Small and Medium Practices Committee

IFAC®

Guide to Review Engagements

International
Federation
of Accountants

Small and Medium Practices Committee
International Federation of Accountants
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The SMP Committee of the International Federation of Accountants (IFAC) represents the interests of professional accountants operating in small- and medium-sized practices (SMPs). The committee develops guidance and tools and works to ensure the needs of SMPs are considered by standard setters, regulators, and policy makers. The committee also speaks out on behalf of SMPs to raise awareness of their role and value, especially in supporting small- and medium-sized entities, and the importance of the small business sector overall. Learn more at www.ifac.org/SMP.

This publication may be downloaded from the Publications & Resources section of the IFAC website: www.ifac.org/publications-resources. The approved text is published in the English language.

IFAC's mission is to serve the public interest by: contributing to the development of high-quality standards and guidance; facilitating the adoption and implementation of high-quality standards and guidance; contributing to the development of strong professional accountancy organizations and accounting firms and to high-quality practices by professional accountants, and promoting the value of professional accountants worldwide; and speaking out on public interest issues.

The SMP Committee extends its appreciation and thanks to its Implementation Guidance Task Force for assisting the committee in developing this Guide. The Implementation Guidance Task Force consists of committee members Abdulwahid Aboo, Subodh Kumar Agrawal, Katharine E. Bagshaw, Brian Bluhm, Phil Cowperthwaite, Chen Longwei, Dawn McGeachy-Colby, Andreas Noodt, and Inge Saeys; and technical advisors Mark Koziel, Gail McEvoy, Ken McManus, Guy Van de Velde, Jonnalagadda Venkateswarlu, Gillian Waldbauer, Makokha Wanjala, and Sun Xiaoyue.

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ISBN: 978-1-60815-164-6

Published by: IFAC International Federation of Accountants®

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Preface

Many small- and medium-sized entities (SMEs) around the world are not required, or do not elect, to have an audit. They may, however, wish to enhance the credibility of, and confidence in, their unaudited financial statements among their users by having some degree of independent assurance on them. A review engagement, which offers limited assurance, may be the ideal solution. Accounting practices, especially small- and medium-sized practices (SMPs) that typically serve SMEs, therefore, need to be prepared to meet the potentially increasing demand for this service. The *Guide to Review Engagements* is intended to do just that.

The Guide aims first and foremost to help IFAC member organizations and their members in practice, especially SMPs, with the implementation of the International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*. The Guide aligns with ISRE 2400 (Revised) as published by the International Auditing and Assurance Standards Board (IAASB) in September 2012. While the Guide includes relevant extracts from the standard, the complete standard is available in the 2013 IAASB Handbook.

Practitioners can use the Guide to develop a deeper understanding of a review engagement conducted in compliance with ISRE 2400 (Revised) through explanation and illustrative examples. The Guide includes a number of appendices with key checklists and forms that practitioners can adapt to meet the requirements and circumstances in their particular jurisdiction. The Guide also contains ideas to help practitioners market review engagements to existing and new clients.

IFAC engaged CPA Canada to develop the guide, and wishes to thank them for their outstanding work. The project also benefited from the direction and input received from the SMP Committee's Implementation Guidance Task Force and, in particular, the leadership, commitment, and time of the staff of the Institut der Wirtschaftsprüfer (IDW).

In order to help member bodies maximize the use of both this Guide and its sister publications, the *Guide to Quality Control for Small- and Medium-Sized Practices* and the *Guide to Using International Standards on Auditing in the Audits of Small- and Medium-Sized Entities*, the SMP Committee has developed a Companion Manual along with additional materials designed to support the use of the Guides for education and training purposes. The Companion Manual includes suggestions on how IFAC member bodies and firms may make best use of the Guides to suit their own needs and jurisdictions.

Finally, we welcome readers to visit the SMP area of the IFAC website at www.ifac.org/SMP for further details about the work of the IFAC SMP Committee and for access to additional publications and resources, including additional implementation guides to assist SMPs in the efficient and effective implementation of the IAASB's standards.

Giancarlo Attolini
Chair, IFAC SMP Committee
December 2013

Disclaimer

This Guide is designed to assist practitioners in the implementation of the International Standard on Review Engagements (ISRE) 2400 (Revised), but is not intended to be a substitute for reading the standard itself. Furthermore, a practitioner should utilize this Guide in light of his/her professional judgment and the facts and circumstances involved in each particular review engagement. IFAC disclaims any responsibility or liability that may occur, directly or indirectly, as a consequence of the use and application of this Guide.

1 HOW TO USE THIS GUIDE

CHAPTER CONTENT

- The purpose of the Guide and its possible uses.
- How the content is organized.

1.1 INTRODUCTION

This Guide addresses the responsibilities of a practitioner (who is not the entity's auditor) when engaged to perform a review of historical financial statements in accordance with the International Standard on Review Engagements (ISRE) 2400 (Revised). This standard was issued in September 2012 and comes into effect for periods ending on or after December 31, 2013.

It is assumed that the practitioners using this Guide will already have knowledge of ISRE 2400 (Revised). The Guide provides non-authoritative guidance on applying ISRE 2400 (Revised). It is not to be used as a substitute for reading the standard, but rather as a supplement to support consistent implementation of the standard. The Guide does not address all aspects of the standard, and should not be used for the purposes of determining or demonstrating compliance with ISRE 2400 (Revised).

IAASB standards do not override national law and regulations in a particular country. Accordingly, not all of the examples provided in this Guide may be appropriate in all jurisdictions. Practitioners should give due consideration to local law in the area in which the review is being undertaken.

1.1-1 Purpose of the Guide

This Guide is directed primarily at those with knowledge of auditing but little or no experience with performing review engagements.

The purpose of this Guide is to provide:

- Practical guidance on the application of the requirements when conducting review engagements.
- Examples of:
  - Typical review engagement procedures and some fictional practice scenarios. Please note that the responses provided for these scenarios are based on the unique facts and circumstances involved and the appropriate use of professional judgment by the practitioner.
  - Key documents, such as engagement and management representation letters (included in the appendices).
- Consider Points that address:
  - Matters that can easily be overlooked or where practitioners often encounter difficulties with implementation.
  - Efficiency suggestions that may help to reduce the time required in performing these engagements.

1.1-2 Uses for the Guide

This Guide can be used to:

- Provide a deeper understanding of a review engagement when conducted in compliance with ISRE 2400 (Revised);
- Serve as a day-to-day reference guide for staff;
- Develop policies/procedures for the firm's quality control manual;
- Create training sessions and enhance individual study and group discussions;
- Ensure the firm's professional staff develop a consistent approach to planning and conducting review engagements; and
- Improve communication amongst the engagement team.

1.1-3 IFAC Resources

To learn more about the IFAC Small and Medium Practices (SMP) Committee, visit the SMP section of the IFAC website. There, you'll have access to numerous SMP resources, including guides, articles, and links to other useful materials.

1.2 CONTENT AND ORGANIZATION

This Guide has been organized to follow the key steps involved in performing a review engagement. The appendices contain definitions of terms used, sample letters, sample checklists, and other practice aids.

1.2-1 Organization of Chapters

Each chapter of this Guide has been organized in the following format:
(a) Overview chart highlighting what is addressed in the chapter.
(b) Relevant requirement paragraphs in ISRE 2400 (Revised) applicable to the topic. (The extracts in the Guide are based solely on the judgment of the authors as to what is relevant for the content of each particular chapter.)
(c) Commentary on the requirements.
(d) Examples of the concepts involved.
(e) Consider Point (practical guidance).

1.2-2 Acronyms Used

Exhibit 1.2-2.A

AFRF	applicable financial reporting framework
CU	currency units (standard currency unit is referred to as "Є")
EQCR	engagement quality control review
F/S	financial statements
IAASB	International Auditing and Assurance Standards Board
IESBA	International Ethics Standards Board for Accountants
IESBA Code	IESBA Code of Ethics for Professional Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
ISA	International Standard on Auditing
ISAE	International Standard on Assurance Engagements
ISQC 1	International Standard on Quality Control 1
ISRE	International Standard on Review Engagements
IT	information technology
SMEs	small- and medium-sized entities
SMPs	small- and medium-sized (accounting) practices
TCWG	those charged with governance
W/P	working paper

2 WHAT IS A REVIEW ENGAGEMENT?

CHAPTER CONTENT

- The scope and objective of a review engagement.
- How a review engagement differs from an audit or a compilation engagement.
- The major uses and benefits of a review engagement.
- The type of work involved in a review engagement.

2.1 THE FUNDAMENTALS

For SMPs, ISRE 2400 (Revised) provides an opportunity to meet an increasing demand for review engagement services created by such factors as:

- Trend toward higher audit exemptions for SMEs.
- Desire for some degree of independent assurance for SMEs and their financial institutions to increase the credibility of their financial statements (even though a statutory audit may not be required).
- Demand for lower cost assurance services. (The limited and less costly nature of a review engagement can provide SMEs with an attractive option when an audit is not required.)
- Demand for reviews where a component of a group is not considered to be a significant component but where the group engagement team considers a review necessary pursuant to ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the work of Component Auditors)* paragraph 29 (ISA 600.29). While such review engagements may be performed by the group engagement team, SMPs may also be engaged as a component auditor under ISA 600 to perform such reviews.

2.1-1 Scope of ISRE 2400 (Revised)

ISRE 2400 (Revised) addresses:

- The practitioner's responsibilities when engaged to perform a review of historical financial statements (when the practitioner is not the auditor of the entity); and
- The form and content of the practitioner's report on the financial statements.

ISRE 2400 (Revised) also applies, and adapts as necessary, reviews of other historical financial information. However, this Guide concentrates on the review of a full set of general purpose financial statements.

ISRE 2400 (Revised) does *not* address:

- Reviews performed by the independent auditor of either the entity's financial statements or reviews of interim financial information. The latter are dealt with by ISRE 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*.
- Limited assurance engagements other than reviews of historical financial information that are performed under ISAE 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*.

For an overview of the aims and background of ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*, refer to the actual standard and IAASB's *At a Glance*.

2.1-2 Engagement Objectives

Paragraph	Requirement
	Objectives
14	**The practitioner's objectives in a review of financial statements under this ISRE are to:** **(a) Obtain limited assurance, primarily by performing inquiry and analytical procedures, about whether the financial statements as a whole are free from material misstatement, thereby enabling the practitioner to express a conclusion on whether anything has come to the practitioner's attention that causes the practitioner to believe the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework; and** **(b) Report on the financial statements as a whole and communicate, as required by this ISRE.**
15	**In all cases when limited assurance cannot be obtained and a qualified conclusion in the practitioner's report is insufficient in the circumstances, this ISRE requires that the practitioner either disclaim a conclusion in the report issued for the engagement or, where appropriate, withdraw from the engagement if withdrawal is possible under applicable law or regulation. (Ref. Para. A8–A10, A115–A116)**

A review engagement is an assurance engagement. The *International Framework for Assurance Engagements* defines an assurance engagement as follows:

> "… an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party …" (Volume II. Paragraph 7)

The *International Framework for Assurance Engagements* describes the two types of assurance engagements that a practitioner is permitted to perform as set out in the following exhibit.

Exhibit 2.1-2A

Type of Engagement	Commonly Known As	Description
Reasonable Assurance	**Audit**	An engagement to support an opinion on the financial statements expressed in the positive form. Reasonable assurance is a high level of assurance that is achieved when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk of an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.
Limited Assurance	**Review**	An engagement to support a conclusion on the financial statements in terms of whether anything has come to the practitioner's attention to indicate that the financial statements are not prepared in accordance with the AFRF. The practitioner conveys a level of assurance that is limited proportional to the level of the practitioner's procedures given the characteristics of the subject matter and other relevant engagement circumstances described in the assurance report.

There are three main parties in an assurance engagement as summarized in the following exhibit.

Exhibit 2.1-2B

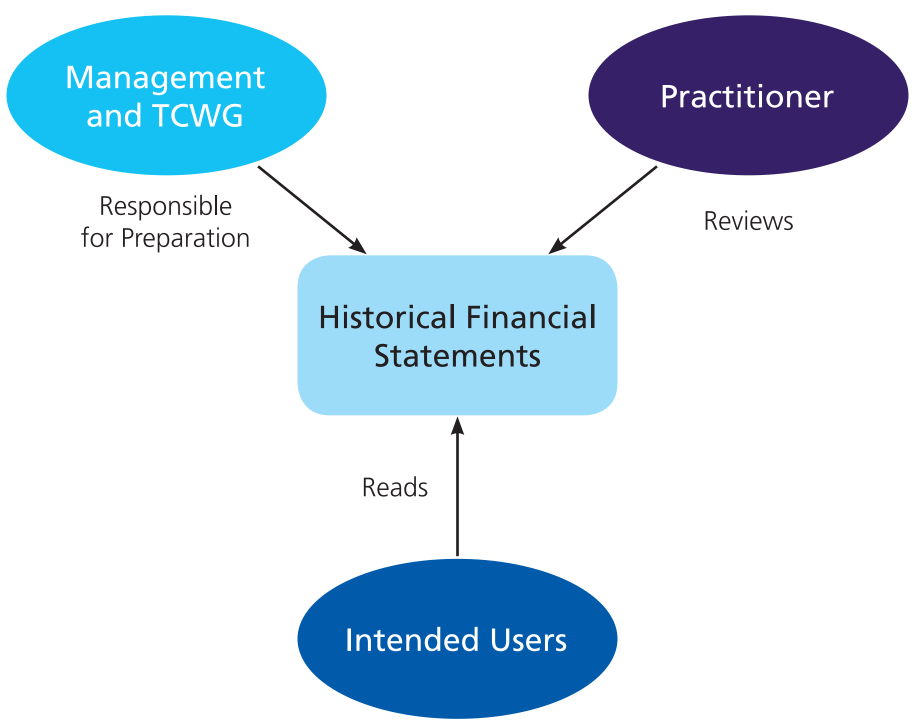


Exhibit 2.1-2C

Party	Description of Role
Management and Those Charged with Governance	Preparing the financial statements (including disclosures) in accordance with the AFRF (such as IFRS for SMEs) is the responsibility of management/those charged with governance. In some jurisdictions, the practitioner may assist management in financial statement preparation subject to any ethical restrictions, but this does not reduce management's responsibility.
Practitioner	The practitioner makes inquiries and performs procedures to determine whether management's financial statements are free from material misstatement due to fraud or error. The extent of procedures performed will depend on whether the engagement is an audit (reasonable assurance obtained) or a review (limited assurance obtained) and on the judgment of the practitioner. Provided the evidence obtained does not cause the practitioner to conclude to the contrary, the practitioner then prepares a report (to be attached to the financial statements) stating: (a) In an audit engagement, that the financial statements present fairly (or true and fair) … in accordance with the AFRF; or (b) In a review engagement, that nothing has come to the practitioner's attention that causes the practitioner to believe that the financial statements do not present fairly, in all material respects (or do not give a true and fair view), in accordance with the AFRF.
Intended Users of Financial Statements	An assurance engagement, whether a review or an audit, enhances the intended users' confidence about the financial statements. In general, this enhanced confidence relates to whether the financial statements are free from material misstatements. Misstatements, including omissions, are considered to be material if they (individually or in the aggregate) could reasonably be expected to influence the economic decisions of users when taken on the basis of the financial statements.

Management and Those Charged with Governance

In small entities, there is often no separation between management's role and TCWG. However, in some jurisdictions, the responsibility for preparing financial statements is the legal responsibility of TCWG; whereas in others, it is management's responsibility.

Consider Point

Regardless of who has the responsibility of preparing financial statements, the preconditions for accepting a review engagement (ISRE 2400.30) are similar to those of an audit engagement ISA 210, *Agreeing the Terms of Audit Engagements*, paragraph 6 (ISA 210.6). For example, if the financial reporting framework applied in the preparation of the financial statements is considered not acceptable for an audit, it will also not be acceptable for a review. Another example would be if an auditor decides that precondition of audit is not fulfilled because management is unable to or will not grant access to accounting records and documents supporting the financial statements, a practitioner will also conclude that the precondition of review is not fulfilled.

2.1-3 Comparing Audits, Reviews, and Compilations

The following exhibit summarizes how a review engagement compares to audit and compilation engagements.

Exhibit 2.1-3A

Engagement	Standards	Assurance	Work Efforts	Report
Audit	ISAs	Reasonable	Risk assessment and procedures that respond to the risks identified	Positive opinion
Review	ISRE 2400	Limited	Primarily inquiry and analysis	Conclusion on what came to the practitioner's attention
Compilation	ISRS 4410	None	Assisting management prepare financial information	Report stating no assurance is provided

In a review engagement, the practitioner's responsibilities (and the resulting report) differ significantly from those of an audit or compilation engagement and from the level of confidence that users could thus reasonably be expected to derive from the respective practitioner's report.

Since a review engagement consists primarily of inquiry and analytical procedures, there is a greater risk that material misstatements will not be detected as compared to an audit.

2.1-4 Steps Involved in Performing a Review Engagement

The following exhibit details the steps involved in performing a review engagement and identifies where each step is addressed within this Guide.

Exhibit 2.1-4A

Key Steps Involved	Location Within the Guide
1. Determine the **acceptability of the engagement and client** relationship.	Chapter 3 (Section 3.2)
2. Obtain an **understanding of the entity** sufficient to first identify areas in the financial statements where material misstatements are likely to arise and then to **design procedures accordingly**.	Chapter 4 (Sections 4.3 and 4.4)
3. **Make inquiries of management** and others within the entity involved in financial and accounting matters. This involves using the practitioner's assurance skills to prepare and ask meaningful questions based on the understanding obtained of the entity and any follow-up questions based on the responses received.	Chapter 5 (Section 5.1)
4. Apply **analytical procedures**.	Chapter 5 (Section 5.1)
5. Design and perform any **additional procedures** required to either confirm or dispel any matter of which the practitioner becomes aware that may cause the financial statements to be materially misstated.	Chapter 5 (Section 5.1)
6. **Evaluate** the sufficiency and appropriateness of the evidence obtained.	Chapter 5 (Section 5.2)
7. Form a **conclusion and report** on the financial statements.	Chapter 6

Consider Point

There is a key difference between the objective of performing an audit and that of a review. The objective of an audit is to obtain reasonable assurance to support a positive opinion on whether the financial statements are presented fairly (or true and fair view), whereas the review engagement report is limited to a conclusion on whether the practitioner has become aware of any matter that may cause the financial statements to be materially misstated.

Although some of the inquiries and procedures performed in a review may be similar to procedures performed in an audit, they do not have the effect of converting the engagement into an audit. The terms of engagement (as agreed with the client) determine the nature of the engagement.

2.1-5 Other Differences between Engagements

The following chart summarizes some of the more significant differences between audits, reviews, and compilations.

Exhibit 2.1-5A

	Audits	Reviews	Compilations
Independence Required?	Yes	Yes	No[1]
Materiality Calculations?	Financial statements as a whole Performance materiality	Financial statements as a whole	Financial statements as a whole for the purpose of compiling the information provided
Engagement Quality Control Review Required?	Listed entities and as specified in firm policy	As specified in firm policy	As specified in firm policy
Understanding of the Entity?	Sufficient to identify and assess the risk of material misstatement at the financial statement and assertion levels	Sufficient to identify areas in the financial statements where material misstatements are likely to arise	Sufficient to compile the information provided
Design of Procedures?	Plan and perform sufficient procedures to reduce the risk of material misstatement in the financial statements to an appropriately low level	Address all material items in the financial statements, including disclosures Focus on financial statement areas where material misstatements are likely to arise	Sufficient to compile the information provided
Required Procedures?	Risk assessment Test of controls[2] Analytical Substantive	Inquiry and analysis Additional procedures as considered necessary in the circumstances	None specified
Assurance Evidence to Be Obtained?	Sufficient and appropriate to be able to draw reasonable conclusions on the financial statements	Sufficient appropriate evidence as the basis for a conclusion on the financial statements as a whole	None specified
Uncorrected Misstatements?	Accumulate, evaluate, and request correction by management	Evaluate and request correction by management	Corrections made as part of compiling the financial information

1 Unless the national rules of conduct have differing requirements. In addition, the practitioner is still required to perform the work with an objective state of mind.

2 Only necessary where the risk assessment includes an expectation that the controls are operating effectively or where substantive procedures alone cannot provide sufficient appropriate audit evidence.

2.2 USES AND BENEFITS

2.2-1 Uses

Some of the possible uses of a review engagement are set out in the following exhibit.

Exhibit 2.2-1A

A review engagement may be used to:
Support a financing proposal presented to potential investors and financial institutions or an application for a government grant.
Validate a need for partners to invest additional capital in the entity.
Provide users, such as shareholders, with some assurance on the annual financial statements where an audit is no longer required.
Help management understand, and take steps to meet, the evolving requirements of regulatory and business reporting.
Help prepare the finance function of a growing company for a transition to mandatory audit.
Obtain limited assurance with regard to the financial statements of small subsidiaries that are part of a group audit.
Support internal reviews of the business by management, acting as an additional control.

