY 2019q 2a)**

1. **A three party relationship** consisting of;
  - The practitioner
  - The responsible party.
  - The intended user(s)
2. **Subject matter.** i.e F/S, ICS etc
3. **Suitable criteria** – characteristic of a suitable Criteria include;
  - **Relevance:** relevant criteria contribute to conclusions that assist decision-making by the intended users.
  - **Completeness:** criteria are sufficiently complete when they include all relevant factors that could affect the conclusions.
  - **Reliability:** reliable criteria allow reasonably consistent evaluation of the subject matter.
  - **Neutrality:** neutral criteria so that conclusions that are free from bias.
  - **Understandability:** conclusions that are clear, comprehensive, and not subject to significantly different interpretations.
4. **Evidence** – Engagement process.
5. **opinion**

Assurance engagement	Auditing
It's a 3 party relationship ie	
-practitioner	Auditor
-responsible party	Management
-Intended users	Management and others like CBK,KRA,ICPAK
Subject matter	F/S,ICS
Suitable criteria	IAS,IFRS,IPSAS,GAAPs
Suitable evidence	Audit evidence
Assurance report	Audit report

#### **Classification of Assurance engagement.**

- i. **Reasonable assurance vs Limited assurance**
- ii. **Attestation engagement vs direct reporting.**

#### **Reasonable Assurance Engagement**

- Is where the objective is a reduction of the assurance engagement risk to an exceptionally low level in the circumstances as a basis for a positive form of expression of an opinion.

#### **Limited Assurance Engagement.**

- Is where the objective is a reduction of the assurance engagement risk to a level that is acceptable in the circumstances but where the risk is greater than in a reasonable assurance engagement as a basis for a negative form of expression of opinion.

Differences btm Reasonable Assurance Engagement and Limited Assurance Engagement.

	Reasonable Assurance	Limited Assurance
Objectives	the objective is a reduction of the assurance engagement risk to an exceptionally low level in the circumstances	the objective is a reduction of the assurance engagement risk to a level that is acceptable in the circumstances but where the risk is greater than in a reasonable assurance engagement
Risk level	Engagement risk is Lower	Engagement risk is Higher
Opinion	Positive form of expression of an opinion	Negative form of expression of opinion
Assurance level	High level of assurance	Low level of assurance
Set of procedures	Extensive procedures	Limited procedures

- **Attestation Engagement-** where the practitioner declares that a given assertion is either correct or not correct
- **Direct Reporting Engagement-** where a professional accountant is engaged to give a special Report on some aspects of client's affairs.

**Assurance Engagement Risk.**

- This is the risk that the practitioner will give an inappropriate opinion when the subject matter information is materially misstated.
- The engagement risk is classified into 2: -
  - a) *Risk that the practitioner has no direct control over;*
    - i. ***Inherent risk*** – this is the susceptibility of the subject matter to material misstatement assuming there are no related controls.
    - ii. ***Control Risk*** – is the risk that the entity's internal controls will fail to detect material misstatement.
  - b) Risk that the practitioner has control of
- This includes Detection risk
  - i. ***Detection risk*** – is the risk that the practitioner procedures either will fail to detect material misstatement in the subject matter information because the procedure are inadequate, inappropriate or are poorly designed.

**Level of assurance provided by Assurance Engagement**

**1. High level/ reasonable**

- This is a level of assurance obtained when the practitioner has reduced the assurance engagement risk to an exceptionally low level in the circumstances to form a basis for a positive form of expression of opinion.
- Through high level, assurance is obtained, it is not absolute assurance.  
Absolute assurance is not possible due to inherent limitation of any process.

**Inherent limitations**

- Use of selective testing
- Possibility of collusion.

- Use of judgement
- Inherent limitation of accounting and ICS
- Characteristic of the subject matter

## **2. Low level/ limited.**

- This is a level of assurance that is obtained when the practitioner has reduced the assurance engagement risk to the level acceptable in the circumstances but where the risk is greater than in a case where reasonable assurance is desired.

### **Acceptance and continuous of an assurance engagement**

The practitioner should only accept or continue with assurance engagement when;

- i. The practitioner is certain that the relevant ethical requirement including independence is satisfied.
- ii. The practitioner is satisfied that the person who will perform the engagement collectively have the appropriate competence and capabilities.
- iii. The basis upon which the engagement is to be performed have been agreed with through;
  - Establishing that the pre- condition of an assurance engagement is present.
  - Confirming that there is a common understanding between the practitioner and the engaging party on the terms of engagement.

#### **Pre- conditions for assurance Engagement.**

- In order to establish whether the pre- conditions of assurance engagement are present, the practitioner should determine whether;
  - The roles and responsibilities of the appropriate parties are suitable in the circumstances.
  - The underline subject matter is appropriate
  - The criteria to be applied is suitable
  - The criteria will be available to the intended users.  The practitioner conclusion will be in appropriate form
  - Rational/ purpose of the engagement exist.

#### **Content of assurance reports.**

- Title
- Addressee
- Practitioner's Signature.
- Practitioner's addressee
- Content and practitioner's conclusion.
- Identification of applicable criteria.
- A statement that the ethical requirement where complied with

#### **Related services by Practicing Accountant.**

1. Agreed upon procedures engagement.
2. Compilation engagement.
3. Review engagement.
4. Due diligence review Engagement.

