

Executive summary

In August 2006, the ICAEW Audit and Assurance Faculty began a two-year consultation on a new assurance service (the ICAEW Assurance Service), an alternative to audit based on the idea of limited assurance introduced by the International Auditing and Assurance Standards Board (IAASB). This report presents findings from practical experience of providing the ICAEW Assurance Service over the subsequent two years and views of users of financial information that help in assessing the relevance of the service to their needs.

Prior to 1993, all UK companies had their financial statements audited as required by company law. By 2006, however, an increasing and substantial majority of companies were taking advantage of a legal option for smaller companies not to have an audit. Against this backdrop, we decided to instigate a debate on whether a new alternative to audit was needed in the UK market by reference to a specific service.

AAF 03/06, the technical guidance which underpins the ICAEW Assurance Service, draws on the IAASB *International Framework for Assurance Engagements* rather than the existing International Standard on Review Engagements (ISRE 2400). Our initiative met with considerable scepticism based on doubts about demand for a new service and concerns about variability in the procedures followed by practitioners applying professional judgement.

The environment changed dramatically over the two-year consultation period in the UK and internationally. There is now far wider acceptance of the need to look at new assurance services. There have also been questions about the economics of auditing private limited companies, in particular small and medium-sized enterprises (SMEs). The topic of alternatives to audit is now of global concern to the business, regulatory and professional accounting communities and is on the agenda of the IAASB.

Against that background, the ICAEW is publishing this report to share its experience and participate in a global debate. We seek to identify and discuss issues identified through our consultation, where possible, in a way that is relevant beyond the UK. We also describe our experience of how professional accountants approach alternatives to audit, how external users use financial information of SMEs and the challenges of establishing new approaches.

Since the South-East Asian economic crisis at the end of 1990s, there has been growing acceptance of the need to implement high quality and internationally consistent accounting and auditing regimes to encourage international capital flows. One of the consequences is the spread of International Financial Reporting Standards (IFRS). Another is support for a shared global understanding of what a financial statement audit is, summarised in the phrase 'an audit is an audit'. Nevertheless, recent moves to enhance International Standards on Auditing (ISAs) have drawn attention to the economics of what we refer to as the 'universal audit' approach.

The 'universal audit' approach, which requires all companies to prepare accounts for their shareholders, to have them audited and to file them at a public registry, is not prevalent or accepted where it once was. The U.S. has never adopted it. In Europe, where the approach was once favoured, deregulatory pressure for increased international competitiveness has led the European Commission and national governments to continually raise audit exemption thresholds. The UK is no exception to the trend. A growing realisation of this has been the key trigger to the ICAEW in exploring voluntary alternatives to audit. There is also a great deal of recent work on the concept of assurance which should be taken into account.

Reflecting on past and current developments, this report supports the need for a comprehensive reappraisal of alternatives to audit, including not only review and assurance services but also agreed-upon procedures and compilation engagements. In doing so, we also consider other possible priorities. These include: agreeing on internationally consistent SME financial information; rethinking SME audit; and simply updating existing standards for review and accounts compilation engagements.

While there are growing signs of engagement within the profession at an international level to consider alternatives to audit, we are also conscious of the need to engage a wide diversity of stakeholders and their different views. The central proposal of this report is that there should be a properly informed international debate led by the IAASB made accessible to a wide range of people. The objective of such a debate should be to develop a common understanding of the issues and language for talking about alternatives to audit, allowing people to communicate effectively across different jurisdictions, reporting regimes, traditions and markets. Rather than leading to new phrases such as 'a review is a review' based on uniform global adoption and implementation, standards could be used as a frame of reference by businesses, professional accountants and regulators in different markets and countries.

We believe that the basic purpose of audit and other assurance services is important in enhancing the confidence placed in financial information. This position is supported by the views of external users of financial information. We strongly support the need for professional judgement in providing audits and other assurance services, allowing professionals to exercise a degree of discretion which cannot simply be reduced to the application of written standards or the completion of a predefined set of procedures. In such engagements, the engagement partner will need to show leadership and take responsibility for the report that is issued.

A properly informed global debate will bring benefits, for example: sharing learning and knowledge; allowing choice and diversity; and supporting economic development. There are also a number of significant challenges, including: demonstrating the benefits of assurance; dealing with the concepts of limited and moderate assurance; recognising the limits of standards in codifying activities such as the exercise of professional judgement; and establishing reporting conventions. These should be addressed through an inclusive and comprehensive international debate in which we believe the IAASB is best placed to play the leading active role.