2.2-2 Benefits

Exhibit 2.2-2A

Benefit	Description
Less Costly Than an Audit	When the degree of confidence required in the entity's financial statements is less than that of an audit, time and cost may be saved by opting for a limited assurance engagement, which generally requires less work to complete. For example, an entity (where an audit is not required) may apply for a loan from a financial institution to be secured on the basis of its profitability and assets (such as inventory or receivables). If the entity regularly supplies the institution with monthly information about its operating results and security, a limited assurance report on the financial statements may well be acceptable. This would save the entity the costs involved in obtaining an audit, but would still provide the institution with limited assurance on the annual financial statements. For a cost that is less than an audit, the review engagement can provide limited assurance to readers that could be very useful when it comes to selling the business, seeking new investors, or making a proposal for a bank loan.
Flexible and Targeted Engagement	A review is based on inquiry and analytical procedures, allowing the practitioner to rely on professional judgment and experience. The practitioner is, therefore, able to focus time and attention according to the complexity of the financial statements and the nature of the business.

2.2-3 Applicability to Financial Statement Users

Exhibit 2.2-3A

Financial Statement Users	Suitable Engagement
Stakeholders in a listed (i.e., public) or a significant publically accountable entity (i.e., a public interest entity).	An audit.
The entity has plans to grow and attract new stakeholders and financing.	An audit or a review, depending on the speed of growth and how soon the mandatory audit threshold will be reached.
Third-party members or stakeholders in an entity exempt from a mandatory audit.	An audit or a review, depending on the assurance needs of the stakeholders.
A financial institution that lends money to an entity exempt from a mandatory audit.	A review engagement may be sufficient.
Family members and a few close friends in an entity exempt from a mandatory audit.	A review engagement may be sufficient.
Members of management only and filings with regulatory bodies (e.g., tax returns).	A compilation or review, depending on whether any form of assurance is required.

Consider Point

The concept of a review engagement may be new to both the firm and its clients, and so it may be useful to:

- Hold information sessions for partners and staff regarding the nature of a review engagement and situations where it would be applicable;
- Ensure that staff involved in performing review engagements receive appropriate training;
- Prepare a simple brochure for clients and potential users of a review engagement report, such as banks, on the benefits of a review engagement and what it entails; and
- Identify clients who would benefit from a review engagement and then arrange a meeting to discuss the benefits and what such an engagement entails, including the less intrusive nature of a review engagement and the time savings it may represent to the client.

2.3 THE ELEMENTS

2.3-1 The Four Elements

The following exhibit outlines the four major elements of a review engagement. The subsequent chapters in this Guide address each of these elements in more detail.

Exhibit 2.3-1A

Element	Activity	Purpose	Documentation
Accepting	Understand firm's quality control (QC) policies for review engagements	Ensure staff are prepared to perform review engagements	Reference to firm's QC policies Training provided on QC and review engagements
Accepting	Perform acceptance or continuance procedures	Decide whether engagement can be performed	Preliminary observations Independence assessment Engagement letter
Planning	Determine materiality Understand the entity and its environment	Identify F/S areas where misstatements are likely to arise	Materiality Understanding of the entity and environment Likely misstatements
Planning	Design inquiries and analytical procedures	Focus work efforts on: • material F/S areas • likely misstatements	Team planning notes Listing (plan) of procedures to be performed
Performing	Perform planned procedures and any additional procedures necessary	Obtain sufficient appropriate evidence	Results of procedures performed Supporting evidence obtained
Performing	Evaluate the information obtained	Dismiss or confirm any concerns about material misstatements that could occur in F/S	Conclusions reached on procedures performed Subsequent events File completion
Reporting	Evaluate findings and discuss with management/TCWG	Ensure effective two-way communication and that all matters are resolved	Review of final F/S presentation/disclosure Results of discussions Significant judgments
Reporting	Form a conclusion Prepare an appropriately worded report	Ensure review conclusion is appropriate	Final conclusions Approval of F/S The final review report

2.3-2 Practitioner's Report

The standard wording of the practitioner's report resulting from a review of historical financial statements prepared in accordance with an AFRF (such as the IFRS for SMEs) is outlined in the following exhibit.

Exhibit 2.3-2A

INDEPENDENT PRACTITIONER'S REVIEW REPORT

[Appropriate addressee]

Report on the Financial Statements

We have reviewed the accompanying financial statements of ABC Company (which comprise the statement of financial position as at December 31, 20XX, the statement of comprehensive income, the statement of changes in equity, and the statement of cash flows for the year then ended) and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standard for Small- and Medium-Sized Entities and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Practitioner's Responsibility

Our responsibility is to express a conclusion on the accompanying financial statements. We conducted our review in accordance with International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*. ISRE 2400 (Revised) requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements (taken as a whole) are not prepared, in all material respects, in accordance with the applicable financial reporting framework. The standard also requires us to comply with relevant ethical requirements.

A review of financial statements in accordance with ISRE 2400 (Revised) is a limited assurance engagement. The practitioner performs procedures (primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures) and evaluates the evidence obtained.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing. Accordingly, we do not express an audit opinion on these financial statements.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that these financial statements do not fairly present, in all material respects *[or do not give a true and fair view of]*, the financial position of ABC Company as at December 31, 20XX, and (of) its financial performance and cash flows for the year then ended, in accordance with the International Financial Reporting Standard for Small- and Medium-Sized Entities.

2.3-3 Effective Date

The effective date of ISRE 2400 (Revised) is for reviews of financial statements for periods ending on or after December 31, 2013.

3 ACCEPTING

Accepting → Planning → Performing → Reporting

CHAPTER CONTENT

- The fundamental requirements to be addressed before a review engagement can be accepted or continued.

3.1 Is the Firm Ready? 2400.18–28	**3.2 Can the Engagement Be Accepted or Continued?** 2400.29	**3.3 Agree Terms of Engagement** 2400.30–41
3.1-1 Understand ISRE 2400 (Revised)	3.2-1 Rational Purpose	3.3-1 Engagement Preconditions
3.1-2 Ethical Standards	3.2-2 Appropriateness of Engagement	3.3-2 Engagement Terms Not Satisfactory
3.1-3 Professional Skepticism	3.2-3 Independence	3.3-3 Agree Terms of Engagement
3.1-4 Professional Judgment	3.2-4 Scope Limitations	
3.1-5 Competency	3.2-5 Doubts About Management’s Integrity	
3.1-6 Quality Control		

Outcome

The firm has acquired the necessary competencies and has designed and implemented a system of quality control.

BEFORE work commences, the firm has obtained a signed engagement letter or suitable written agreement.

3.1 IS THE FIRM READY?

Before a firm can accept and perform a review engagement, it needs to address the matters set out below.

3.1-1 Understand ISRE 2400 (Revised)

Paragraph	Requirement
	Conduct of a Review Engagement in Accordance with this ISRE
18	**The practitioner shall have an understanding of the entire text of this ISRE, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A14)**
	Complying with Relevant Requirements
19	**The practitioner shall comply with each requirement of this ISRE, unless a requirement is not relevant to the review engagement. A requirement is relevant to the review engagement when the circumstances addressed by the requirement exist.**
20	**The practitioner shall not represent compliance with this ISRE in the practitioner's report unless the practitioner has complied with all the requirements of this ISRE relevant to the review engagement.**

The first step in performing a review engagement is to ensure every member of the engagement team has a sufficient understanding of the standard and its requirements. This understanding can be supplemented with the practical guidance contained in this Guide and through appropriate training programs.

Consider Point

The practitioner needs to take the time to understand (read) the entire standard, not just the "shall" requirements. This includes the objectives, definitions, application, and other explanatory material. The practitioner must also ensure that any other members of the engagement team also have a sufficient understanding thereof. Note that ISQC 1.57 requires firms to establish policies and procedures for producing appropriate documentation to provide evidence of the operation of each element of its system of quality control. It would be useful to document the steps taken to obtain/update this understanding as part of the firm's quality control procedures; however, these steps do not need to be documented on every engagement file.

Consider whether local laws or regulations override any requirements in the standard. If so, consider whether a review engagement conducted in accordance with local standards would actually comply with this standard. For example, if the local prescribed wording for a review engagement report differs significantly from the wording required by this standard, the engagement would not comply.

3.1-2 Ethical Standards

Paragraph	Requirement
	Ethical Requirements
21	**The practitioner shall comply with relevant ethical requirements, including those pertaining to independence. (Ref: Para. A15–A16)**

Relevant ethical requirements are the ethical requirements to which the engagement team is subject when undertaking review engagements. Ordinarily, these requirements comprise Parts A and B of the IESBA Code together with national requirements that are more restrictive.

For more information, please see the IESBA *2013 Handbook of the Code of Ethics for Professional Accountants* and the IAASB *2013 Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*.

To ensure the firm and its personnel continuously comply with the ethical requirements, the firm will need to design and implement policies and procedures that could be included in its quality control manual or equivalent.

Consider Point

Some jurisdictions may have requirements and guidance that differ from those contained in the IESBA Code. Practitioners in those jurisdictions need to be aware of those differences and comply with the more stringent (but not less stringent) requirements and guidance of the *2013 Handbook of the Code of Ethics for Professional Accountants* unless prohibited by law or regulation.

3.1-3 Professional Skepticism

Paragraph	Requirement
	Professional Skepticism and Professional Judgment
22	**The practitioner shall plan and perform the engagement with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: Para. A17–A20)**

Professional skepticism is an attitude of mind that enhances a practitioner's ability to identify and respond to conditions that may indicate possible misstatement. For more information, please refer to the IAASB's *Staff Questions & Answers—Professional Skepticism in an Audit of Financial Statements*.

The main elements of professional skepticism are summarized in the following exhibit.

Exhibit 3.1-3A

Professional Skepticism

An essential ATTITUDE to enhance ability to:			
Identify/respond to conditions that indicate possible misstatement	**Critically assess** information and evidence obtained	**Remain alert** for evidence that: • is contradictory; or • questions reliability of management or TCWG representations	**Draw** appropriate conclusions

The following examples illustrate situations where the application of professional skepticism may well have uncovered misstatements in the financial statements. The key point is that whenever the practitioner identifies an unusual or suspicious situation, additional inquiries need to be made and the responses need to be assessed in light of the practitioner's knowledge of the entity and its environment. Indeed, if the practitioner becomes aware of a matter(s) that causes the practitioner to believe the financial statement may be materially misstated, additional work needs to be performed. It is not enough to simply accept the assurances provided by management.

Exhibit 3.1-3B

Examples Where Professional Skepticism Would Have Led to More Questions/Procedures
1. Identifying/Responding to Conditions That Indicate Possible Misstatement
The economy is in recession. Unemployment is very high and sales revenue for most entities in the apparel business is significantly down. In performing the review engagement, Kamal spent 10 minutes of research on the Internet and discovered that apparel sales are down in his country. He asked management about the increase in apparel sales this period and was told it was entirely due to the great sales team the entity employed. On the surface, this seemed to be a reasonable explanation, so Kamal accepted it. However, when a variance is significant, some additional explanations would be helpful. Kamal should have exercised professional skepticism rather than simply accepting management's explanation without further inquiry. He could have asked some additional questions of management or the salespersons involved as to exactly how it was possible that the entity's sales team could have beaten the industry trend. Such a variance needs to be further explored, as it could well be indicative of fraud. Other analytical review procedures that could have been performed include a review of sales by month, changes in the accounts receivable balance, and inquiries about the new customers.
2. Critically Assessing Information Obtained
In performing review engagement procedures, Fatima inquired of the general manager why there was such a large increase this year in the estimate for inventory obsolescence. The manager replied that despite the overall increase in sales last year, a large inventory of certain electronic parts remains, which will be tough to sell this year. Knowing how electronic parts can become obsolete very quickly, Fatima accepted this explanation and went to her next question. However, Fatima failed to link this answer to an earlier comment by the accountant that the business owner felt extremely overtaxed and wanted to do something about it. Had Fatima made some additional inquiries, such as inquiring about the outcome of last year's estimate for inventory obsolescence, she would have realized that virtually none of the provisions made in the previous period were actually necessary. In addition, in response to further inquiry, the sales manager might have told her that the electronic parts were actually selling very well, which was the prime reason for having such a large inventory on hand at the end of the year.
3. Remaining Alert
Emma asked the accountant about the changes in the entity's property, plant, and equipment during the year. She was provided with a listing of additions and disposals during the year along with the invoices. She quickly scanned the invoices and noticed that a computer and printer had been shipped directly to the business owner's house and not to the business address. She asked why this had happened and was told it was just a simple mistake by the supplier. As the amount involved was fairly small, Emma took no further action. However, had Emma asked a few more questions or looked at a few more invoices, she would have found that management (as part of a tax-evasion scheme) had included a number of personal expenses in the accounting records as business expenses.
4. Drawing Appropriate Conclusions
Julian was asked to inquire about the adequacy of the sales cutoff procedures at year end. Everything seemed to be similar to previous years, until he overheard an accounting clerk joking with another employee about a bunch of sales invoices he had been asked to record just prior to the year end. Julian decided to ask the accountant about these entries. The accountant responded that nothing unusual had taken place and he should check some invoices for himself if he was concerned. Julian did not want to create an issue based on this one verbal comment, so he concluded that the cutoff procedures were working as intended and that no material misstatement existed. What Julian did not know was that the business owner was planning an expansion that involved obtaining a new bank loan. To help this along, he had asked the accountant to make sure the financial statements showed good results. The accountant decided to record a number of sales to related parties in the current period that had actually occurred in the next period, thereby inflating sales. If Julian had believed that the financial statements may be materially misstated as a result of these extra sales invoices, some additional procedures would have been necessary. Julian could have inquired about larger than normal accounts receivable balances at year end and reviewed some shipping logs for invoices just prior to year end to determine when the goods were actually shipped.

3.1-4 Professional Judgment

Paragraph	Requirement
23	**The practitioner shall exercise professional judgment in conducting a review engagement. (Ref: Para. A21–A25)**

Professional judgment involves the application of relevant training, knowledge, and experience (within the context provided by the assurance, accounting, and ethical standards) in making informed decisions about the courses of action that are appropriate in the circumstances.

Professional judgment requires practitioners to apply their training, knowledge, and experience to the known facts and circumstances of the particular engagement. Where necessary, the appropriate consultation with others will help to ensure that reasonable judgments are made.

Exhibit 3.1-4A

Examples of the Uses of Professional Judgment	Determining materiality for the engagement.
	Determining the areas in the financial statements where material misstatements are likely to arise.
	Determining where in the engagement the professional judgment of an experienced practitioner would be essential and where less experienced engagement team members could work with the appropriate supervision.
	Using past experience (in performing assurance engagements) and the understanding obtained of the entity to determine which inquiries and analytical procedures to perform.
	Evaluating the information obtained from inquiries and the sufficiency of the evidence obtained.
	Using professional experience to determine the additional work required when the information received was unexpected and causes the practitioner to believe the financial statements may be materially misstated.
	Determining the appropriate application of the entity's AFRF and the nature of disclosures in the financial statements.
	Drawing on professional experience to determine appropriate engagement conclusions based on the information obtained.

The use of professional judgment also needs to be documented. Documentation shall be sufficient to enable an experienced practitioner having no previous connection with the engagement to understand the significant judgments made in reaching those conclusions.

3.1-5 Competency

Paragraph	Requirement
	Engagement Level Quality Control
24	**The engagement partner shall possess competence in assurance skills and techniques, and competence in financial reporting, appropriate to the engagement circumstances. (Ref: Para. A26)**

A review engagement may only be accepted by (or assigned by the firm to) an engagement partner who has the professional competencies to perform the work required. This competency may have already been obtained through performing other assurance engagements, receiving coaching from experienced staff, or working alongside others who are already competent. Otherwise, competency will need to be obtained by attending suitable training courses, reading relevant material (including ISRE 2400 [Revised] in addition to this Guide), and passing any required professional examinations.

ISRE 2400 (Revised) addresses the important competencies that the practitioner shall possess, including assurance skills and techniques as well as competence in financial reporting.

The required competencies are addressed in the following exhibit.

Exhibit 3.1-5A

Required Competencies
How to apply professional skepticism and professional judgment when: • Planning and performing an assurance engagement; and • Obtaining and evaluating evidence.
Understanding information systems and the role and limitations of internal control.
Linking the consideration of materiality and engagement risks to the nature, timing, and extent of procedures for the review.
Applying procedures, as appropriate, to the review engagement. This includes the use of other types of procedures in addition to inquiry and analytical procedures (such as inspection, recalculation, re-performance, observation, and confirmation).
Establishing systematic documentation practices.
Applying the skills and practices relevant for writing assurance engagement reports.

Consider Point

Because a review engagement is largely based on inquiry and analysis, it is important that the assigned personnel properly understand the interrelationships between various parts of the financial statements (such as the impact on cash flow and income if inventory turnover decreased significantly) and how to prepare and conduct appropriate inquiries of management.

Financial Reporting

Competence in financial reporting is necessary to ensure the requirements of the AFRF (such as IFRS for SMEs or another applicable framework that is country specific) are understood in sufficient detail to identify areas in the financial statements where material misstatements are likely to arise and to be able to design appropriate procedures to address those areas.

3.1-6 Quality Control

Paragraph	Requirement
	Relationship with ISQC 1
4	**Quality control systems, policies and procedures are the responsibility of the firm. ISQC 1 applies to firms of professional accountants in respect of a firm's engagements to review financial statements. The provisions of ISRE 2400 (Revised) regarding quality control at the level of individual review engagements are premised on the basis that the firm is subject to ISQC 1 or requirements that are at least as demanding. (Ref: Para. A3–A5)**
25	**The engagement partner shall take responsibility for: (Ref: Para. A27–A30)** **(a) The overall quality of each review engagement to which that partner is assigned;** **(b) The direction, supervision, planning and performance of the review engagement in compliance with professional standards and applicable legal and regulatory requirements; (Ref: Para. A31)** **(c) The practitioner's report being appropriate in the circumstances; and**

Paragraph	Requirement
25 *(continued)*	**(d) The engagement being performed in accordance with the firm's quality control policies, including the following:** **(i) Being satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and engagements have been followed, and that conclusions reached are appropriate, including considering whether there is information that would lead the engagement partner to conclude that management lacks integrity; (Ref: Para. A32–A33)** **(ii) Being satisfied that the engagement team collectively has the appropriate competence and capabilities, including assurance skills and techniques and expertise in financial reporting, to:** **a. Perform the review engagement in accordance with professional standards and applicable legal and regulatory requirements; and** **b. Enable a report that is appropriate in the circumstances to be issued; and** **(iii) Taking responsibility for appropriate engagement documentation being maintained.**
	Relevant Considerations after Engagement Acceptance
26	**If the engagement partner obtains information that would have caused the firm to decline the engagement had that information been available earlier, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action.**
	Compliance with Relevant Ethical Requirements
27	**Throughout the engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of noncompliance with relevant ethical requirements by members of the engagement team. If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, shall determine the appropriate action.**
	Monitoring
28	**An effective system of quality control for a firm includes a monitoring process designed to provide the firm with reasonable assurance that the firm's policies and procedures relating to the system of quality control are relevant, adequate, and operate effectively. The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the review engagement.**

Applicability of ISQC 1

Under ISQC 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

- The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and
- Reports issued by the firm or engagement partners are appropriate in the circumstances.

If the firm is already subject to ISQC 1 in relation to other assurance and related services engagements, the requirement to comply with this standard should have already been met. If not, the firm is required to design and implement policies and procedures that will achieve the objectives of a quality control system and then to regularly monitor compliance with those policies.

The following exhibit shows ISQC 1 as the foundation upon which the firm develops its firm-wide system of quality control. ISRE 2400 (Revised) outlines the engagement standards for a review engagement. This exhibit also summarizes the relationship between policies and procedures at the firm and engagement levels.

Exhibit 3.1-6A

National Level	**International Standard on Quality Control (ISQC 1)**		
Firm Level (Policies & Procedures)	**A System of Quality Control (QC) That Complies with ISQC 1**		
Engagement Level (Policies & Procedures)	**Implement Firm's QC System on Each Engagement**		
	Audits (ISA 220)	Reviews (ISRE 2400)	Compilations (ISRS 4410)

Consider Point

Documentation

Address how compliance with the firm's policies and procedures will be documented. This could include evidence of the independence assessments on each engagement and details of ethical issues that required a decision to be made, such as safeguards to address an independence threat.

Resources

IFAC and the IAASB have developed a number of useful resources, such as:

- *Guide to Quality Control for Small- and Medium-Sized Practices, Third Edition*;
- *Staff Questions & Answers—Applying ISQC 1 Proportionately with the Nature and Size of a Firm*; and
- *Staff Questions & Answers—Professional Skepticism in an Audit of Financial Statements*.

3.2 CAN THE ENGAGEMENT BE ACCEPTED OR CONTINUED?

Before a particular review engagement can be accepted or continued, there are a number of matters to be addressed. The information obtained from performing these preliminary procedures can also be useful in performing other significant activities later in the engagement. Please see Appendix B for a sample client acceptance/continuance checklist.

Paragraph	Requirement
	Factors Affecting Acceptance and Continuance of Client Relationships and Review Engagements
29	**Unless required by law or regulation, the practitioner shall not accept a review engagement if: (Ref: Para. A34–A35)** **(a) The practitioner is not satisfied:** **(i) That there is a rational purpose for the engagement; or (Ref: Para. A36)** **(ii) That a review engagement would be appropriate in the circumstances; (Ref: Para. A37)** **(b) The practitioner has reason to believe that relevant ethical requirements, including independence, will not be satisfied;** **(c) The practitioner's preliminary understanding of the engagement circumstances indicates that information needed to perform the review engagement is likely to be unavailable or unreliable; (Ref: Para. A38)** **(d) The practitioner has cause to doubt management's integrity such that it is likely to affect proper performance of the review; or (Ref: Para. A37(b))** **(e) Management or those charged with governance impose a limitation on the scope of the practitioner's work in the terms of a proposed review engagement such that the practitioner believes the limitation will result in the practitioner disclaiming a conclusion on the financial statements.**

3.2-1 Rational Purpose

There should always be a rational (logical) purpose for any assurance engagement, including a client requesting a review engagement.