5. Review of prospective Financial Information.
6. Compilation Engagement.

#### **a. Agreed Upon Procedures Engagement**

- This is an engagement where a practitioner is engaged to carryout procedures of audit nature to which the practitioners the engaging party and any other relevant third party have agreed upon and report on factual finding.

#### **Circumstances when the agreed upon procedure engagement will be appropriate.**

- In investigating frauds and irregularities.
- In verifying insurance claims
- In reporting of non- financial data

#### **General principles on agreed upon procedures Engagement**

- The practitioner must comply with the fundamental principle outlined in the IFAC code which include;
  - Integrity
  - Objectivity
  - Confidentiality
  - Professional Behavior.
  - Technical Standards.

Note: Independence is not a requirement in agreed upon procedures engagement. **Matters to be agreed upon**

- Nature of the engagement
- Purpose of the engagement
- Financial and non- financial information.
- Nature, timing and extent of the specific procedures to be applied.
- Anticipated form of report of factual findings.
- Limitation of the distribution of the report of factual findings.

#### **Example of the procedure applied in the Engagement**

- Inquiring
- Analysis
- Re- computation and other clerical accuracy checks.
  - Observation
    - Inspection.
    - Circularization.

#### **Content of the report of factual findings.**

- ✓ Title
- ✓ Addressee
- ✓ Date of the report.
- ✓ Practitioner's address and signature.

- ✓ A listing of the specific procedures performed.
- ✓ A statement that the procedures performed were those that were agreed upon with the recipient.

#### **b. Compilation engagement.**

- This is a non- assurance engagement in which a professional accountant is engaged to use accounting expertise as opposed to auditing expertise to collect, classify and summaries financial information.

##### **Contents of the Report of compilation Engagement**

- Title
- Addressee
- Date of the report.
- Accountant's signature.
- A statement that the engagement was performed in accordance with the international standards on related services applicable to compilation engagement.

#### **Condition for accepting a compilation Engagement**

- The practitioner must obtain the acknowledgment of the management regarding;
  - i. The financial information to be compiled by the practitioner.
  - ii. While the practitioner assists the management in preparing and presenting the financial information in accordance with the applicable framework the management retains responsibility for that information

#### **c. Review Engagement**

- It is a review of the entity's financial information other than the one that is done by the entity as part of the statutory audit.

##### **Application of Review engagement.**

- Review of interim Financial Statement.
- Due diligence review.
- Review of historical financial information

#### **Elements in a review engagement**

- ✓ Title
- ✓ Addressee
- ✓ Introductory paragraph
- ✓ A description of the practitioner responsibility.
- ✓ Date of the report
- ✓ Practitioner address and signature.

#### **Distinction between a review engagement and an audit of financial statement.**

- i. A review engagement provides limited assurance while an audit provides reasonableness.
- ii. Engagement risk in a review engagement is higher than in an audit.
- iii. In a review engagement the set of procedure professional performed are limited compared to those in an audit.

- iv. In a review engagement, the practitioner's opinion is expressed in a negative form while in an audit the opinion is expressed in a positive form.
- v. A review of financial informant is voluntary while an audit is a statutory requirement

**Pre- condition for accepting a review engagement. (May 2018 q1 a)**

Prior to accepting a review engagement, the practitioner should;

- Determine whether the FRF applied in the preparation of the FS is acceptable
- Obtain an acknowledgement from the management that they understand it is their responsibility to prepare Financial Statement in accordance with the applicable FRF.
- Obtain an acknowledgment from the management that they understand it is their responsibility to implement controls necessary to ensure that the Financial Statement are free from material misstatement.
- Obtain an agreement from the management that they will provide the practitioner with access to all information.
- Obtain an agreement from the management that they will provide the practitioner with any addition information that the practitioner may request for the purpose of the review.
- Obtain an agreement from the management that they will give the practitioner unrestricted access to persons within the entity from whom the practitioner may wish to obtain evidence.

**d. Due Diligence Engagement**

- This is where a practitioner is engaged to systematically carry out an assessment to reduce the risk associated with the transaction.
- Financial due diligence focuses on providing potential investors with an understanding of the company; 
  - ✓ Sustainable economic earnings.
  - ✓ Historical sales trends
  - ✓ Historical workings capital needs
  - ✓ Key assumption used
  - ✓ Key personnel
  - ✓ Accounting information system

**Areas where due diligence is applied**

- Financial due diligence
- Operational/ IT due diligence
- People due diligence
- Regulatory due diligence
- Environment due diligence

**Report on due diligence Review Engagement**

- Typically, the report should consist of;
  1. Scope of the engagement.
  2. Executive summary which include;
    - ✓ History of target company
    - ✓ Nature of the target
    - ✓ Group structure

Audit	Due Diligence
Independent Auditor/ Accountant	Accountants experienced in such assignment
Scope is determined by ISAs	Scope is varied Determined by the buyer.
Involves detailed verification testing of F.S	Focuses on dead issues. Limited verification testing.
Typically covers the result for the year under audit.	Cover the last several years
Timing is dependent on stakeholders	Can range from 1-day desk review to several weeks of internal process, Critical Accounting policies etc

### **Contrast, Due Diligence & Audit**

#### **e. Engagement to review prospective Financial Information.**

Prospective financial information is information that is based on assumption about in the future and the actions the management is expected to make as of the date of that information