A review engagement is typically requested to enhance the degree of confidence that intended users will place on the financial statements. Rational purposes would include situations where:

- A bank requests a review engagement report with regard to a loan made to the entity;
- A government agency requires a review engagement report in connection with its funding support; or
- The entity has external stakeholders (investors, members, or supporters) to whom they are accountable.

If, however, a rational purpose is not evident, the engagement should be declined. Examples of circumstances where a rational purpose is not present are outlined in the following exhibit.

Exhibit 3.2-1.A

A Rational Purpose Would NOT Exist	The firm suspects that the potential client may associate the firm's name with the financial statements in an inappropriate manner. For example, the client tells third parties that the firm's involvement in reviewing the financial statements was the same as an audit or that the firm, and not management, had prepared the financial statements.
	An audit, not a review, is what is required by the relevant law/regulation.
	A significant scope limitation exists. This could include missing or inaccessible information, lack of permission to speak to key people, or unrealistic deadlines being imposed.

3.2-2 Appropriateness of Engagement

Based on the information obtained about the client and the particular circumstances, the engagement partner must consider, in addition to the rational purpose identified, whether accepting such an engagement would be appropriate. This decision would be based on professional judgment. Some situations where acceptance of an engagement would not be appropriate are outlined in the following exhibit.

Exhibit 3.2-2A

Further Reasons Why a Review Engagement May NOT Be Accepted	Doubts exist about the integrity of the principal owners, management, and/or TCWG and about the potential misuse of the review report.
	The practitioner's preliminary understanding of the engagement circumstances indicates that information is unlikely to be either unavailable or unreliable.
	Significant matters have arisen during the current engagement or during a previous engagement. Examples could be a serious disagreement on financial statement presentation/disclosures, the suitability of the accounting policies in use, or the discovery of transactions or liabilities that were not fully disclosed by management when inquiries were made. Management may be seeking to avoid modification of the opinion in the auditor's report by requesting a limited assurance engagement when an audit would better meet user needs.
	The financial statements are highly complex or require a detailed knowledge of a specialized area of accounting, such as hedging transactions and the practitioner believes that management intends to use the review engagement in order to conceal or minimize the impact of certain facts or information that would have been subject to more detailed procedures if an audit engagement were performed.

Consider Point

In some situations, the client may well have different "needs" from those who may seek to rely on the client's financial statements. This assessment of appropriateness is aimed at ensuring practitioners act in the public interest and do not cohort with clients to the detriment of the users.

If the engagement is not appropriate, consider whether another type of engagement would meet the client's, and its financial statement users', needs and be suitable in the engagement circumstances (such as an audit, compilation, agreed-upon procedures, or other accounting service). Refer to Chapter 2 of this Guide, which outlines the differences between audit, review, and compilation engagements.

3.2-3 Independence

Before any work commences, an assessment of whether the ethical requirements can be met, including any threats to independence, must be made and documented. This requirement is the same as for any other assurance engagement.

If independence threats do exist, their significance should be evaluated and the appropriate safeguards should be applied to eliminate the threats or reduce them to an acceptable level. If safeguards are not available, it will be necessary either to eliminate the circumstance or relationship creating the threats or to decline or terminate the engagement.

Independence threats could arise from a variety of factors, including financial interests in the entity, loans and guarantees, business relationships, family and personal relationships, making decisions for management on accounting matters (such as choice or application of accounting policies or making journal entries for the client), or long-time association with the client. Refer to the *2013 Handbook of the Code of Ethics for Professional Accountants* for further information on the various types of threats and possible safeguards.

Consider Point

An assessment of independence and compliance with relevant ethical requirements must be performed and documented on an annual basis for every client. Ensure that staff members performing this assessment have access to all relevant information and that they clearly understand the independence requirements.

A common independence threat arises when the client asks the practitioner to assist in drafting the financial statements in addition to performing the review engagement (a self-review threat). In this situation, proper safeguards include obtaining documented client approval of all adjusting entries proposed, allocating account balances in the financial statements, and ensuring the client understands and takes full responsibility for the final financial statements. Where possible, having different staff members prepare and review the financial statements may also be beneficial.

3.2-4 Scope Limitations

In some situations, there may be circumstances that make it impossible to perform a review engagement. As a result, the engagement shall be declined unless prohibited by law or regulation. However, an engagement conducted under such circumstances would not comply with ISRE 2400 (Revised). Some examples are contained in the following exhibit.

Exhibit 3.2-4A

Scope Limitations	Unrealistic deadlines imposed by management for performing the engagement.
	Doubts that the information needed to perform the review (e.g., records, documentation, and other matters) will be available or reliable, including information needed to perform analytical procedures.
	Restricted access to certain persons within or outside the entity that may have relevant information or evidence.
	Restricted access to certain premises (such as an inventory warehouse or operating locations) or restrictions on movement during an inventory count or at the period-end date.
	Doubts about management's integrity. When this occurs, the procedures that involve inquiry of management are unlikely to be effective and written representations would not be reliable.
	Lack of commitment by management to adequate internal control, such as incomplete or messy record keeping.
	Management's nonacceptance of certain staff members chosen by the firm to perform the engagement.
	Management indicating its intention not to sign the requested written representations at the end of the engagement.
	Unwillingness to pay a fair fee for services to be performed.

3.2-5 Doubts About Management's Integrity

It is generally recognized that the tone set by top management is one of the most important factors contributing to the integrity of the financial reporting process. If the tone set by management reflects a lack of integrity and indifference toward control, fraudulent financial reporting is more likely to occur.

If the top management of an entity (including principal owners, key management, and TCWG) are untrustworthy, the results of performing inquiries and analytical procedures (as required in a review engagement) are unlikely to be reliable and, as a result, the financial statements could be materially misstated.

Consequently, on every engagement, the practitioner is required to assess whether there is any cause to doubt management's integrity to a degree that is likely to affect proper performance of the review. When such a doubt has been identified, it is not appropriate to accept the engagement unless required by law or regulation.

Information that could raise doubts about management's integrity is set out in the following exhibit.

Exhibit 3.2-5A

Doubts about Management's Integrity	History of any ethical or regulatory infringements, such as tax evasion.
	Poor reputation for honesty or ethics within business community.
	Suspicions exist that management might be involved in money laundering or other criminal activities.
	The business being conducted has a reputation for unethical behavior.
	There are related party transactions, the purpose of which is unclear.
	History of management bias in estimates or non-disclosed related parties.
	There are highly complex transactions or activities that do not appear to be necessary or have any rational purpose.
	Management has a poor attitude toward control or maintaining accounting records.
	Management is reluctant to provide the information necessary to perform the engagement.
	Seemingly well-founded allegations of wrongdoing have been publically made in the press or on the Internet.
	In previous engagements, management did not disclose important information (e.g., contract violations, loan covenants, or litigation) or has made misleading or false representations.

Consider Point

In some jurisdictions, there may be legislation that requires practitioners to take additional steps before accepting a client. For example, where anti-money laundering legislation is in place, practitioners may need to:

- Carry out specific procedures to verify the identity of potential clients;
- Assess whether there is a risk from potential money laundering activities; and
- Consider the impact of their findings on the client acceptance or continuance decision.

3.3 AGREE TERMS OF ENGAGEMENT

In addition to the factors affecting acceptance and continuance previously outlined in this chapter, there are two further steps required before a review engagement can be performed.

3.3-1 Engagement Preconditions

Paragraph	Requirement
	Preconditions for Accepting a Review Engagement
30	**Prior to accepting a review engagement, the practitioner shall: (Ref: Para. A39)** **(a) Determine whether the financial reporting framework applied in the preparation of the financial statements is acceptable; and (Ref: Para. A40–A46)** **(b) Obtain the agreement of management that it acknowledges and understands its responsibilities: (Ref: Para. A47–A50)** **(i) For preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation;** **(ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and** **(iii) To provide the practitioner with:** **a. Access to all information of which management is aware that is relevant to the preparation of the financial statements, such as records, documentation and other matters;** **b. Additional information that the practitioner may request from management for the purpose of the review; and** **c. Unrestricted access to persons within the entity from whom the practitioner determines it necessary to obtain evidence.**

The practitioner's conclusion in a review engagement relates to the entity's financial statements. Although, in some jurisdictions, the practitioner may assist in their preparation, it remains the responsibility of management and TCWG, as appropriate, to prepare (and take full ownership for) the entity's financial statements.

These engagement preconditions for any assurance engagement, whether audit or review, are designed to ensure that before any work commences, management does, indeed, understand the full extent of its responsibility for the preparation of the financial statements and for providing the practitioner with access to relevant information and personnel.

These requirements, as outlined in the following exhibit, should be discussed with management and TCWG to ensure they understand their responsibilities.

Exhibit 3.3-1A

Preconditions for Accepting a Review Engagement

An acceptable financial reporting framework for preparing the F/S

Management acknowledges/understands the following responsibilities:

To **comply** with the applicable financial reporting framework

For such **internal control** as is necessary for the F/S to be free from material misstatement (*error or fraud*)

To **provide** the practitioner with:
- Access to all relevant information
- Additional information as requested
- Unrestricted access to personnel

Consider Point

Many small clients make the mistake of assuming that, because of their expertise, the practitioner is responsible for the preparation and fair presentation of the financial statements. Take the time to meet with the client and review the client's responsibilities as outlined above. Do not assume that when management or TCWG sign the engagement letter, they necessarily understand the full extent of their responsibilities.

Acceptable Financial Reporting Framework

The choice of the AFRF is often prescribed by law or regulation. However, it can sometimes be made by management based on the needs of the intended users of the financial statements. In this case, the choice is often based on the nature of the entity and the objective of the financial statements.

A precondition for accepting a review engagement is for the practitioner to determine that the entity's choice of financial reporting framework is acceptable in relation to the intended financial statement users. This step is necessary, because the requirements of the AFRF will determine the form and content of the financial statements, including what constitutes a complete set of financial statements.

Most financial statements are prepared in accordance with a general purpose framework that is designed to meet the common financial needs of a wide range of users. IFRS and IFRS for SMEs are examples of general purpose frameworks.

The financial reporting framework may be a fair presentation framework or a compliance framework as outlined in the following exhibit.

Exhibit 3.3-1B

Financial Reporting Frameworks

Fair Presentation Framework

The term *fair presentation framework* is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:
- Acknowledges explicitly or implicitly that to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; and
- Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

Compliance Framework

The term *compliance framework* is used to refer to a financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgements above.

Special Purpose Financial Statements

In some situations, the entity will need special purpose financial statements, which will be prepared in accordance with a special purpose framework. For example, the terms of a contract may require specific matters to be reported upon, such as revenues or expenditures, or provide that specific accounting policies be adopted in specified circumstances.

Internal Control

Another precondition relates to management's responsibility for preparing financial statements that are free from material misstatement, whether due to fraud or error. This responsibility requires management to have identified the risk of material misstatement in the financial statements and to have addressed them through the design and implementation of relevant internal controls as management determines necessary.

Internal control is the process designed, implemented, and maintained by management, TCWG, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term controls refers to any aspects of one or more of the components of internal control.

Exhibit 3.3-1C

Examples of Internal Control Processes	The control environment includes commitment to integrity and ethics, competence of personnel, and effectiveness of management and TCWG.
	Minutes/details of key decisions made by management and TCWG.
	Annual budgets and business plans.
	Management's ongoing assessment of the risk of material misstatement.
	The authorization, recording, and processing of transactions. Examples include shipping logs to ensure all sales are invoiced, management's signatures to approve goods received, and bank reconciliations.
	Controls over the acquisition, use, protection, and disposal of physical assets.
	Information systems, including general IT controls and applications.
	Listings and details of related party transactions, unusual events, contracts, financing arrangements, and other agreements for appropriate authorization.
	Security measures in place to both control access and protect data within the accounting books and records.
	Processes used by management for preparing estimates and journal entries and for ensuring key information is captured and communicated on a timely basis for decision making.

Consider Point

Smaller entities do not generally need sophisticated processes relevant to financial reporting. In many cases, controls over financial reporting can be established through:

- A healthy corporate culture developed through oral communications and the example set by senior management;
- Senior management's authorization of most transactions, which can reduce the risk of errors being made and the risk of employee fraud;
- Maintenance of accounting records that are prepared accurately and on a timely basis; and
- Simple processes and procedures to address matters such as revenue recognition, cutoff, inventory counts, and journal entries.

However, do not overlook the opportunity for management to override these controls.

Remember that management's agreement that it acknowledges and accepts its responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatements is one of the preconditions for accepting a review engagement. If management has doubts as to whether it has established adequate internal control, the practitioner cannot accept the review engagement. However, in a review engagement, it is not necessary for the practitioner to test internal controls to make any such determination.

Access to Information and Personnel

To perform the engagement effectively, there needs to be an effective two-way communication between the practitioner and the entity's management. This will ensure that matters arising during the engagement are understood and a constructive working relationship is developed.

The first step in developing this level of communication is to ensure that management understands exactly what the practitioner will need, such as:

- Access to all information (records, documentation, and other matters) relevant to the preparation of the financial statements;
- Any additional information that the practitioner may request from management; and
- Unrestricted access to persons within the entity from whom the practitioner determines it necessary to obtain evidence.

Other Matters to Include in the Engagement Letter

The engagement letter may also be used to address the understanding reached of other matters that pertain to the work required. Some of these matters are outlined in the following exhibit.

Exhibit 3.3-1D

Other Matters to Consider for Possible Inclusion in the Engagement Letter	Use and distribution of our report.
	Inclusion of the financial statements in an annual report or on a website.
	Preparation of schedules by management.
	Use of information received and third-party file inspections.
	Dispute resolution and indemnities (where permissible under local requirements).
	Reporting time frames.
	Fees and billing arrangements.
	Engagement termination.
	Other services (where relevant).

Some suggested wording that addresses each of these matters is included in the sample engagement letter in Appendix C.

3.3-2 Engagement Terms Not Satisfactory

Paragraph	Requirement
31	**If the practitioner is not satisfied as to any of the matters set out above as preconditions for accepting a review engagement, the practitioner shall discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the practitioner as to those matters, the practitioner shall not accept the proposed engagement unless required by law or regulation to do so. However, an engagement conducted under such circumstances does not comply with this ISRE. Accordingly, the practitioner shall not include any reference within the practitioner's report to the review having been conducted in accordance with this ISRE.**
32	**If it is discovered after the engagement has been accepted that the practitioner is not satisfied as to any of the above preconditions, the practitioner shall discuss the matter with management or those charged with governance, and shall determine:** **(a) Whether the matter can be resolved;** **(b) Whether it is appropriate to continue with the engagement; and** **(c) Whether and, if so, how to communicate the matter in the practitioner's report.**

In some instances, it may not be possible to agree on satisfactory terms of engagement. In such cases, the matter should be discussed with management or TCWG to determine if a resolution is possible.

If a resolution is still not possible, the engagement cannot be accepted unless the practitioner is required by law or regulation to do so, in which case the engagement would no longer be an ISRE 2400 Review. If the engagement is already in progress, a decision will need to be made on whether to continue with the engagement and how the matter will be communicated in the practitioner's report.

3.3-3 Agree Terms of Engagement

Paragraph	Requirement
	Agreeing the Terms of Engagement
36	**The practitioner shall agree the terms of the engagement with management or those charged with governance, as appropriate, prior to performing the engagement.**
37	**The agreed terms of engagement shall be recorded in an engagement letter or other suitable form of written agreement, and shall include: (Ref: Para. A52–A54, A56)** **(a) The intended use and distribution of the financial statements and any restrictions on use or distribution where applicable;** **(b) Identification of the applicable financial reporting framework;** **(c) The objective and scope of the review engagement;** **(d) The responsibilities of the practitioner;** **(e) The responsibilities of management, including those in paragraph 30(b); (Ref: Para. A47–A50, A55)** **(f) A statement that the engagement is not an audit, and that the practitioner will not express an audit opinion on the financial statements; and** **(g) Reference to the expected form and content of the report to be issued by the practitioner, and a statement that there may be circumstances in which the report may differ from its expected form and content.**

To help avoid misunderstandings with respect to the engagement and the respective responsibilities, it is in the interests of all parties (TCWG, management, and the practitioner) that the terms of engagement be clearly documented in an engagement letter (or other suitable form of written agreement) and be signed by management or TCWG, as appropriate, prior to performing the engagement.

When preparing an engagement letter or other suitable form of written agreement:

- Customize the terms of the letter to reflect the individual requirements and circumstances of the specific engagement; and
- Consider the need to review any complex or potentially controversial terms with legal counsel.

Please refer to Appendix C for a sample engagement letter based on the example contained in ISRE 2400 (Revised).

Recurring Engagements

Paragraph	Requirement
	Recurring Engagements
38	**On recurring review engagements, the practitioner shall evaluate whether circumstances, including changes in the engagement acceptance considerations, require the terms of engagement to be revised and whether there is a need to remind management or those charged with governance, as appropriate, of the existing terms of engagement. (Ref: Para. A57)**

It is not necessary to obtain a new engagement letter or other written agreement each period when there have been no changes in the circumstances that would affect the engagement.

However, a new letter should be considered in instances such as outlined in the following exhibit.

Exhibit 3.3-3A

Indicators of Need to Update the Engagement Letter	Any indication that management misunderstands the objective and scope of the review engagement.
	Any revised or special terms of the engagement.
	A recent change of senior management of the entity.
	A significant change in the ownership of the entity.
	A significant change in the nature or size of the entity's business.
	A change in legal or regulatory requirements affecting the entity.
	A change in the AFRF.

Consider Point

Many firms have a policy requiring that the firm obtain a new engagement letter every year or at least every three years even where circumstances have not changed. This ensures management is reminded about the terms of engagement on a timely basis.

Acceptance of a Change in the Engagement Terms

Paragraph	Requirement
	Acceptance of a Change in the Terms of the Review Engagement
39	**The practitioner shall not agree to a change in the terms of the engagement where there is no reasonable justification for doing so. (Ref: Para. A58–A60)**
40	**If, prior to completing the review engagement, the practitioner is requested to change the engagement to an engagement for which no assurance is obtained, the practitioner shall determine whether there is reasonable justification for doing so. (Ref: Para. A61–A62)**
41	**If the terms of engagement are changed during the course of the engagement, the practitioner and management or those charged with governance, as appropriate, shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.**

If management requests a change in the terms of the review engagement, the practitioner is required to determine whether there is reasonable justification for doing so.

Reasonable Justification Exists

This could result from a change in circumstances affecting the need for the service or a misunderstanding about the nature of a review engagement. In this case, a revised engagement letter or other suitable form of written agreement would be required.

Reasonable Justification Does Not Exist

If reasonable justification does not exist, the practitioner shall not agree to a change in the terms of engagement. For example, after performing inquiries and analytical procedures, the practitioner may inform management that the information provided is incorrect, incomplete, or otherwise unsatisfactory and that a modified conclusion will be required. Management cannot avoid such a modified conclusion by simply requesting a change in the nature of the engagement.

Wording of Practitioner's Report When Prescribed by Law or Regulation

Paragraph	Requirement
	Additional Considerations When the Wording of the Practitioner's Report Is Prescribed by Law or Regulation
33	**The practitioner's report issued for the review engagement shall refer to this ISRE only if the report complies with the requirements of paragraph 86.**
34	**In some cases when the review is performed pursuant to applicable law or regulation of a jurisdiction, the relevant law or regulation may prescribe the layout or wording of the practitioner's report in a form or in terms that are significantly different from the requirements of this ISRE. In those circumstances, the practitioner shall evaluate whether users might misunderstand the assurance obtained from the review of the financial statements and, if so, whether additional explanation in the practitioner's report can mitigate possible misunderstanding. (Ref: Para. A51, A142)**
35	**If the practitioner concludes that additional explanation in the practitioner's report cannot mitigate possible misunderstanding, the practitioner shall not accept the review engagement unless required by law or regulation to do so. A review conducted in accordance with such law or regulation does not comply with this ISRE. Accordingly, the practitioner shall not include any reference within the practitioner's report to the review having been conducted in accordance with this ISRE. (Ref: Para. A51, A142)**

The general requirement is that if a review performed does not comply with ISRE 2400 (Revised), the practitioner cannot represent compliance with the ISRE in the review engagement report.

Standardized wording in the review report provides consistency in the report and communicates that the review of the financial statements has been conducted in accordance with globally recognized standards.

In situations where the wording of the report is prescribed locally, the practitioner is still encouraged to apply the requirements of ISRE 2400 (Revised) (including the reporting requirements) to the extent practicable. However, the practitioner will be unable to assert compliance with ISRE 2400 (Revised) in the report. The review report may still refer to ISRE 2400 (Revised) when the differences between the legal or regulatory requirements and the ISRE relate only to the layout or wording of the practitioner's report and, at a minimum, the report contains the elements outlined in paragraph 86 of ISRE 2400 (Revised).

4 PLANNING

Accepting → **Planning** → Performing → Reporting

CHAPTER CONTENT

- Importance of effective two-way communications.
- Concentrating work efforts on areas where material misstatements are likely to arise.
- Determining and applying materiality.
- Understanding the entity and designing appropriate procedures.

4.1 Ongoing Communications 2400.42	**4.2 Determine and Apply Materiality** 2400.43–44	**4.3 Understand the Entity** 2400.45–46	**4.4 Design Appropriate Procedures** 2400.47–49
4.1-1 Those Charged with Governance	4.2-1 Calculate Engagement Materiality	4.3-1 Why?	4.4-1 Types of Procedure
4.1-2 Modes of Communication	4.2-2 Apply	4.3-2 Scope	4.4-2 Inquiries
	4.2-3 Revise	4.3-3 How?	4.4-3 Analytical Procedures
		4.3-4 Planning	

Outcome

A plan of action for obtaining limited assurance, primarily by performing inquiry and analytical procedures, about whether the financial statements as a whole are free from material misstatement.

4.1 ONGOING COMMUNICATIONS

Paragraph	Requirement
	Communication with Management and Those Charged with Governance
42	**The practitioner shall communicate with management or those charged with governance, as appropriate, on a timely basis during the course of the review engagement, all matters concerning the review engagement that, in the practitioner's professional judgment, are of sufficient importance to merit the attention of management or those charged with governance, as appropriate. (Ref: Para. A63–A69)**

Effective two-way communication on a review engagement involves the practitioner, the engagement team, management, and TCWG. Good communication requires the ongoing use of professional judgment to ensure:

- No vagueness or confusion exist in the messages or information provided; and
- Both the sender and receiver understand (share) the same message or information.

Without good communication, misunderstandings can arise, inquiries of management may not be understood (resulting in incomplete or incorrect responses), important matters or inquiries could be missed, and unwanted surprises may result.

4.1-1 Those Charged with Governance

The first step in effective communication is to determine the appropriate person(s) with whom to communicate within the entity's governance structure (TCWG).

Larger and many not-for-profit entities often have a governing body, such as a board of directors or supervisory board, that is separate from management. Management has the executive responsibility for day-to-day operations.

In smaller entities, however, one person, such as the owner-manager or a sole trustee, may be charged with both governance and management. In other situations, such as in a family business, all of TCWG may be involved in managing some aspect of the entity.

When accepting a new client:

- Inquire about the governance structure.
- Discuss and agree with the engaging party the relevant person(s) with whom to communicate. In some cases, the appropriate person(s) may vary depending on the matter to be communicated.

4.1-2 Modes of Communication

Communication involves the development of constructive working relationships within the engagement team, as well as with the entity's management and TCWG, while still maintaining independence and objectivity.

Two-way communication recognizes that:

- The practitioner is responsible for communicating matters that are of sufficient importance to merit the attention of management or TCWG; and
- Management or TCWG will assist the practitioner in understanding the entity, and providing responses to inquiries and information about specific transactions, trends, variances, or events.

Some typical communications that would take place in a review engagement are set out in the following exhibit.

Exhibit 4.1-2A

Between	Nature of Communication
Practitioner and Engagement Team	• Oral or email instructions highlighting from where information was obtained, such as previous engagement files • Briefing to assist in understanding the entity and specific requirements • Planning discussions • Determination of materiality • Responding to questions on work to be performed • Providing feedback on work already performed • Sharing of information on findings and other matters • Raising and responding to queries raised on the review of working papers
Engagement Team	• Informal and formal sharing of information throughout the engagement, particularly concerning areas that are linked to one another • Asking questions and discussing the information obtained • Providing feedback
Practitioner/ Engagement Team with Entity Personnel, Management, and TCWG	• Sharing of information to assist in understanding the entity • Engagement planning • Informal and formal inquiries, including analysis of financial results, and obtaining responses thereto • Discussing the need for additional procedures where necessary • Requests for specific information • Formal correspondence, such as the terms of engagement (engagement letter) and management representations • Discussions about engagement findings and identified misstatements • Details of any journal entries prepared by the client (if applicable) • Discussions to resolve any specific matters arising

At the planning stage of the engagement, it is useful to identify the types of communication and inquiries that will be required and then to ensure they are appropriately included in the engagement timetable.

It will also be necessary to ensure that both management and TCWG fully appreciate and understand the need for their cooperation and availability with respect to the practitioner and engagement team.

Exhibit 4.1-2B

Need for Two-Way Communication	Develop constructive working relationships.
	Avoid misunderstandings, such as on the terms of engagement or other aspects of the engagement.
	Provide a foundation and understanding for the design and performance of the inquiries of management and the need to obtain other relevant information/analysis during the course of the engagement.
	Understand and resolve matters that arise during the engagement. This could relate to findings from performance of procedures, discussion of accounting policies, and financial statement presentation and disclosures.
	Discuss views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.
	Obtain evidence in the form of responses to specific inquiries and follow up on the inquiries.
	Discuss situations where additional procedures will need to be performed.
	Address significant difficulties experienced (such as unavailability of expected information, unexpected inability to obtain evidence, or restrictions imposed on the practitioner by management).
	Consider any matters arising that may lead to modification of the practitioner's conclusion or withdrawal from the engagement altogether.

Note

The responsibility to communicate matters with both management and TCWG does not change when different persons are responsible for management and governance. Its only effect would be on the form or timing of the communication.

In some situations, local laws or regulation may:

- Restrict communication of certain matters with TCWG, such as a communication that might prejudice an investigation by an appropriate authority into an actual or suspected illegal act. If there is doubt about a particular communication, it is suggested that legal advice be obtained.
- Require a regulatory or an enforcement body to be notified of certain matters (such as misstatements identified or not corrected) or to provide a third party with a copy of the practitioner's written communications with TCWG (such as a management letter). In these situations, consider the need to obtain the prior consent of management or TCWG before doing so.

4.2 DETERMINE AND APPLY MATERIALITY

Paragraph	Requirement
	Materiality in a Review of Financial Statements
43	**The practitioner shall determine materiality for the financial statements as a whole, and apply this materiality in designing the procedures and in evaluating the results obtained from those procedures. (Ref: Para. A70–A73)**

In many situations, the AFRF being used for the preparation of the financial statements will include a discussion of materiality, which equally applies to both audit and review engagements. This will provide a frame of reference for determining materiality. If such a discussion is not included in the framework, the guidance contained in ISRE 2400 (Revised) can be used.

Practitioners are required to determine materiality for the financial statements as a whole. The concept of materiality recognizes that some matters (such as the magnitude of misstatements in financial statements, including omissions of information) could influence a group of persons making an economic decision, such as investing in, or lending money to, an entity, when taken on the basis of the financial statements. Consequently, misstatements, including omissions, are generally considered to be material if they (including individually immaterial items that could amount to a material misstatement when taken together) could reasonably be expected to influence the economic decisions of users when taken on the basis of the financial statements.

Since materiality is determined on the basis of both the financial statements and the practitioner's assumptions as to users of those financial statements, in practice, the determination of materiality may be influenced as the practitioner develops an understanding of the entity and its environment and performs review procedures. For example, information gained in obtaining an understanding of the entity may cause the practitioner to reassess their original assumptions about users. Equally, findings from review procedures may cause the financial statements to be amended prior to management finalizing them. Thus, in practice, determination of materiality is unlikely to be a discrete phase of a review engagement.

In some situations, judgments about materiality will reflect the nature of a matter as opposed to the amount involved. For example, a minor fraud, an undisclosed related party transaction, or evidence of management bias could have minimal impact on statement users, but could be considered very serious from a governance standpoint, as it may cast doubt on the integrity of management and would have a significant impact on the review procedures performed. Also, what would appear to be an isolated incidence of minor fraud may need to be further investigated, as it could be indicative of more widespread fraudulent activity.

Note that because a review engagement consists primarily of inquiry and analysis, there is no need to determine "performance materiality," which is used in an audit engagement for determining the extent of testing required for particular classes of transactions, account balances, or disclosures.

4.2-1 Calculate Engagement Materiality

Misstatements in the financial statements may arise from a number of causes, such as:

- Fraud and error;
- Departures from the AFRF;
- Inappropriate estimates; and
- Less than adequate, or omitted, disclosures of important information.

When a misstatement or the aggregate of all misstatements is significant enough to change or influence the decision of an informed group of financial statement users deemed to have common financial information needs (e.g., creditors, bankers, investors, donors, tax authorities, and regulators), a material misstatement has occurred. Below this threshold, the misstatement is regarded as immaterial. However, the possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered unless the engagement is intended to meet the particular needs of specific users.

Materiality is not a fine line. It represents a grey area between what is very likely immaterial and what is very likely material. Consequently, the assessment of what is material is always a matter of professional judgment.

Materiality also involves both qualitative and quantitative considerations. In some cases, misstatements of relatively small amounts could have a material effect on the financial statements. Examples could include a misstatement that has the effect of turning a small profit into a loss, an illegal payment of an otherwise immaterial amount, or failure to comply with some regulatory requirement that could result in a material contingent liability.

Determining materiality for the financial statements as a whole involves the steps in the following exhibit.

Exhibit 4.2-1A

Action Step	Description
Identify the Intended Financial Statement Users	Who are the most likely common users of the financial statements? This could well be the owner-manager and the entity's bank. However, consider other stakeholder groups who may make reasonable economic decisions based on the financial statements. Examples include TCWG, investors not involved in day-to-day operations, members of a not-for-profit entity, financial institutions, franchisors, major funders, employees, customers, creditors, and government agencies and departments.
Determine the Likely Needs of Intended Users	Will the groups of identified users focus primarily on the operating results, such as sales revenue expenses or profits and losses, or will they be more interested in the entity's assets, liabilities, and equity? Also consider expectations such as compliance with sensitive laws and regulations, revenue/expense allocations, and industry-specific disclosures. In this context, it is reasonable to assume that users: • Have a reasonable knowledge of business, economic activities, and accounting and a willingness to study the financial statements with reasonable diligence; • Understand that financial statements are prepared, presented, and reviewed to levels of materiality; • Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events; and • Make reasonable economic decisions on the basis of the information in the financial statements.
Establish the Level of Misstatement that Would Be Material to Users	Based on the information obtained about users, use professional judgment to determine the highest amount of misstatement(s) that could be included in the financial statements without affecting the economic decisions made by the financial statement users. If materiality is set too low, it will likely result in additional procedures being necessary to address the lower threshold of potential misstatements.

Action Step	Description
Rules of Thumb	Rules of thumb provide a general guide for calculating materiality based on the needs of the financial statement users. However, they are not a substitute for first identifying the groups of users and their needs. • **For profit-oriented entities**, a percentage of income, before taxes, from continuing operations could be used after any adjustment to normalize the base, such as bonuses or nonrecurring items. Other possible rules of thumb would include a percentage of revenues, expenditures, assets, or equity. • **For not-for-profit entities**, a percentage of revenues, expenditures, or assets could be used.
Document the Materiality Amount and Reasoning	Include in the file documentation: • The amount established for materiality; • The factors considered in determining materiality; and • Details of any revision to materiality as the engagement progressed.

Consider Point

Materiality for the financial statements as a whole relates to the needs of the intended users of the financial statements. It does not relate to the level of assurance being provided or the likelihood that material misstatements exist in the financial statements. Consequently, the amount established for materiality is generally not likely to require revision during the engagement unless there has been a major change in the circumstances of the entity or the information used to determine materiality in the first place. Refer to Section 4.2-3 of this chapter.

When factual misstatements are identified, other than those that are clearly trivial, practitioners often request that management make an adjustment regardless of the size. If management refuses, the reasons need to be carefully considered, as this could raise questions about management's integrity.

Example

Damien Maquire owns a sporting goods store that has annual sales of €620,000 and a net profit before taxes of €79,000. The total assets are €430,000 and Damien has a bank loan of €200,000 secured by the inventory in the store.

The calculation and documentation of materiality could be as follows:

Financial Statement Framework

IFRS for SMEs, which includes the concept of materiality based on the extent of misstatements (including omissions), that could reasonably be expected to influence the economic decisions of users when taken on the basis of the financial statements.

Financial Statement Users

The major user will be the owner-manager and his family, plus the bank (whose financial information needs to include the amount of inventory being held as security, the profitability of the store, and the resulting cash flow available to service the loan).

Normalized Annual Income

Normalized annual profits total €129,000. This is the €79,000 profit before tax, plus the bonus of €50,000 that was paid to Damien based on the results.

Calculation of Materiality

The following bases for determining materiality were considered:

- 5 to 10 percent of normalized profits before tax. This would provide a materiality amount of between €6,450 to €12,900.
- 1 to 2 percent of revenues. This would provide a materiality amount of between €6,200 to €12,400.
- .5 to 1 percent of total assets. This would provide a materiality amount of between €2,150 to €4,300.

Given that the stated users would be primarily interested in the profitability of the entity, it is my professional judgment that a materiality amount of €10,000 would be appropriate for this engagement. This is based on just under 8 percent of normalized profits before tax.

4.2-2 Apply

Once established, the materiality amount will serve as a benchmark for planning the procedures to be performed and evaluating the information obtained. The principal uses for materiality are outlined in the following exhibit.

Exhibit 4.2-2A

Common Applications of Materiality	Communicate to the team members and TCWG what materiality threshold will be used. [2400.43]
	Determine what financial statement items, including disclosures, are material. [2400.47(a)]
	Identify areas in the financial statements where material misstatements are likely to arise [2400.45] so that work efforts may be focused on addressing those areas. [2400.47(b)]
	Provide a context for evaluating the information obtained as a result of performing the planned procedures.
	Assess whether the information obtained causes the practitioner to believe that the financial statements may be materially misstated and, if so, plan what additional procedures are required.
	Evaluate the nature and impact of identified misstatements and, if not corrected, whether a modification to the review engagement conclusion is required as a result.
	Assess any new information obtained that could require a revision to the initial determination of materiality.

Consider Point

Documentation of Misstatements

At the planning stage, it would be useful to address:

- How misstatements, when identified (as a result of performing review engagement procedures), will be documented and accumulated with other misstatements; and
- When management will be asked to make the appropriate corrections (such as when identified or in the latter stages of the engagement).

Trivial Misstatements

It may also be useful to determine an amount below which a misstatement would be clearly trivial that, if identified, would not need to be documented in the working papers or assessed in any way. If there is any doubt whether a particular misstatement is trivial, then it is likely not trivial.

Examples

Identify Material Balances

Based on the calculated materiality amount, the following items in the statement of financial position have been identified as being material for the purposes of the review engagement. These include inventory, revenues, expenses, receivables, payables, bank indebtedness, fixed assets, and a loan to a related party.

Apply in Planning

In planning the inquiries and analytical review procedures to be performed, this materiality amount will be communicated to the team members and used to assess the information obtained and to identify any other areas where material misstatements are likely to arise.

4.2-3 Revise

Paragraph	Requirement
44	**The practitioner shall revise materiality for the financial statements as a whole in the event of becoming aware of information during the review that would have caused the practitioner to have determined a different amount initially. (Ref. Para. A74)**

In most engagements, the initial assessment of materiality will remain unchanged. In some situations, however, there may be a change in circumstances or new information obtained that would require a revision to the initial level of materiality. An example may be unexpected operating results that are substantially different from the anticipated period-end financial results.

Example

Saigeni is a company that makes software applications for smartphones. Materiality was initially determined at Є12,000 based on user needs and budgeted income before taxes for the current year. However, one particular software application was extremely successful during this year and company sales and profitability were double the budgeted amount used for the initial materiality calculation. In light of this new information, the practitioner decided to revise the materiality amount from Є12,000 to Є24,000.

4.3 UNDERSTAND THE ENTITY

Paragraph	Requirement
	The Practitioner's Understanding
45	**The practitioner shall obtain an understanding of the entity and its environment, and the applicable financial reporting framework, to identify areas in the financial statements where material misstatements are likely to arise and thereby provide a basis for designing procedures to address those areas. (Ref: Para. A75–A77)**

4.3-1 Why?

Until an understanding of the entity is obtained, the practitioner is not in a position to identify where material misstatements are likely to arise or to design suitable procedures (inquiry and analytical procedures). A summary of the requirements to obtain an understanding, including the reasons why, is illustrated in the following exhibit.

Exhibit 4.3-1A

Requirement	Purpose	Process
1. Obtain an understanding of the entity and its environment and the AFRF…	Provides a **frame of reference** within which the practitioner plans and performs the engagement and exercises professional judgment.	A **continual dynamic process** of gathering, updating, and analyzing information throughout the engagement.
2. …to identify areas in the F/S where material misstatements are likely to arise…	Provides the necessary information for the practitioner to **focus work** on the F/S areas where material misstatements are likely to arise and reduce work on less material areas.	**Using the information** obtained about the entity and its environment to identify specific F/S areas where material misstatements are likely to arise and the reasons why.
3. …to provide a BASIS for designing procedures to address those areas.	**Enables** the practitioner to **use professional judgment** in designing and performing appropriate and cost-efficient procedures.	**Designing procedures** (customized as much as possible) that appropriately address the reasons identified as to why a material misstatement is likely to arise.

Likely to Arise

The requirement in ISRE 2400 (Revised) is to obtain an understanding of the entity in order to identify areas in the financial statements where material misstatements are likely to arise. The procedures required in a review are less onerous than the audit requirement to identify and assess the risk of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

Financial statement areas where misstatements are likely to arise would include areas prone to misstatement due to matters such as estimation uncertainty, complexity, or need for judgment (hard-to-value inventories, etc.). Financial statement areas that fall under the "likely to arise" category would not include areas that are immaterial or relatively easy to review, such as the cost of a building held for some years.

Some of the benefits obtained from understanding the entity are outlined in the following exhibit.

Exhibit 4.3-1B

Benefits of Understanding the Entity	A frame of reference for planning and performing the review engagement and making professional judgments about financial statement areas where misstatements are likely to arise.
	Information for developing the expectations needed for performing analytical procedures.
	The understanding establishes a frame of reference to which the practitioner can refer throughout the engagement and a basis for developing appropriate procedures (responses) to the financial statement areas where misstatements are likely to arise.
	Information for identifying such matters as undisclosed related party transactions, inventory pricing matters, foreign exchange transactions, going-concern uncertainties, unusual transactions, or noncompliance with laws and regulations.
	Evaluating whether sufficient appropriate evidence has been obtained from the procedures performed.
	Information for assessing management's selection and application of accounting policies and the adequacy of financial statement presentation and disclosures. [2400.69 and 2400.71]

The practitioner's understanding is obtained and applied on an iterative basis throughout the performance of the engagement and is updated as changes in conditions and circumstances occur. This is illustrated in the following exhibit.

Exhibit 4.3-1C

Stage of Engagement	Information Source
Client Acceptance	Engagement acceptance procedures.
Client Continuance	Prior engagements performed.
Planning and Determining Materiality	Preliminary analysis and management inquiries, including major changes that have occurred during the period.
Performing	Results of performing inquiry and analytical procedures.
Concluding	Final discussions with the client and TCWG.

Consider Point

Avoid the temptation, particularly on recurring engagements, to skip the understanding of the entity step on the assumption that it was all acquired in previous years and nothing has changed. This approach can result in a standard set of review procedures being performed with little or no thought given to financial statement areas where misstatements are likely to arise. Consequently, too much work may be performed in minor areas and not enough or no work on the important areas.

Obtaining an understanding of the entity is not a discrete task that can be completed early in the engagement and then put to one side. It is important to keep learning about the entity throughout the engagement and be alert to possible misstatements not previously identified or to where the original assessment of possible misstatements needs updating. When changes in conditions and circumstances occur, ensure the documentation is updated and any implications, such as a change in review procedures, are addressed.

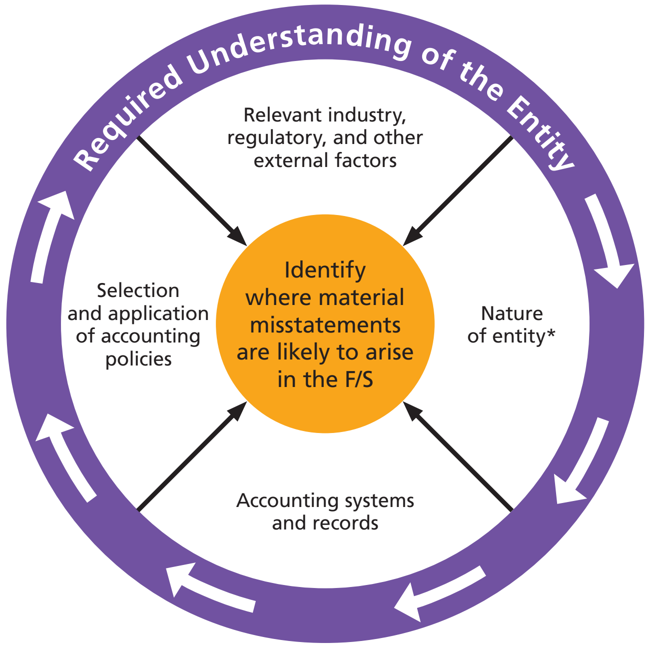
4.3-2 Scope

Paragraph	Requirement
46	**The practitioner's understanding shall include the following: (Ref: Para. A78, A87, A89)** **(a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework;** **(b) The nature of the entity, including:** **(i) Its operations;** **(ii) Its ownership and governance structure;** **(iii) The types of investments that the entity is making and plans to make;** **(iv) The way that the entity is structured and how it is financed; and** **(v) The entity's objectives and strategies;** **(c) The entity's accounting systems and accounting records; and** **(d) The entity's selection and application of accounting policies.**

The understanding of the entity required should be sufficient to meet the practitioner's objectives for the engagement. The extent will be based on professional judgment; however, the depth and breadth of the understanding required is less than that possessed by management.

The standard sets out four specified areas of understanding as illustrated in the following exhibit.

Exhibit 4.3-2A



*Including: operations, ownership/governance, investments (made and proposed), operating structure, financing structure, and entity objectives and strategies

In addition to the above, the practitioner may also consider the following areas when developing an understanding of the entity and its environment.

Exhibit 4.3-2B

Other Areas of Understanding the Entity to Consider	The "**tone at the top**" and the entity's control environment through which the entity addresses risks relating to financial reporting and compliance with its financial reporting obligations. The level of development and complexity of the entity's financial accounting and reporting systems and related controls through which the entity's accounting records and related information are maintained.
	The level of development of the **entity's management and governance structure** regarding management and oversight of the entity's accounting records and financial reporting systems that underpin preparation of the financial statements. Smaller entities often have fewer employees, which may influence how management exercises oversight. For example, segregation of duties may not be practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties.
	The entity's **financial reporting obligations** or requirements and whether those obligations or requirements exist under applicable law or regulation or in the context of voluntary financial reporting arrangements established under formalized governance or accountability arrangements (e.g., under contractual arrangements with third parties).
	Relevant **provisions of laws and regulations** that are generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements, such as tax and pension laws and regulations, environmental issues, etc.
	The **complexity** of the financial reporting framework.
	Whether the entity is a **component of a group** of entities or associated with other entities.
	How the entity **identifies and treats the risks** relating to financial reporting and potential fraud scenarios (management and employees), and how compliance is assured with the financial reporting obligations.
	The entity's **procedures for recording, classifying, and summarizing transactions**, accumulating information for inclusion in the financial statements, and disclosing related information.
	The types of matters that required **accounting adjustments** in the entity's financial statements in prior periods.

Consider Point

Internal Control

In a review engagement, the practitioner obtains a basic understanding of internal control, such as the entity's policies and procedures for:

- Recording, classifying, and summarizing transactions; and
- Accumulating information for inclusion and disclosure in the financial statements.

There is no requirement, such as required in an audit engagement, to evaluate the design and implementation of relevant controls or, where applicable, to test the operating effectiveness of controls.

Examples of Possible Implications of NOT Understanding the Entity

Failure to obtain an appropriate understanding of the entity can result in the practitioner being unaware of important changes or events that took place during the period that could result in a material misstatement or lack of disclosure in the financial statements. For example, if inquiries were not made about the customer base in an entity, the practitioner may be unaware of matters such as:

- Customers who are in financial difficulty and having trouble paying their bills. This would impact the provision for doubtful receivables.
- Large new customers who may receive significant discounts or other preferential treatment. This could affect financial ratios and revenue recognition policies.
- Customers who are significant contributors to salespersons' bonuses. This could result in sales being recorded in the wrong period.
- Lost customers to competitors who are offering better value in terms of price or quality. This could result in excess inventory that needs to be written down to realizable value. It could also indicate that the entity may be in financial difficulty.

Consider Point

In many jurisdictions, **environmental legislation** requires specific actions to be taken by management to avoid significant penalties for noncompliance. Inquire about such legislation, and the penalties involved, as part of obtaining the understanding of the entity.

4.3-3 How?

An understanding of the entity and its environment can be obtained from both internal and external sources. The suggested steps to follow are outlined in the following exhibit.

Exhibit 4.3-3A

Action Step	Description
Make Inquiries of Management	Identify who in the entity is the most qualified person for obtaining the needed information in relation to each of the four specified areas of understanding (Exhibit 4.3-2A), and then for the other areas outlined above (Exhibit 4.3-2B). Arrange to meet with the person(s) identified to ask the necessary questions and document the responses. An alternative approach is to provide the above-identified person(s) with a list of questions, or a worksheet, with a request that they be completed by management in advance of the meeting.
Consider the Information Readily Available from External Sources	Although inquiry will be the principal source of information, the practitioner may determine that, in addition, data about general economic conditions, the state of the client's industry, and even information about the specific client and senior management would be useful for understanding the entity. While not specifically required by ISRE 2400 (Revised), such information can often be obtained from the Internet, trade associations, newspapers, and magazines.
Evaluate the Information Obtained	Review the information obtained to identify areas in the financial statements where material misstatements are likely to arise. Document the findings and what procedures will be designed and performed to address these possible misstatements. This evaluation could also be part of a planning discussion with the engagement team, where suitable procedures to address these areas could be discussed and designed.

Note

In a review engagement, the practitioner considers the responses received to inquiries in light of the understanding obtained as well as the results of analytical procedures performed. There is no requirement to substantiate information received in response to inquiries or to conduct any particular type of research unless the practitioner becomes aware of a matter(s) that causes the practitioner to believe the financial statements may be materially misstated. In this case, additional procedures would be required to confirm or dispel whether a material misstatement has occurred. For example, if the practitioner becomes aware of a significant contract, the practitioner may choose to read the contract.

Consider Point

The most effective review engagement procedures will generally consist of inquiry and analysis. However, where it would be more efficient to perform a substantive procedure instead of inquiry (such as a proof in total on a particular balance, to confirm 100 percent of annual sales, or to confirm a receivable balance or a bank loan), this is entirely acceptable.

Example

Aiden and Sophia own and operate a small retirement home with eight residents. They have asked the firm Blinberry & Co. to review their financial statements, which will likely be used to obtain bank financing for improvements and an addition to the retirement home.

The accountant provided a list of questions for Aiden and Sophia to consider prior to a meeting that had been arranged for October 25. The questions provided were as follows:

- Are there any industry, regulatory, or other external factors that will impact your business?
- What are the industry trends in general, and how competitive is your retirement home?
- Describe any major changes over the last 12 months (such as operations, personnel, financing, or new contracts).
- What are the major challenges you are addressing in running the retirement home?
- Who owns the entity, and is there any governance structure in place?
- Is there a stated mission/vision for the entity, any core values, or a code of conduct for employees?
- Describe how the entity is managed on a day-to-day basis.
- Describe the organizational structure, including numbers of employees and job responsibilities.
- Who maintains the books of account, and how often are the financial reports prepared?
- Who reviews the financial reports to ensure that they are accurate and reflect all the entity's transactions?
- How do you ensure the completeness of revenues received?
- What is the process for authorizing expenditures and maintaining control over fixed assets acquired?
- Do you have a business plan? If not, what changes are planned for business activities or personnel in the next few years?
- Have there been any major issues in the past year (such as bad publicity, lawsuits, poor cash flow, resident complaints, or regulatory issues) or any financial issues (such as need for new capital investment or inability to attract people with the required skills)?
- Has there been a change of, or consistent use of, accounting policies?
- Are there any difficult or complex areas involved in the entity's financial reporting (such as estimates, valuation of assets, or accruals)?
- Describe how the entity is financed (e.g., names of banks, details of financing terms, and interest rates).
- Does the entity have any investments or ownership in other entities?
- Are there any related parties? If so, can you provide details of transactions?
- Is there any history or known risk of employee fraud? If so, has action been taken to minimize such risks?

Following the meeting on October 25, the accountants evaluated the information obtained and documented the following areas (*extract provided*) where material misstatements are likely to arise.

Financial Statement Area	Nature of Possible Material Misstatements	Review Procedures to Address the Possible Misstatement
All Areas	*A new part-time accountant was hired during the year. This person is prone to making accounting errors.*	*Perform additional analysis on account balances of error-prone areas, such as cutoff.*
Inventories	*The retirement home has considerable inventories of bed linens, cleaning supplies, and food. These are counted once a year. However, due to theft, there is often a significant difference between the amounts in the accounting records and physical quantities.*	*Discuss the controls over inventory, the count procedures, and the results of the physical count. Also, inquire into the reasons for major variances.*
Physical Assets	*There is a significant investment in property, plant, and equipment, with many additions and disposals during the period.*	*Discuss the controls over physical assets, the procedures used to record additions and disposals, and the relevant accounting policy. Also, review the nature and amount of the additions and disposals during the period.*
Revenues	*The system for tracking special care services provided to residents does not work well. Consequently, there may be services rendered that have not yet been billed which could potentially result in a material misstatement.*	*Review the revenues for special care services in relation to previous years and the current period budget. Inquire about any variances. As an additional procedure, select one or two residents that receive special services and ensure such services were regularly billed.*
Disclosures	*The family of a former resident is suing the home for the poor treatment their mother received in her last days.*	*Inquire about the lawsuit and consider whether financial statement disclosure is required. Depending on the circumstances, it may also be appropriate to read the correspondence with the entity's lawyers, or consider sending a legal letter.*

Consider Point

Dual Purpose Inquiries

The responses to questions such as those outlined above not only will help in obtaining the required understanding of the entity, but also may comprise a major part of the evidence required to form a conclusion on the financial statements.

4.3-4 Planning

Now that materiality has been determined and an understanding of the entity, its environment, and the AFRF has been obtained, the next step is to plan the review procedures to be performed.

Planning is a critical step in performing an efficient and effective review engagement. Time spent in planning can focus work efforts toward material matters and away from insignificant matters.

Exhibit 4.3-4A

Uses of Planning	Focus partner/staff attention on engagement objectives.
	Identify ways in which the entity could assist the engagement, such as preparing certain working papers and analyses.
	Identify material financial statement items and disclosures and where material misstatements are likely to arise, and then develop an appropriate response.
	Ensure that a coherent set of review procedures is developed to achieve the engagement objectives. This includes removal (based on professional judgment) of those review procedures considered unnecessary for this engagement, such as from standard checklists.
Benefits of Planning	Team members are properly briefed on the engagement objectives and expectations.
	Problem areas can be anticipated, to the extent possible, and surprises avoided.
	Review procedures are focused on areas of potential material misstatement.
	The engagement is properly organized, staffed, and managed.

Many review engagements performed by SMPs will involve relatively small engagement teams or may be carried out by a single practitioner. Ideally, the planning discussions would involve all of the engagement team, but it is most important that senior engagement personnel be involved. The partner and senior staff usually have the most information about the entity and are in a position to make key decisions.

Where a planning discussion is held, the following could be discussed.

Exhibit 4.3-4B

Content of Planning Discussions	The entity (operations, personnel, etc.) and what has changed this period as well as any difficulties encountered by the client.
	Material misstatements most likely to occur (and the reasons why) in the financial statements as well as the appropriate response.
	Specific concerns (such as related party transactions, complex estimates, litigation or claims, and going-concern events/conditions).
	Lessons learned from previous engagements (such as matters noted in the file for carry forward, difficult areas, nature and amount of misstatements identified, and management's response to any recommendations made).
	Any changes in the AFRF (such as new accounting standards).
	Potential for improving engagement quality and file documentation, and the efficiency/effectiveness of review procedures performed.
	Any indicators of management or employee fraud to consider.
	What staff will be required to do and the reasons why.
	Document the results in a planning memo.
Content of Planning Memo	Nature of the engagement and any special requests.
	Guidance on what should be considered material.
	An overall strategy (significant risk factors to consider, timing, and approach to the engagement), with a focus on areas where material misstatements are likely to arise.
	A detailed plan of action (the review procedures to be performed), with a focus on areas where material misstatements are likely to arise.
	Assignment of specific responsibilities to team members, with a focus on areas where material misstatements are likely to arise.

Consider Point

Ensure staff members are briefed about the entity and industry before they start work. Management does not appreciate new or uninformed staff asking about basic information (not subject to change) that they could have easily obtained from the previous year's file.

Remember to document the results of engagement planning and the decisions made. For a small entity, this could consist of just a brief memorandum.

Where possible, ask management to prepare supporting work papers, if required, such as reconciliations and analysis of balances.

Consider using a spreadsheet or other software to perform such time-consuming tasks as posting journal entries, tracking analytical comparisons, preparing lead sheets, and creating the financial statements.

Where possible, complete the work, including the file review, at the client's premises. Going back to the entity at a later time and requesting additional information is inefficient.

Example of a Memorandum Addressing Key Aspects of the Entity and Its Environment and Review Engagement Planning

Entity: *The XYZ Manufacturing Company Limited*

Period ended: *December 31, 20XX*

Business

- The company purchases electric pumps and attachments and assembles them for sale to end users.
- The industry and market for pumps are in slow decline. Pump technology is advancing and profit margins on the completed pumps are being squeezed. We need to inquire about possible inventory obsolescence.

Ownership

- The company started 10 years ago. The president, Mr. A.D. Green, was the founding shareholder. Ownership is all within the family.
- There is a governance board that consists primarily of family members with limited financial experience. This board approves the business plan each year and meets every two months to review progress and discuss any operating issues.

Tone at the Top

- There seems to be a strong commitment to integrity, which is demonstrated by the actions of Mr. Green.
- The key staff members all seem to be competent and have well-defined job responsibilities.
- We are not aware of any instances of management override of controls.
- Some inventory supplies have been the subject of theft in the past, and a sales employee was fired two years ago for inflating his expenses.

Materiality

- The bank and family members are the principal users of the financial statements. Materiality of Є18,000 has been based on 5 percent of income from continuing operations.
- Last year's materiality was Є15,000.

Accounting Records

- Gwen Smith is in charge of accounting. She oversees all accounting functions and has one assistant.
- A standard accounting software package is used for the general ledger, accounts receivable, accounts payable, payroll, and inventory. Gwen also prepares monthly bank reconciliations.
- Gwen has agreed to prepare the working papers we requested.
- Gwen and the key managers have remote access to the financial records and other operating data. Jack Billings is an external IT consultant who oversees the IT needs of the company and is responsible for control over remote access, virus protection, and the integrity/back-up of all corporate data.

Timing

- The time budget is *XX* staff hours. One staff member is assigned to this review.
- The engagement is planned to commence *January 14, 20XX*. Note that Mr. Green likes to finalize the statements before his annual vacation in late February.

Areas Identified Where Material Misstatements Are Likely to Arise

- In addition to items that exceed materiality, the key areas to address are:
  (a) Inventories due to size of balance and estimates required for obsolescence, etc. We should also ask about the inventory count procedures, the methods used to value slow-moving items, and the cutoff procedures at year end.
  (b) Receivables due to size of balance and estimates for doubtful accounts.
  (c) Sales due to the possibility of unrecorded sales or revenue recognition not in accord with the entity's significant accounting policies.
  (d) Cost of sales due to potential misclassifications of expense accounts and treatment of foreign currency amounts.
- Be alert for possible related parties and any going-concern uncertainties.
- Based on conversation with Mr. Green, the company expects growth of approximately 5 percent this year. Given the changes in technology and the industry shape in general, we need to inquire about any major changes that could occur in inventory, receivables, and payables.
- Additional bank financing may be required to finance planned research and development activities.
- In light of the industry trends, the owners may be contemplating a sale of the business. Consequently, management may be looking for higher profits this year as opposed to last year when the priority was to minimize the tax burden.

Review Procedures to Be Performed

Refer to forms A-ZZ in the file.

Prepared by: *Jan Friskoe* Date: *January 10, 20XX*

Reviewed by: *Faylia Jayit* Date: *January 15, 20XX*

4.4 DESIGN APPROPRIATE PROCEDURES

Paragraph	Requirement
	Designing and Performing Procedures
47	**In obtaining sufficient appropriate evidence as the basis for a conclusion on the financial statements as a whole, the practitioner shall design and perform inquiry and analytical procedures: (Ref: Para. A79–A83, A87, A89)** **(a) To address all material items in the financial statements, including disclosures; and** **(b) To focus on addressing areas in the financial statements where material misstatements are likely to arise.**

The last step in planning is to determine the nature, timing, and extent of the procedures needed to obtain sufficient appropriate evidence for the review engagement. The planned procedures will address:

- The requirements of ISRE 2400 (Revised), including:
  (a) All material items in the financial statements, including disclosures;
  (b) Financial statement areas where material misstatements are likely to arise;
  (c) Specified areas (such as, related party transactions, going concern, fraud, and noncompliance); and
- Requirements (including additional reporting requirements) established under applicable laws or regulations.

4.4-1 Types of Procedure

To achieve the objectives of obtaining sufficient appropriate evidence to support the limited assurance conclusion, a number of review engagement procedures need to be designed and then performed. The nature of those procedures is outlined in the following exhibit. Note that careful evaluation of the information obtained is an integral part of performing any of these procedures.

Exhibit 4.4-1A

Type of Procedure	Nature of Procedure
Inquiry	Seeking information of management and other persons within the entity as considered appropriate in the circumstances. Expanding inquiries, where appropriate, to obtain nonfinancial data. Evaluating responses provided by management.
Analytical	Identifying inconsistencies or variances from expected trends, values, or norms in the financial statements, such as the level of congruence of the financial statements with key data, including key performance indicators. Obtaining or updating the practitioner's understanding of the entity and its environment, including being able to identify areas where material misstatements are likely to arise in the financial statements. Providing corroborative evidence in relation to other inquiries or analytical procedures already performed. Evaluating identified inconsistencies through further inquiries and other procedures.
Tailored to the Circumstances	Performing procedures, in addition to inquiry and analysis, where a matter(s) causes the practitioner to believe the financial statements may be materially misstated. These procedures are to be sufficient for a conclusion to be reached that the matter(s): • Is not likely to cause the financial statements as a whole to be materially misstated; or • Would cause the financial statements as a whole to be materially misstated. Evaluating information obtained and/or responses provided by management.
Other	Any circumstances where, in the professional judgment of the practitioner, it is considered necessary, or just simply more efficient, to perform other types of procedures, such as substantive tests of details, external confirmations, reading the terms of a major contract, or reviewing accounting records. Performing other procedures does not alter the objective of the engagement, which is to obtain limited assurance in relation to the financial statements as a whole. Evaluating other information obtained and/or responses provided by management.

Consider Point

Remember to consider evidence that may already have been obtained from understanding the entity when determining what additional procedures to perform.

Additional guidance on how to perform these types of procedures is contained in Chapter 5 of this Guide and in paragraphs 2400.48-49 and 2400.A84-A91 of the standard.

4.4-2 Inquiries

Paragraph	Requirement
48	**The practitioner's inquiries of management and others within the entity, as appropriate, shall include the following: (Ref: Para. A84–A87)** **(a) How management makes the significant accounting estimates required under the applicable financial reporting framework;** **(b) The identification of related parties and related party transactions [see Appendix A for a description of related parties], including the purpose of those transactions;** **(c) Whether there are significant, unusual, or complex transactions, events or matters that have affected or may affect the entity's financial statements, including:** **(i) Significant changes in the entity's business activities or operations;** **(ii) Significant changes to the terms of contracts that materially affect the entity's financial statements, including terms of finance and debt contracts or covenants;** **(iii) Significant journal entries or other adjustments to the financial statements;** **(iv) Significant transactions occurring or recognized near the end of the reporting period;** **(v) The status of any uncorrected misstatements identified during previous engagements; and** **(vi) Effects or possible implications for the entity of transactions or relationships with related parties;** **(d) The existence of any actual, suspected or alleged:** **(i) Fraud or illegal acts affecting the entity; and** **(ii) Noncompliance with provisions of laws and regulations that are generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements, such as tax and pension laws and regulations;** **(e) Whether management has identified and addressed events occurring between the date of the financial statements and the date of the practitioner's report that require adjustment of, or disclosure in, the financial statements;** **(f) The basis for management's assessment of the entity's ability to continue as a going concern; (Ref: Para. A88)** **(g) Whether there are events or conditions that appear to cast doubt on the entity's ability to continue as a going concern;** **(h) Material commitments, contractual obligations or contingencies that have affected or may affect the entity's financial statements, including disclosures; and** **(i) Material nonmonetary transactions or transactions for no consideration in the financial reporting period under consideration.**

Refer to Appendix D for a table that outlines the nature of inquiries contained in ISRE 2400 (Revised).

4.4-3 Analytical Procedures

Paragraph	Requirement
49	**In designing analytical procedures, the practitioner shall consider whether the data from the entity's accounting system and accounting records are adequate for the purpose of performing the analytical procedures. (Ref: Para. A89–A91)**

Analytical procedures involve evaluation of financial information through analysis of relationships among both financial and nonfinancial data.

Analytical procedures are used to:
- Identify areas where material misstatements may exist in the financial statements in support of the practitioner's initial inquiries.
- Identify inconsistencies or variances from expected trends, values, or norms in the financial statements, such as the level of congruence of the financial statements with key data, including key performance indicators that could cause the practitioner to believe the financial statements may be materially misstated.
- Provide corroborative evidence in relation to other inquiries or analytical procedures already performed.

Uses of Analytical Procedures:

Exhibit 4.4-3A

Uses	Purpose
Obtain/Update the Understanding of the Entity	To help identify areas where material misstatements are likely to arise in the financial statements. For example, in analyzing a decrease in gross margin, it was discovered that some inventory items are being sold off at reduced prices due to potential obsolescence. The reasons and extent of the obsolescence can then be explored further.
Obtain Relevant Information	To gather information about expected operating and financial results, such as: • Budgets or forecasts, including extrapolations from interim or annual data; and • Information regarding the industry in which the entity operates, such as gross margin information or comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.
Understand the Relationships between Data	To identify a matter(s) that could cause the practitioner to believe the financial statements may be materially misstated by obtaining an understanding of the relationships between: • Elements of financial information within the period; and • Financial information with relevant nonfinancial information, such as payroll costs to number of employees.
Perform Additional Procedures	To investigate any identified matters that cause the practitioner to believe the financial statements may be materially misstated. For example, if a concern is identified that sales may be incomplete, a comparison could be made of sales by major category with previous months, quarters, or periods and explanations could be sought for any variances.

Methods of Analysis

The methods used to identify relationships and individual items that appear unusual or vary from expected trends or values are outlined in the following exhibit.

Exhibit 4.4-3B

Method	Purpose
Simple Comparisons	Establish the relationships among both financial and nonfinancial data. For example, if it is known that the cost of electric power went up during the year, it would be expected that the cost of obtaining that power would also have gone up. If not, the reason (such as power savings implemented during the period) would be investigated.
Comparisons to Expected Values	Assess financial results for consistency with expected values. For example, if the price of the products being sold was increased during the period, there should also be an increase in gross margin as compared to prior periods unless, of course, purchase costs have also risen.
Comparisons with Expectations Developed from Other Sources	Compare recorded amounts, or ratios developed from recorded amounts, to expectations developed from information obtained from relevant sources. For example, if an entity builds 50 electric motors in a year and sells them each for approximately €10,000, the recorded amount for sales revenue should be close to €500,000. If not, the reasons would be investigated.
Complex Analysis Using Statistical Techniques, such as Regression Analysis	Examine relationships between a dependent variable and one or more independent variables. For example, regression analysis can be used to calculate costs of sales over a certain period (such as three years) using several components of cost of sales and sales data for various product types. The costs of sales could then be determined for a given level of sales by product for the current year based on the mathematical relationship between the different variables.

Adequacy of Data Used

Before an analytical procedure is performed, it is important to consider whether the data to be used is adequate for the intended purpose. This will be based on:
- The understanding obtained of the entity and its environment;
- The nature and source of the data to be used; and
- The circumstances in which the data is obtained.

Exhibit 4.4-3C

	Consider the Circumstances
How Was the Data Obtained?	Information may be more reliable when it is obtained from independent sources outside the entity.
	Is the available information comparable? For example, broad industry data may need to be supplemented or adjusted to be comparable to data of an entity that produces and sells specialized products.
	Consider the nature and relevance of the information available (e.g., whether the entity's budgets are established as results to be expected rather than as goals to be achieved).
	What knowledge and expertise was involved in the preparation of the information and related controls that are designed to ensure its completeness, accuracy, and validity. Such controls may include, for example, controls over the preparation, review, and maintenance of budgetary information.

Examples of Using Inadequate Data
- Comparing operating results to a preliminary budget as opposed to the one approved by management or TCWG.
- Comparing the gross margin percentage to previous years without first establishing the consistency of amounts included in cost of sales and in sales.
- Comparing the average payroll per employee without first determining the correct number of employees during the period.
- Comparing sales per square foot without considering the actual square feet available.
- Calculating revenues from a condominium complex without first determining the number of units available and the vacancies during the period.

Consider Point

The planning stage is a good time to consider ways in which the engagement can be performed efficiently and effectively. Some areas to consider include:

Planning

Time taken to plan the engagement can often result in much more time being saved in execution. For example:
- Plan the work so that the more difficult financial statement areas, such as where judgments are required, are addressed first. This will allow more time for discussion and resolution of such matters before the completion of field work.
- Consider whether inquiries made to gain an understanding of the entity could also be used as evidence for determining whether material misstatements are likely to exist.

Client Assistance

Can time be saved by requesting that the client prepare certain information, schedules, or analysis that would otherwise be prepared by the engagement team?

Work at Client Premises

Can more work be performed at the client's premises? This enables information to be obtained and questions answered on a timely basis as opposed to the need for emails, phone calls, and special visits.

Leverage Firm Knowledge

Can you leverage the knowledge gained about a particular industry to save time in identifying where material misstatements are likely to arise in other clients involved in the same industry?

Checklists

If checklists are used, can they be customized to eliminate the "not applicable" procedures and include additional procedures for the areas where material misstatements are likely to arise?

Automation

Can some of the required work be automated? This could include analysis of certain accounts and financial statement preparation.

5 PERFORMING

Accepting → Planning → Performing → Reporting

CHAPTER CONTENT

- How to perform inquiry and analytical procedures.
- When additional procedures are required.
- How to evaluate/document the results.

5.1 Perform Procedures 2400.50–65	**5.2 Evaluate Evidence Obtained** 2400.66–68	**5.3 Review Documentation** 2400.93–96
5.1-1 Analytical Procedures	5.2-1 Supervision and Review	5.3-1 Documentation
5.1-2 Making Inquiries	5.2-2 Has Sufficient Appropriate Evidence Been Obtained?	5.3-2 File Assembly
5.1-3 Related Parties		
5.1-4 Fraud and Noncompliance		
5.1-5 Going Concern		
5.1-6 Reviews for Component Auditors		
5.1-7 Other Matters		
5.1-8 Additional Procedures		
5.1-9 Subsequent Events		
5.1-10 Written Representations		

Outcome

Sufficient appropriate evidence has been obtained and documented in the engagement file.

5.1 PERFORM PROCEDURES

Review procedures are based on the understanding obtained of the entity, its environment, and the AFRF. They consist primarily of inquiry and analytical procedures and include other procedures considered necessary in the circumstances. The specific procedures to be performed will be based on professional judgment. A description of these procedures and design considerations are outlined in Chapter 4.

The practitioner is entitled to accept the information obtained from these procedures (which will often be oral) as long as the responses are consistent with the understanding obtained of the entity and no matters arise that cause the practitioner to believe the financial statements may be materially misstated.

If matters are identified that cause the practitioner to believe the financial statements may be materially misstated, additional procedures are required to either confirm or dispel the concerns.

5.1-1 Analytical Procedures

Chapter 4, Section 4.4, outlines the various types of analytical procedures and matters to consider in their design.

The most common analytical procedures address matters such as:

- Comparing the financial statements with those of the immediately preceding period, and with budgets (if available) for the current period, to identify trends and changes in operating profits/losses, sales, profit margins, investment in inventory or receivables, debt, and working capital;
- Identifying the interrelationships of key elements of financial statements that would be expected to conform to a predictable pattern based on previous experience and inquiring about any exceptions; and
- Comparing recorded amounts to predicted values calculated from other sources.

Some typical analytical procedures for selected account balances are contained in Appendix E. Remember that analytical procedures are only required to address all financial statement items that are material and focus on areas where material misstatements are likely to arise, including disclosures (refer to Chapter 4).

Example:

Sandy is performing a review engagement on an entity that prepares processed food. In performing analytical procedures on inventory, he noted that inventories had increased from €862,000 to €1,045,000 (or 18 percent). On inquiring why there had been such a big change when sales were flat, the owner seemed surprised at the level but stated that they needed more inventory on hand to sell to all the new customers they were seeking. The gross margin on sales had also been squeezed from 48 percent to 43 percent for the year, which was also a surprise to management.

Although Sandy thought the owner's response could explain the increase in inventory, it seemed incongruent with the facts that sales were flat and the gross margin squeezed. Sandy decided to explore a little further and reviewed the inventory listing with the owner. The owner quickly identified that the level of frozen beef patties on hand was extremely high. He asked the accountant to review the inventory count sheets. The count sheets showed exactly half of the amount in the final listing, indicating the item had been entered twice.

With the error corrected, the inventory was reduced to €906,896, which is more in line with expectations. Given the amount of the error found, the owner asked the accountant to review the listing and count sheets in more detail to ensure no other items had been incorrectly transferred from the count sheets to the listing. No other errors were found.

5.1-2 Making Inquiries

Inquiries are required to:

- Address all financial statement items that are material; and
- Focus on areas where material misstatements are likely to arise, including disclosures (refer to Chapter 4).

When making inquiries, there are certain principles that will help practitioners obtain the best possible quality of evidence. These are outlined in the following exhibit.

Exhibit 5.1-2A

Principle	Description
Set Objectives	Establish the line of questioning before asking questions of the entity's management and staff.
Identify the Best Person in the Entity to Ask	Consider making inquiries of more people than TCWG, the senior manager, and the accountant. Others (such as sales managers, production managers, and IT personnel) may have important, and possibly unexpected, information to share.
Use the Understanding Obtained of the Entity as a Frame of Reference for Questions	Do not ask questions without having any way to evaluate the response. Questions should always be derived from the understanding already obtained of the entity. This enables the practitioner to consider what the most likely response would be. Then, consider the actual response received: • If the response is too general, be prepared to ask additional probing questions to obtain the details required. • If the response seems odd or evasive or if it is inconsistent with other data, be prepared to challenge the response with appropriate follow-up questions. For example, the question regarding whether the entity prepares a budget would have already been determined during the understanding phase. At the performing phase, the question could be "What is the reason for the variance between budgeted sales and actual sales?" If the response was simply that more sales had been made, follow-up questions would be required (such as: "What particular products or services contributed to the sales increase and why?"; "Have new customers been obtained?"; and "Were there any price increases?"). If the follow-up questions do not produce adequate answers, it may be helpful to ask the same questions of others, such as the sales manager.
Use Open-Ended Questions	Do not phrase questions so that they can be answered by a simple "Yes" or "No." A question such as, "Do you have inventory cutoff procedures?" may produce a "Yes" answer but provide little information to evaluate the response. Instead, consider asking, "What types of problems were identified by your inventory cutoff procedures?" If they answer, "We don't have specific cutoff procedures," then you can pursue that line of questioning further. Start questions with the words Why or What. These questions lead to explanations or descriptions which are much more informative. For example, "Why is there an increase in commission expense this period?"
Prepare Follow-Up Questions	Before posing the question, think about the answers that may be provided and what additional information might be needed as a result. If this additional information can be obtained at the first meeting, it will save the time and effort of making further inquiries later in the engagement.
Delve into the Subject Matter	An initial general question can be used to get things started. Then, focus your questions on the particular subject matter. For example, when making inquiries about revenue recognition, do not just ask what accounting policy they use. Also ask about any difficulties involved in applying the policy, any exceptions made to the policy during the period, the circumstances (if any) where judgments are necessary by management, and any specific items identified where the policy does not seem to have been followed for any reason.
Listen	Listen carefully to the entire response being provided before making an evaluation. Avoid the temptation to assume you know the content of the response that will be provided and then, instead of listening, begin focusing your attention on the next question to be asked.
Look for Indicators of Discomfort	Look at the person to whom inquiries are directed rather than a notepad or the prepared list of questions. Take note if certain questions seem to cause more discomfort or stress than others. When this occurs, consider the need for some additional work in that particular area.
Avoid Making Assumptions in a Question	A question such as "Why is the gross margin 35 percent?" assumes that the gross margin is 35 percent, which may or may not be the case. An alternative would be to ask, "What are your targets for gross margin and what are the key drivers involved?", which allows for a more complete answer.

Principle	Description
Avoid Technical Jargon	Be careful to communicate exactly what is meant in as simple terms as possible. Accountants tend to use a lot of accounting terminology in everyday work that management may not understand.
Document the Results	Document the inquiries as soon as possible following the meeting. Otherwise, many of the details of the discussion will be lost. Take notes of key points arising during the meeting.
Evaluate the Information Obtained	Read through the inquiry documentation and: (a) Consider the inter-relationships of the data obtained with information obtained on other financial statement areas; (b) Cross-reference data to corroborating information already obtained; (c) Identify areas where material misstatements are likely to arise for purposes of designing review procedures; (d) Identify areas where inquiries have made you aware that a material misstatement may exist; (e) Identify any additional inquiries or information required; and (f) Conclude on whether or not the objectives of the inquiry were achieved.

Consider Point

In a review engagement, the inquiries made and documenting information obtained will likely constitute a significant part of the total time required to complete the engagement.

In light of this, it is important to plan the inquiries to be made to ensure they:

- Focus on areas where a material misstatement may exist.
- Take into account the principles outlined in the chart above.
- Are addressed to the person most likely to have the required information.
- Make effective use of the time available. For example:
  (a) Inquiries related to understanding the entity with specific financial statement areas or disclosures may be combined in some instances.
  (b) Review the proposed inquiries to ensure they are proportionate to the complexity of the engagement and the likelihood of material misstatement. If standard checklists are used, ensure they are appropriately customized.
  (c) Identify who on the team should be making the inquiries. More complex areas may be more effectively addressed and documented by more senior personnel.
- Where interviews are required with a number of entity personnel, consider scheduling them in advance to ensure personnel are available at the times required.

Some typical inquiries, oral responses received, and suggested notes for the file are provided in the exhibit below. The issue of documenting the procedures performed during a review engagement is addressed in more detail in Section 5.3 of this chapter. Please note the following:

- The inquiries outlined below would only be required where the financial statement item is material or material misstatements have been identified as likely to occur.
- Documentation of the responses received to inquiries should be proportionate to the complexity of the engagement and the likelihood of material misstatement occurring. The examples of documentation are presented as "notes for the file" for illustrative purposes only and do not purport to represent best practice. The precise level of detail recorded and style of documentation (e.g., as notes, prose, or citation) are matters for the judgment of the individual practitioner in adhering to the requirements of ISRE 2400 (Revised).
- Firms are encouraged to tailor their file documentation to also suit regulatory, cultural, and other local requirements where appropriate.

While it is unnecessary to document inquiries made and answers given word for word, documentation must be sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand certain aspects of the engagement (see Section 5.3 of this chapter).

Note that the following exhibit outlines just one way of documenting the inquiries made. There may be many other ways to document that would also be acceptable. However, whatever form of documentation is used, it should include the inquiries that took place, when and with whom they were made, and the information obtained as a result.

Exhibit 5.1-2B

A) Balance Sheet Area

<table>
<tr><th colspan="3">Accounts Receivable</th></tr>
<tr><th>Typical Lines of Inquiry</th><th>Oral Discussions (sample text)</th><th>Notes for the File (sample text)</th></tr>
<tr><td>Unrecorded Transactions/Terms
Ask staff dealing with receivables about instances where:
(a) Certain customers were given preferential treatment;
(b) Terms of sale have been modified;
(c) Related party transactions were involved; or
(d) Internal credit limits were significantly overridden.</td><td>Per discussion with the accounting clerk and the sales manager, credit checks are performed on all customers seeking credit terms. Only customers with more than six months' payment history are given terms over €10,000. Terms are 30 days on all invoices. Invoices not paid on time are charged 1 percent interest per month retroactively to the invoice date. To the accounting clerk's knowledge, no customers have special terms or have been given preferential treatment. Credit limits were not significantly overridden.</td><td>Meeting held on Nov. 30, 20XX, with accounting clerk and sales manager. Information obtained:
(a) No customers have preferential treatment.
(b) Terms of sale are only modified for special large orders, usually with Bigentity Ltd.
(c) No related party transactions were involved.
(d) Credit checks are rarely overridden.</td></tr>
<tr><td>Allowance for Doubtful Accounts
(a) Inquire about, and document, management's procedures for ensuring the adequacy of the allowance for doubtful accounts (considering past due and disputed amounts), and the adequacy of these procedures.
(b) Inquire about the composition of bad debts expense to understand the nature and amount of invoices written off or recovered during the period.
(c) Inquire whether receivables considered uncollectable have been written off. Where significant overdue balances have not been collected subsequent to period end, document management's explanations for why these amounts are still collectable.</td><td>(a) Per discussion with the accounting clerk and owner-manager, all accounts over 45 days are followed up every month. The clerk gives the manager a listing of overdue accounts on the 15th and 30th of every month for follow-up. Unsuccessful collection of these accounts will lead to Cash on Delivery (COD) terms. All accounts over 90 days are sent to a collection agency. An allowance of 50 percent is recorded in the accounting records if the client is still solvent. Accounts where the client is in bankruptcy are fully written off.
(b) Per review of the allowance and bad debts expense, only three accounts amounting to €3,500 that were written off were subsequently recovered.
(c) The clerk noted all accounts over 90 days except for one. The balance not provided for was a customer now on cash-only terms and making monthly payments for the balance.</td><td>Meeting held on Nov. 30, 20XX, with accounting clerk and owner-manager. Information obtained:
(a) Accounts over 45 days are followed up monthly.
(b) Accounts over 90 days are sent to a collection agency and a provision of 50 percent is made if the entity is solvent or 100 percent if the entity is in financial trouble. One exception to this policy occurred where a customer was paying the amount off on a monthly schedule.
(c) Only €3,500 was recovered from accounts written off during the year.</td></tr>
</table>

Accounts Receivable		
Typical Lines of Inquiry	**Oral Discussions** *(sample text)*	**Notes for the File** *(sample text)*
Adequacy of Cutoff		
Inquire about, and document, the client's procedures for ensuring revenue transactions (including credit memos and other sales adjustments) are recorded in the appropriate period, and record your conclusions as to whether this would have led to a proper cutoff. Where deficiencies are identified, document procedures.	*The cutoff procedures have been documented in the engagement file for the previous year. This was reviewed with the accounting clerk and no changes were noted. An extract of the procedure notes is as follows:* *"Based on our understanding of the revenue/receivable/receipts system, invoices are prepared for, and accompany, every shipment. The accounting system is set up to print a packing slip and invoice at the same time to ensure the quantities and details always match. The inventory adjustment for the goods shipped is booked at the same time. At the end of each week, the accounting clerk prints a report for all open orders and reviews these with the sales manager to ensure that none of them were shipped. At the end of the year, the clerk reviews all of the shipments for two weeks after year end to ensure that they are recorded in the proper period based on the shipping dates."*	*According to the accounting clerk, no changes were made to the cutoff procedures documented on W/P X-X.*

B) Income Statement Area

Income Statement		
Typical Lines of Inquiry	**Oral Discussions** *(sample text)*	**Notes for the File** *(sample text)*
Sales Revenue		

Inquire about, and document, the following:
(a) Composition of sales, new customers, and sales trends;
(b) Any changes in the revenue recognition policies;
(c) Credit and collection policies;
(d) Extent of sales returns and credit memos during the year and, specifically, if any provision has been made for such returns at year end;
(e) Sales commission structure;
(f) Sales completeness; and
(g) Cutoff procedures.
	I met with Armin, the sales manager, and discussed the following:
	(a) ***[Asked Armin about any new sales accounts, new products, or significant new customers during the year.]*** *Sales – No new sales categories (i.e., accounts) during the year. The company still has the same product lines but has been struggling to increase sales in this economy. Sales price increases were not possible and, although the company has two new large customers, some existing customers cut back their orders.*
	(b) ***[Asked Armin about revenue recognition policy and if any new or existing customers were given better terms or discounts to encourage sales.]*** *Revenue recognition – Per Armin, although they have not been able to pass on price increases, they have not reduced prices or extended credit terms beyond the 30-day norm. Larger customers do get better pricing due to order size, but this has not changed from the prior year. Revenue is only recognized when the complete customer order is shipped. Deposits are booked in Account 3200.*
		Meeting held on Nov. 30, 20XX, with sales manager. Information obtained:
		• *No new product lines.*
		• *Sales were sluggish in year but no price increases, reduced prices, or extended credit terms provided.*
		• *No volume discounts given.*
		• *Two new large customers.*
		• *No changes in:*
		  ○ *Credit and collection policies.*
		  ○ *Revenue recognition policy. Revenue only recognized when the complete customer order is shipped.*
		  ○ *Sales commissions.*

Income Statement		
Typical Lines of Inquiry	**Oral Discussions** *(sample text)*	**Notes for the File** *(sample text)*
	(c) ***[Asked Armin if larger customers get separate volume discounts based on annual quantities.]*** *Volume discounts—This has never been a company policy or practice.* (d) ***[Asked if credit and collection policies have changed.]*** *Per discussion with Armin, these have not changed. All customers who are given terms (i.e., not COD or credit card) for a credit limit over €500 have a credit check performed prior to approval by Armin—no exceptions. Accountant gives Armin a listing to follow up on accounts over 60 days. If payment (for at least 50 percent of the order) is not received before the next order, the customer is put on COD terms.* (e) ***[Asked to review the sales commission structure with Armin.]*** *Sales commission – Went through commission structure on WIP 510-3 with Armin. No major changes noted.* (f) ***[Asked Armin how he knows that all sales have been recorded and that sales persons are not recording sales early.]*** *Sales completeness – Per discussion, Armin stated that the system prints packing slips and invoices at the same time. Although this can be overridden, only he and the owner can do this and it's flagged in the system. He said he monitors sales weekly and all commissions must be approved by him. He told us that he has not caught anyone manipulating the dates. Since regular sales persons cannot mark the item as shipped (only the shipping department, Armin, and the owner can do this), the invoice, hence the commission, cannot be generated.* ***[Asked if it has ever been overridden.]*** *Yes. In rare circumstances, the customers want to be invoiced for the full amount before the order has been shipped, because they want to get the expense in their accounting period.* ***[Asked how this is overridden.]*** *Armin would enter his administrator password and record the goods as being shipped in the system so the relevant documents are produced. Armin mails the invoice but keeps a copy (stamped "Copy") with the order. When the order is shipped, the invoice copy is sent along with the order. He keeps track of these exceptions manually in a folder on his desk.* ***[Asked if there are any of these open orders at year end.]*** *No. Armin showed me the folder on this desk and the only invoice copy with notes was an invoice prepared and sent on January 31. Per Armin, the items were still in inventory on December 31.* (g) ***[Asked Armin how the company ensures that sales are recorded in the correct accounting period at year end.]*** *Armin indicated that cutoff errors are rare, since the system records sales when shipped. He also reviewed all open orders at year end to ensure no sales should have been recorded. The accountant also asked him to review a listing of invoices for two weeks after year end. No errors were found.*	• *Sales cutoff errors are rare, since the computer system for sales only records sales when shipped. This can be overridden by Armin but only used for a few customers who want to be invoiced for the full amount before the order has been shipped. Armin stated that there were no such orders open at year end.*

Income Statement		
Typical Lines of Inquiry	**Oral Discussions** *(sample text)*	**Notes for the File** *(sample text)*
Expenses		
Obtain an understanding of expense accounts, including changes from the prior period for: (a) Gross margin expectations and changes to the gross margin (overall and/or by product/function); (b) Composition of, and changes to, payroll expense (overall); (c) Payroll deductions and benefits; and (d) Other key expense items or variances.	*I met with Roger (the owner-manager) and Armin (the sales manager) and discussed the following:* *(a)* ***Gross margin:*** ***[Asked Roger and Armin about the gross margin and changes this period.]*** *The company prices products to achieve a 40 percent gross margin in general. Some key customers are given preferential pricing due to the volume they purchase. The discounts vary from 3 to 5 percent, depending on the product.* ***[Asked Roger and Armin how they monitor the actual gross margin and what the actual gross margin was.]*** *Armin indicated that he and Roger monitor the gross margin monthly and do some analysis on a quarterly basis to understand why it's up or down from the expected margin. They indicated that the actual margin of 37 percent was in line with expectations based on the sales mix. This is consistent with the four-year average of 38 percent. The margin is in line with our expectations and explanations.*	*Meeting held on Nov. 30, 20XX, with owner-manager and sales manager. Information obtained:* *(a) Gross margin—Current year's gross margin of 37 percent is in line with prior year and management expectations (i.e., most contracts aim for a 40 percent margin).* *(b) Payroll expense—Company still has three salaried and five hourly full-time employees. No one was hired and no one left during the year. Increase of 2 percent in payroll expense over prior year is in line with pay increase of 2.5 percent.* *(c) Payroll deductions—Payroll outsourced to third-party provider. Deductions are in line with statutory rates.* *(d) Increase in advertising and promotion this year due to increased focus on rising sales. Consulting expenses higher this year due to ISO 9001 consultant hired.*

Income Statement		
Typical Lines of Inquiry	**Oral Discussions** *(sample text)*	**Notes for the File** *(sample text)*
	(b) ***Payroll expense:*** ***[Asked Roger about the composition of payroll expense this year.]*** *I reviewed the payroll documentation on file (W/P 674-4) with Roger. He confirmed that there are still three full-time, salaried employees and five hourly employees. Both had received a 2.5 percent increase in base pay. All employees are paid every two weeks. The company uses the same payroll service through their bank. Roger reviews the payroll summary (prepared every two weeks) prior to approving the payroll journal entry and signing the authorization for the bank funds transfers to employees.* ***[Asked Roger whether: there were any new employees; anyone has been terminated; or anyone has left the company.]*** *Roger stated that no one left or was hired but that one of the sales clerks is off for six months on maternity leave this year and is not being replaced during that time. These explanations are consistent with the 2 percent increase in payroll expense from the prior year.* ***[Asked Roger how he ensures that all employees are paid the correct rate and how the company ensures the hourly employees have the correct number of hours.]*** *Roger stated that only he can approve payroll changes at the payroll service. The payroll report also highlights new/deleted employees or any changes in pay. Any changes not approved by Roger would appear in the report, which he reviews prior to approving the payroll. Hourly employees use a punch clock for each shift. The machine produces reports, including a summary report for the bimonthly payroll. Roger compares this to the expected hours from the employee shift schedule prior to submitting the hours to the bank for processing.* *(c)* ***Payroll benefits:*** *See W/P 720-4 on payroll deduction analysis.* ***[Asked Roger how the company ensures the payroll deductions are correct.]*** *Roger indicated that he really relies on the bank's payroll service (one of the main reasons they went to them) versus doing the payroll themselves. He was not aware of any significant changes to the statutory rates.* ***[Asked Roger if there are any other payroll benefits (such as paying employees for health care after they retire, pension contributions, etc.).]*** *He indicated there were none. The percentages for pension, employer health tax, etc., are in line with expectations and statutory rates.* *(d)* ***Other key expenses:*** ***[Inquired about Roger's expectations and changes to key expenses this year.]*** *He confirmed that the only major increases this year are to advertising and promotion due to an increased effort to expand sales. Radio and print ads increased this year. Also noted change in consulting fees this year due to ISO 9001 certification consulting charges.*	

Income Statement		
Typical Lines of Inquiry	**Oral Discussions** *(sample text)*	**Notes for the File** *(sample text)*
Unrecorded Assets and Liabilities Inquire about, and document, whether: (a) The entity has reviewed the expense accounts (repairs and maintenance, supplies, etc.) for compliance with capitalization policies to ensure assets have not been expensed; and (b) All customer deposits have been excluded from revenue.	*(a) The company has a capitalization policy threshold of €1,000 for all items of property, plant, and equipment and €750 for computer equipment and software. Per discussion with the accountant, she had reviewed the repairs and maintenance account for any capital items. She has found no misstatements.* *(b) Per discussion with the accountant, all customer deposits have been booked.*	*Meeting held on Nov. 30, 20XX, with accountant and owner-manager. Information obtained:* *(a) Capitalization policy followed. Repairs and maintenance as well as other expenses were reviewed for capital items at year end. No errors found by client.* *(b) All customer deposits have been excluded from revenue and booked as deposits.*

5.1-3 Related Parties

Paragraph	Requirement
	Related parties
50	**During the review, the practitioner shall remain alert for arrangements or information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the practitioner.**
51	**If the practitioner identifies significant transactions outside the entity's normal course of business in the course of performing the review, the practitioner shall inquire of management about:** **(a) The nature of those transactions;** **(b) Whether related parties could be involved; and** **(c) The business rationale (or lack thereof) of those transactions.**

Refer to Appendix A of this Guide for a definition of the term *related party*.

Many general purpose financial reporting frameworks require disclosure of information relating to related parties and, thus, generally provide a definition or discussion of related parties. Even in engagement circumstances where this is not the case, related party relationships and transactions with related parties are likely to be relevant to the review engagement. Thus, the practitioner would need to be aware of the existence of related parties in order to consider any potential impact on the financial statements.

Many related party transactions are in the normal course of business and carry no higher likelihood of a material misstatement than similar transactions with unrelated parties. In fact, in some countries, doing business with related parties is extensive and considered normal.

However, due to the nature of related party relationships and transactions, they can also easily be used to manipulate financial statement results or misappropriate entity assets. As part of ISRE 2400.48(b) (also addressed in Chapter 4), practitioners are required to make inquiries about the existence of related parties and related party transactions, including the purpose of those transactions.

The steps to address are outlined in the following exhibit.

Exhibit 5.1-3A

Procedure	Description
Inquire as to Management's Understanding of What Constitutes a Related Party	If the AFRF includes a definition or discussion of related parties, ensure management is aware of the definition and that it understands what it means in the context of the entity. If there is no definition in the AFRF, discuss the concept with management so that it understands the significance of related parties and related party transactions.
Ask for a Listing of Related Parties and Transactions	At the commencement of each engagement, discuss with management what related party relationships exist and then ask management to prepare a complete listing of related parties and transactions. Then, inquire about the purpose of those transactions.
Remain Alert for Undisclosed Transactions	Ensure the engagement team is aware of the list of related parties provided by management and request that they remain alert (when performing inquiries and analysis) for other previously undisclosed related party relationships or transactions.
Identify Significant Transactions outside the Entity's Normal Course of Business	When such transactions are identified, inquire of management about: (a) The nature of those transactions; (b) Whether related parties could be involved; and (c) The business rationale (or lack thereof) of those transactions.
Evaluate the Results	Document the findings and consider the need for: (a) Additional procedures to be performed if the financial statements could be materially misstated; and (b) Additional disclosures in the financial statements.
Obtain Written Representations	Request written representations from management that it has disclosed the identity of the entity's related parties and all the related party relationships and transactions of which it is aware.

Example

Chen Lee's company sells a range of tires for commercial delivery vehicles. His brother, Peng, sells automotive parts. There has been no history of transactions between the companies.

In performing his review procedures this year, Dong Chi (the practitioner) noted that a number of old tires (previously written down to net realizable value in the accounting records, since they were not a popular size and were over two years old) had been sold at full value. Dong made inquiries about this transaction and found the sale was made to one of Peng's subsidiary companies. This company was not previously disclosed as a related party, so Dong decided to perform some additional inquiries and procedures to identify any other undisclosed related parties.

Dong also asked for the business rationale behind the sale to Peng:
- Why would Peng pay full price for two-year-old tires that are not a popular size?
- What would Peng's company do with the tires, since the company was not set up to handle tire installations?

In addition to receiving satisfactory explanations to the questions outlined above, Dong also:
- Ensured the transactions (sale and receivable) were disclosed in accordance with the AFRF; and
- Obtained a written assurance from Chen that the sale to Peng was final and would not be reversed in the subsequent period.

5.1-4 Fraud and Noncompliance

Paragraph	Requirement
	Fraud and non-compliance with laws or regulations
52	**When there is an indication that fraud or noncompliance with laws or regulations, or suspected fraud or noncompliance with laws or regulations, has occurred in the entity, the practitioner shall:** **(a) Communicate that matter to the appropriate level of senior management or those charged with governance as appropriate;** **(b) Request management's assessment of the effect(s), if any, on the financial statements;** **(c) Consider the effect, if any, of management's assessment of the effects of fraud or noncompliance with laws or regulations communicated to the practitioner on the practitioner's conclusion on the financial statements and on the practitioner's report; and** **(d) Determine whether there is a responsibility to report the occurrence or suspicion of fraud or illegal acts to a party outside the entity. (Ref: Para. A92)**

As part of understanding the entity, ISRE 2400.48(d) (also addressed in Chapter 4) requires the practitioner to make inquiries about any actual, suspected, or alleged:

- Fraud or illegal acts affecting the entity; and
- Noncompliance with provisions of laws and regulations that directly affect material amounts and disclosures in the financial statements.

Exhibit 5.1-4A

Action	Description
Update the Understanding of the Entity	Any actual, suspected, or alleged fraud or illegal acts. Any instances of noncompliance with significant laws and regulations. If so, what are the financial reporting implications? Any dealings with a lawyer during the period to discuss any legal issues.
If Fraud or Noncompliance Has Occurred	Inquire about how it originated, what actions management or TCWG have taken or plan to take as a result, and their assessment of financial reporting implications.
Remain Alert	Question inconsistencies identified and investigate contradictory evidence with a skeptical attitude. Also question the reliability of responses to inquiries and other information obtained from management and TCWG.
Communicate	Communicate any actual, suspected, or alleged instances of fraud or noncompliance with the appropriate level of senior management or TCWG.
Request Management's Assessment	Request management's assessment of the effect(s), if any, on the financial statements and consider the implications for the conclusion on the financial statements and the wording of the practitioner's report.
Determine Whether There Is a Duty to Disclose	Determine whether there is a legal responsibility to report the occurrence or suspicion of fraud or illegal acts to a party outside the entity that would override the practitioner's (ethical) duty of confidentiality.
Determine Whether Any Legal Requirements Prevent the Practitioner from Discussing Matters	Determine whether there is any legal requirement not to discuss particular matters (e.g., money laundering laws may prevent "tipping off" those possibly involved in suspected cases) of which the practitioner may become aware during the review engagement.

Action	Description
Inquire about Litigation Claims and Instances of Noncompliance	Inquire about the existence of any litigation, claims, and noncompliance with laws and regulations during the period. Also consider whether the results of performing other procedures provide indications of litigation, claims, and noncompliance with laws and regulations. If there is no litigation or claims outstanding and management has not had extensive dealings with a lawyer during the period, there is usually no need to go any further (such as obtaining a legal letter). If there are outstanding issues that may have a material impact on the financial statements, consider the following: • Review minutes of meetings of TCWG; • Review correspondence between the entity and external legal counsel; • Review legal expense accounts; and • Review correspondence with relevant regulatory, licensing, and taxation authorities. Also consider asking management to contact the lawyer(s) with a request for a letter, to be sent directly to the practitioner, outlining the details of the litigation and an assessment of the outcome. Ensure that all litigation and claims that could have a material effect on the financial statements have been adequately disclosed in accordance with the AFRF.

When a fraud is suspected, there are no requirements for the practitioner to perform additional procedures to ascertain whether or not the fraud has occurred or the probability that fraud has occurred.

Consider Point

Where the practitioner identifies a misstatement that is indicative of fraud, the implications of such a misstatement in relation to other aspects of the engagement may need to be considered. For example, when there are indications of management fraud, the reliability of management representations and responses to the practitioner's inquiries may also need to be considered. The practitioner is also required to consider the effect, if any, on the practitioner's conclusion and report. Also refer to Chapter 6.

Example

In performing his inquiries, John (the practitioner) asked Maurice (the owner-manager of a local hotel) whether he was aware of any actual, suspected, or alleged fraud or illegal acts. Maurice disclosed that his staff members were recently shocked to discover that their highly trusted assistant accountant for the last 12 years had been stealing cash. She was immediately fired. The fraud came to light as a result of suspicions being aroused when sales from the restaurant, coffee shop, and coin laundry were all declining, but hotel occupancy rates were actually increasing.

An investigation by the chief accountant brought to light inconsistencies between the cash register tapes and the cash deposits. The employee had recorded all the credit card sales and room charges but then underreported the cash sales, which she took for herself. Subsequent interviews with restaurant employees also indicated that some high-value inventory items might have also gone missing.

The employee was confronted with the discrepancies and she quickly admitted to "borrowing" some of the funds due to a personal situation. However, she also admitted to having no means of repaying the amounts taken.

John asked about management's assessment of the effect of this fraud on the financial statements. Maurice responded that management is currently reviewing all of the cash register tapes, cash reconciliations, and bank deposits for the year. So far, over €74,000 in cash has been found to be missing. John's materiality for the financial statements as a whole is €50,000. Investigation into any missing inventory has not yet begun. As of the year end, the investigation continues. Maurice also indicated that new internal control procedures have been proposed by the chief accountant and that he would like John to review them.

The good news is that although the amount is material, it has not created a material uncertainty for the company, as their cash flow is still good. At this point, management has not determined whether to file charges against the employee or file a claim with the insurance company. John then discussed with Maurice whether this fraud has been reported to any parties outside the entity. Maurice indicated he had, somewhat reluctantly, informed his bank about the situation and the ongoing investigation. John considered both his legal and client confidentiality responsibilities and confirmed that, in the particular circumstances, there were no other parties outside the entity that would have to be informed.

Notwithstanding that the €74,000 in allegedly stolen cash was correctly accounted for and disclosed in the financial statements, John was of the opinion that he could neither conclude that a material misstatement did exist nor that the matter was unlikely to cause the financial statements as a whole to be materially misstated. Consequently, he would have to issue a disclaimer of conclusion on the financial statements unless the release of the statements could be delayed until the results of the investigation are final.

5.1-5 Going Concern

Paragraph	Requirement
	Going Concern
53	**A review of financial statements includes consideration of the entity's ability to continue as a going concern. In considering management's assessment of the entity's ability to continue as a going concern, the practitioner shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation where a longer period is specified.**
54	**If, during the performance of the review, the practitioner becomes aware of events or conditions that may cast significant doubt about the entity's ability to continue as a going concern, the practitioner shall: (Ref: Para. A93)** **(a) Inquire of management about plans for future actions affecting the entity's ability to continue as a going concern and about the feasibility of those plans, and also whether management believes the outcome of those plans will improve the situation regarding the entity's ability to continue as a going concern;** **(b) Evaluate the results of those inquiries, to consider whether management's responses provide a sufficient basis to:** **(i) Continue to present the financial statements on the going concern basis if the applicable financial reporting framework includes the assumption of an entity's continuance as a going concern; or** **(ii) Conclude whether the financial statements are materially misstated, or are otherwise misleading regarding the entity's ability to continue as a going concern; and** **(c) Consider management's responses in light of all relevant information of which the practitioner is aware as a result of the review.**

As part of understanding the entity, ISRE 2400.48(f) (also addressed in Chapter 4) requires the practitioner to make inquiries about going-concern uncertainties.

Most financial reporting frameworks require the use of the going-concern assumption in preparing the financial statements. The going-concern assumption assumes that the entity is able to realize its assets and discharge its liabilities during the normal course of operations over the short term, often 12 months after the reporting period. If there are serious doubts about the entity's ability to continue as a going concern, the statements should be presented on a liquidation basis, which could (for entities with inventory and property, plant, and equipment assets) result in a materially different valuation of assets and liabilities. For example, plant and equipment may only be worth a significantly lower percentage of their net book value if sold at auction.

Consider Point

Regardless of how well the entity appears to be performing, the practitioner is required, in every engagement, to inquire about the ability of the entity to continue as a going concern.

The period to be covered by this assessment is usually 12 months from the period end; however, first, check whether the AFRF or local laws/regulations specify a different period.

The steps involved in a going-concern assessment are outlined in the following exhibit.

Exhibit 5.1-5A

Action Step	Comments
1. Inquire about any events or conditions that cause doubt about going concern.	Make inquiries about management's assessment (if any) of the entity's ability to continue as a going concern. Then, remain alert during the review engagement for the occurrence of any event or condition (such as those listed in ISRE 2400.A93 and reproduced in Appendix F of this Guide) that may cast significant doubt about the entity's ability to continue as a going concern.
2. If the practitioner does not become aware of any uncertainties, no further work is required.	Document the results of the inquiries and that no further work is required.
3. If the practitioner becomes aware of uncertainties, make additional inquiries of management about its plans to address those uncertainties. [2400.54]	Inquire about: • Management's plan of action; • The feasibility of such a plan; and • Whether management believes the outcome of the plan will improve the situation. If management has not developed a plan, discuss the nature of the uncertainty and request that a plan of action be developed.
4. Evaluate and document the results of those inquiries.	Consider whether management's responses provide a sufficient basis to: • Continue to present the financial statements on the going-concern basis if the AFRF includes the assumption of an entity's continuance as a going concern; or • Conclude whether the financial statements are materially misstated, or are otherwise misleading, regarding the entity's ability to continue as a going concern. In such a case, the practitioner will need to consider the impact on the practitioner's report.
5. Consider management's responses in light of all other relevant information.	This includes the understanding obtained of the entity and the identified financial statement areas where material misstatements could arise.

In evaluating management's action plans in response to an uncertainty (such as those outlined in ISRE 2400.A93), consider whether the significance of such events or conditions can be mitigated by other factors. For example:

- If the entity is unable to make its normal debt repayments, could cash flow be generated by means such as disposing of assets, rescheduling loan repayments, or obtaining additional capital?
- Could the loss of a principal supplier be mitigated by a suitable alternative?
- Could temporary personnel be employed to cover the loss of key management personnel?

Consider Point

In some situations, there may be uncertainty about the entity's ability to continue as a going concern (even where management has a plan of action) that it is simply not possible to obtain the evidence necessary to form a conclusion about the appropriateness of management's use of the going-concern assumption in the preparation of the financial statements. In such situations, a disclaimer of conclusion would be required.

5.1-6 Reviews for Component Auditors

In some situations, a group auditor may request (pursuant to ISA 600.29) that a review engagement be performed in respect to a nonsignificant component of a group. When performing such a review, the component reviewer (practitioner) needs to be aware of certain group audit requirements, such as outlined below, that are contained in ISA 600.

Such requirements dictate how the practitioner and the group auditor relate to one another and how and what they will communicate with one another. Although these requirements are not dealt with in ISRE 2400 (Revised), practitioners who are engaged to perform review engagements within the context of a group audit will need to be aware of what the group auditor may request of them.

Exhibit 5.1-6A

Requirement	Commentary
Understand the Component Reviewer	Before the engagement can be performed, the group auditor will obtain information about the component reviewer to assess whether they can work together. This will involve various communications between the group auditor and the component reviewer to determine: • Whether the component reviewer understands, and will comply with, the relevant ethical requirements, including independence; • The component reviewer's professional competence; • Any involvement required by the group engagement team; and • The regulatory environment that actively oversees the work of the component reviewer.
Issue Group Instructions	The group auditor is required to provide instructions on a timely basis to the component practitioner that addresses matters such as: • The work to be performed, the use to be made of that work, and the form and content of the component reviewer's communication with the group engagement team. • Ethical requirements relevant to the group audit, including independence. • Materiality to be used for performing the review of the component. Note, however, that this does not override the requirements of ISRE 2400.43. • Identified significant risks of material misstatement of the group financial statements. • A listing of related parties prepared by group management. • Details of specific procedures to be performed, such as analysis of certain accounts, obtaining details of significant transactions, and intercompany reconciliations.

5.1-7 Other Matters

Accounting Estimates and Fair Values

As part of understanding the entity, ISRE 2400.48(a) requires the practitioner to make inquiries about accounting estimates and fair values.

Accounting estimates and fair values are further areas that are often used to manipulate financial statements in management estimates. This is particularly true if management bias causes estimates to be consistently at one end of a range of what would be reasonable or when a high degree of estimation uncertainty is involved.

The degree of estimation uncertainty is often greater in complex and larger entities than in less complex smaller and micro entities. Consequently, the less the degree of complexity in the entity being reviewed, the less work is required by the practitioner. For example, in a small entity, a customer may have agreed to pay for a large order in two installments, the second of which is not due for more than 12 months. If management is doubtful about receiving the second installment in its entirety, a simple estimate for a bad debt provision on the second installment is all that would be required.

ISRE 2400 (Revised) does not prescribe detailed requirements in regard to accounting estimates and fair values. However, in reviewing management estimates, the practitioner may need to consider the following.

Exhibit 5.1-7A

Action	Description
Identify Applicable Estimates	Based on the understanding of the entity already obtained, inquire about those transactions, events, and conditions that could give rise to material misstatements in the accounting estimates.
Understand the Basis of Calculation	Through inquiry, obtain an understanding of the measurement techniques used and the significant drivers (interest rates, commodity prices, etc.) that affect estimates and the assumptions used. Also inquire about: • Whether management used an expert to develop estimates; • Changes or trends in the current period that impact the drivers identified above; and • The existence of supporting information, assumptions, and calculations.
Analyze the Entity's History of Making Estimates	Perform analytical procedures to assess the accuracy of previous estimates by comparing the outcome of prior period estimates (and fair values) with actual results.
Review the Results of the Calculations	Consider whether to review the calculations and assumptions used to prepare the current estimates. Consider: • Magnitude of the accounting estimates; • Accuracy of preparation; • Consistency with prior period estimates (inquire about differences); and • Indicators of possible management bias or employee fraud.

Work Performed by Others

Paragraph	Requirement
	Use of work performed by others
55	**In performing the review, it may be necessary for the practitioner to use work performed by other practitioners, or the work of an individual or organization possessing expertise in a field other than accounting or assurance. If the practitioner uses work performed by another practitioner or an expert in the course of performing the review, the practitioner shall take appropriate steps to be satisfied for the practitioner's purposes. (Ref: Para. A80)**

ISRE 2400 (Revised) does not prescribe detailed requirements as to the steps the practitioner is required to take to be satisfied with the adequacy of the work performed. However, if, in the professional judgment of the practitioner, expertise in a field other than accounting or assurance is necessary, the following matters may need to be addressed.

Exhibit 5.1-7B

Action	Description
Determine the Work Required and Its Significance to the Review Engagement	Based on professional judgment, determine the nature, timing, and scope of the expert's work and consider: • The likelihood of a material misstatement in the matter to which that expert's work relates; • The significance of the expert's work in the context of the review engagement; • The practitioner's knowledge of, and experience with, previous work performed by that expert; and • Whether the expert is subject to some appropriate quality control policies and procedures.
Evaluate Competence	Evaluate whether the expert has the necessary competence, capabilities, and objectivity required. The practitioner should also consider whether they have a sufficient understanding of the field of expertise to evaluate the adequacy of the work performed.
Obtain Agreement	Agree on the following matters with the expert: • Respective roles and responsibilities; and • The form and content of the communication required from the expert.
Review the Adequacy of the Work Performed	Review the adequacy of the expert's work for the practitioner's purposes, including the relevance and reasonableness of the expert's assumptions, methods, findings, conclusions, and their consistency with the practitioner's understanding of the entity.

Reconciling Financial Statements to Underlying Accounting Records

Paragraph	Requirement
	Reconciling the Financial Statements to the Underlying Accounting Records
56	**The practitioner shall obtain evidence that the financial statements agree with, or reconcile to, the entity's underlying accounting records. (Ref: Para. A94)**

Evidence that the financial statements agree with, or reconcile to, the underlying accounting records can be obtained by agreeing the financial statement amounts and balances to:

- The relevant accounting records, such as the general ledger; or
- A summary record or schedule, such as a trial balance.

5.1-8 Additional Procedures

Paragraph	Requirement
	Additional Procedures When the Practitioner Becomes Aware that the Financial Statements May Be Materially Misstated
57	**If the practitioner becomes aware of a matter(s) that causes the practitioner to believe the financial statements may be materially misstated, the practitioner shall design and perform additional procedures sufficient to enable the practitioner to: (Ref: Para. A95–A99)** **(a) Conclude that the matter(s) is not likely to cause the financial statements as a whole to be materially misstated; or** **(b) Determine that the matter(s) causes the financial statements as a whole to be materially misstated.**

In every review engagement, the practitioner is required to primarily perform inquiry and analytical procedures relating to financial statement areas:

- That are material in relation to the financial statements as a whole, including disclosures; and
- Where material misstatements are likely to arise.

The identification of such areas is based on the understanding of the entity obtained by the practitioner.

If sufficient appropriate evidence is obtained from performing these procedures, then no additional procedures are required.

However, when performing these procedures, the practitioner may become aware of a matter(s) that causes the practitioner to believe the financial statements may be materially misstated. When such a situation arises, ISRE 2400.57 requires the practitioner to design and perform additional procedures until such time that the practitioner can confirm either that the financial statements are materially misstated or that the matter(s) is not likely to cause the financial statements as a whole to be materially misstated.

For example, when inquiring about inventory cutoff, it becomes evident that certain shipments of goods in the current period may actually have been recorded in the accounting records for the subsequent period. Should the wrongful recording of these shipments cause the practitioner to believe that the financial statements may be materially misstated, additional procedures will be required.

The nature and extent of the additional procedures will vary, depending on the circumstances, and are matters for the practitioner's professional judgment. Additional procedures could consist of:

- Additional inquiry or analytical procedures focused on the particular matter. In the inventory example outlined above, additional inquiries could be made about the shipping dates of orders around the year end and when they were recorded in the accounting record.
- Other procedures (such as substantive tests of details or external confirmations) that will provide evidence regarding the matter.

Considerations in determining the nature, timing, and extent of additional procedures include:

- Information obtained from procedures already performed;
- Understanding of the entity as updated through the engagement to date; and
- The persuasiveness of the evidence needed to address the matter.

The following exhibit, taken from ISRE 2400.A99, demonstrates how the practitioner becomes aware of a matter requiring additional procedures to be performed.

Exhibit 5.1-8A

Need for Additional Procedures

In the course of performing inquiry and analytical procedures, the practitioner's analysis of accounts receivable (A/R) shows a material amount of past due A/R for which there is no allowance for bad or doubtful debts.

Consequence
Practitioner becomes aware that the A/R balance in the F/S may be materially misstated.

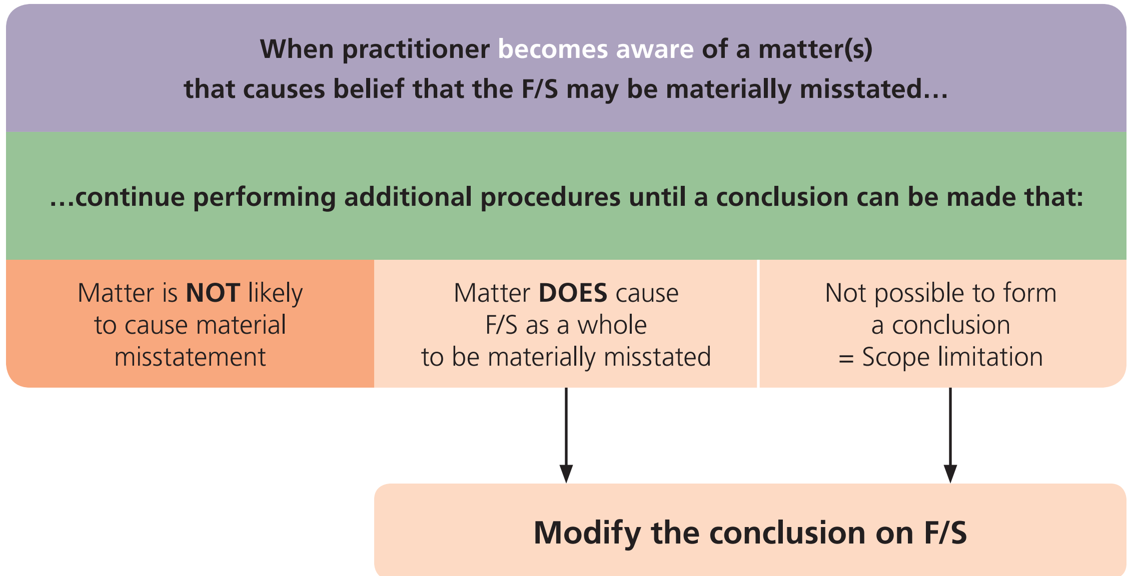
Action required
Additional inquiries of management about whether there are uncollectible A/R balances that would need to be shown as impaired.

Practitioner evaluates management's response to the additional inquiries

Result of additional inquiries	Conclusion reached
A. A/R balance is not likely to be materially misstated.	No further procedures are required.
B. Practitioner determines that the matter causes the F/S to be materially misstated.	No further procedures are required. Conclusion is formed that the financial statements as a whole are materially misstated.
C. A/R balance is likely to be materially misstated, while not providing sufficient appropriate evidence to determine that it is, in fact, misstated.	Continue performing additional procedures (such as requesting an analysis of amounts received after the balance sheet date to identify uncollectible accounts receivable) until the conclusion in either Points A or B is reached.

If it is not possible to either conclude that the matter is not likely to cause the F/S as a whole to be materially misstated or to determine that the matter does cause the F/S as a whole to be materially misstated, then a scope limitation exists and the practitioner is not able to form an unmodified conclusion on the F/S.

Exhibit 5.1-8B



Consider Point

Contradictory Information

Exercising professional skepticism means avoiding the temptation to ignore or rationalize contradictory or inconsistent information on the basis that the amounts involved are not material. Fraud, in particular, is generally discovered by following up on small and unusual patterns, exceptions, and oddities. If you have any reason to doubt the information being provided, ask more questions and review supporting information rather than accepting management's explanations at face value.

Examples of Additional Procedures

The exhibit below outlines some possible areas of concern that might have caused the practitioner to believe the financial statements may be materially misstated and provides examples of additional procedures that could be performed in the circumstances. Actual procedures selected should address the specific circumstances of the client and the use of professional judgment.

Note that after completing each additional procedure, the practitioner should step back and consider whether the new information obtained either confirms or dismisses the concern that a material misstatement might exist in the financial statements. If the result of performing the procedure confirms or dismisses the cause for concern, then no further procedures would be necessary. If not, the practitioner should move on to the next procedure.

Exhibit 5.1-8C

Excessive Inventory Provisions	
Cause for Concern	**Potential Material Misstatement in Financial Statements**
Sales manager indicated there were no inventory items selling poorly. Management seemed evasive on its reasons for making provisions on specific stock items. The managing director has indicated in the past that she wants to minimize their tax bill and be prepared for bad times ahead.	The provision recorded for slow-moving and obsolete inventory could be much higher than actually required.

Excessive Inventory Provisions	
Examples of Additional Procedures	**Issue resolved? *If yes, stop.***
Identify any new developments (e.g., new technologies, innovations, or competitor products) that could make a particular stock item obsolete.	
Physically inspect the condition of stock items (subject to provisions).	
Inquire about any discounts, promotions, or price decreases on the inventory items subject to provision.	
Review sales, after period end, of the inventory subject to provision. If sales have been made, consider the volume size and the discount terms.	
Review the movements (in and out) of the inventory in question. For example, recent purchases of the inventory would indicate that no provision was necessary at period end.	
Review the actual outcome of similar provisions made in previous periods.	

Improper Sales Cutoff	
Cause for Concern	**Potential Material Misstatement in Financial Statements**
In reviewing subsequent events, we noted a sharp increase in sales that occurred in the month following the period end. Management has no particular explanation for this increase other than that it was a good sales month.	Understatement of sales. It is possible that some sales in the period subsequent to the period-end date should have been recorded in the current period (a possible cutoff error).
Examples of Additional Procedures	**Issue resolved? *If yes, stop.***
Review the adequacy of the entity's cutoff policies/procedures and its application.	
Review some larger sales invoices after period end to determine whether they are recorded in the correct period.	
Consider whether related party transactions could be involved or whether any evidence exists of management override of controls.	

Unusual Gross Margins	
Cause for Concern	**Potential Material Misstatement in Financial Statements**
Gross operating margins vary considerably from prior periods and industry norms. Management has not supplied any particular explanation for this variation.	Sales or expenses could be overstated/understated, or some income/expenditures may be incorrectly recorded in the accounting records.
Examples of Additional Procedures	**Issue resolved? *If yes, stop.***
Identify relationships with other accounts, such as inventory turnover, purchases, and accounts receivable, to determine whether similar variations to expectations exist.	
If the gross margin has increased, look for any missing expense accounts.	
If the gross margin has dropped, consider the possibility of unrecorded sales.	
Inquire about heavily discounted sales or purchases of materials at higher than normal prices.	
Inquire about the consistent application of revenue recognition policies and the accuracy of the year-end cutoff.	

Unusual Gross Margins	
Examples of Additional Procedures	**Issue resolved?** ***If yes, stop.***
Compare each account making up the margin to the prior year for individual variances and then analyze the accounts accordingly.	
Use available information on the industry to compare to the various accounts. If you have another client in the same industry, compare each type of account as a percentage of sales.	

Uncertain Valuation of Investments	
Cause for Concern	**Potential Material Misstatement in Financial Statements**
There is no conclusive evidence to support the recorded value of a number of securities that have not traded for some months. There is a large spread between the bid and ask price on these securities.	The recorded value of investments could be overstated, requiring a write-down for impairment.
Examples of Additional Procedures	**Issue resolved?** ***If yes, stop.***
Ask management to obtain the most recent financial statements and any recent news events that might indicate impairment of investments.	
Consider using an outside expert to assist in providing an objective valuation of the investments.	

Fictitious Sales	
Cause for Concern	**Potential Material Misstatement in Financial Statements**
The entity is very close to breaking bank covenants. A number of credit notes relating to sales made just prior to year end were issued immediately following year end. Some slow-moving and written-down inventory was unexpectedly sold just before year end.	Sales are overstated and provisions on slow-moving inventory, which serve to increase profits and prevent a violation of bank covenant agreements, may have been removed.
Examples of Additional Procedures	**Issue resolved?** ***If yes, stop.***
Review the history of credit notes being issued during the year to determine whether credit notes issued after year end are unusual in any way.	
Review a sample of the actual credit notes issued after year end and review the underlying reasons.	
Ascertain the actual existence of the customers being issued credit notes and whether the entities could be related parties.	
Determine whether other credit notes issued relate to sales of slow-moving inventory.	
Determine if the invoices for unexpected sales of slow-moving inventory have subsequently been paid.	
Review any other large unexpected sales of slow-moving inventory near the year end.	

Additional Procedures Requested by Management

In some circumstances, additional procedures, such as accounts receivable circularization or attendance at inventory counts, may be performed at the request of management or TCWG. Such procedures are "agreed upon procedures," which do not generally form part of the review engagement. It is advisable to ensure that this is clear to management.

When this occurs:

- Document the reasons for performing such additional procedures in the working papers and refer to them in the engagement letter; and
- Agree with management or TCWG on whether preparing a separate report outlining the results of performing the additional procedures is required.

5.1-9 Subsequent Events

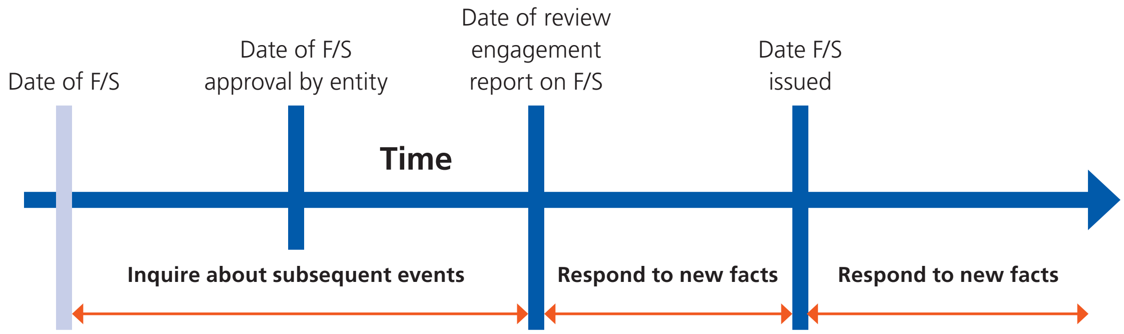
Paragraph	Requirement
	Subsequent Events
58	**If the practitioner becomes aware of events occurring between the date of the financial statements and the date of the practitioner's report that require adjustment of, or disclosure in, the financial statements, the practitioner shall request management to correct those misstatements.**
59	**The practitioner has no obligation to perform any procedures regarding the financial statements after the date of the practitioner's report. However, if, after the date of the practitioner's report but before the date the financial statements are issued, a fact becomes known to the practitioner that, had it been known to the practitioner at the date of the practitioner's report, may have caused the practitioner to amend the report, the practitioner shall:** **(a) Discuss the matter with management or those charged with governance, as appropriate;** **(b) Determine whether the financial statements need amendment; and** **(c) If so, inquire how management intends to address the matter in the financial statements.**
60	**If management does not amend the financial statements in circumstances where the practitioner believes they need to be amended, and the practitioner's report has already been provided to the entity, the practitioner shall notify management and those charged with governance not to issue the financial statements to third parties before the necessary amendments have been made. If the financial statements are nevertheless subsequently issued without the necessary amendments, the practitioner shall take appropriate action to seek to prevent reliance on the practitioner's report.**

Subsequent events refer to:

- Events occurring between the date of the financial statements and the date of the practitioner's report on the financial statements;
- Facts that become known to the practitioner after the date of the review engagement report but before the report is issued; and
- Facts that become known after the report is issued for use by third parties.

This is illustrated in the following exhibit.

Exhibit 5.1-9A



While ISRE 2400 (Revised) does not require the practitioner to actively search for subsequent events during a review engagement, ISRE 2400.48(e) does require the practitioner to make certain inquiries of management about events occurring between the date of the financial statements and the date of the practitioner's report.

Exhibit 5.1-9B

Procedure	Description
Inquire About Subsequent Events up to the Report Date	Inquire whether management has identified and addressed events occurring between the date of the financial statements and the date of the practitioner's report that require adjustment of, or disclosure in, the financial statements. Matters such as the following could be considered: • New commitments, borrowings, or guarantees; • Sales or acquisitions of assets that have occurred or are planned; • Increases in capital or issuance of debt instruments; • Agreements to merge or liquidate; • Assets that have been appropriated by government or destroyed; • Litigation, claims, and contingencies; • Any unusual accounting adjustments made or contemplated; • Any events that cast doubt on the appropriateness of the going-concern assumption or other accounting policies; • Any events affecting the measurement of estimates or provisions in the financial statements; and • Any events relevant to the recoverability of assets. If the practitioner becomes aware of a matter that indicates there may be a material misstatement in the financial statements, additional procedures could include: • Reading minutes of meetings (management and TCWG) held after the date of the financial statements or inquiring about matters discussed at meetings for which minutes are not available; • Reading any financial reports produced after the period end; and • Reviewing recent correspondence from legal counsel.

Procedure	Description
Practitioner Becomes Aware of New Facts After the Report Has Been Dated	*Note that there is no obligation to perform any procedures regarding the financial statements after the date of the practitioner's report.* Discuss the matter with management (and, where applicable, TCWG). Determine whether financial statements require amendment and, if so: • Inquire about how management intends to address the matter. If management does not amend the financial statements, consider the need for a modified conclusion. • Where possible, request that management not release the report until amendments have been made. If the report is released despite this request, take appropriate action (after consulting with legal counsel) to prevent inappropriate reliance on the report. • Consider the need for any additional procedures, such as inquiries about other subsequent events. • Issue a new conclusion on the amended financial statements. • Consider whether legal advice should be obtained. If the review engagement report has already been released, in addition to the steps above: • Review management's actions to ensure anyone in receipt of the previously issued financial statements and report have been informed of the situation. • Consider whether legal advice should be obtained.

5.1-10 Written Representations

Paragraph	Requirement
	Written Representations
61	**The practitioner shall request management to provide a written representation that management has fulfilled its responsibilities described in the agreed terms of engagement. The written representation shall include that: (Ref: Para. A100–A102)** **(a) Management has fulfilled its responsibility for the preparation of financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, and has provided the practitioner with all relevant information and access to information as agreed in the terms of the engagement; and** **(b) All transactions have been recorded and are reflected in the financial statements.** **If law or regulation requires management to make written public statements about its responsibilities, and the practitioner determines that such statements provide some or all of the representations required by subparagraphs (a)–(b), the relevant matters covered by such statements need not be included in the written representation.**
62	**The practitioner shall also request management's written representations that management has disclosed to the practitioner: (Ref: Para. A101)** **(a) The identity of the entity's related parties and all the related party relationships and transactions of which management is aware;** **(b) Significant facts relating to any frauds or suspected frauds known to management that may have affected the entity;** **(c) Known actual or possible noncompliance with laws and regulations for which the effects of noncompliance affect the entity's financial statements;** **(d) All information relevant to use of the going-concern assumption in the financial statements;** **(e) That all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure, have been adjusted or disclosed;** **(f) Material commitments, contractual obligations or contingencies that have affected or may affect the entity's financial statements, including disclosures; and** **(g) Material non-monetary transactions or transactions for no consideration undertaken by the entity in the financial reporting period under consideration.**

Paragraph	Requirement
63	**If management does not provide one or more of the requested written representations, the practitioner shall: (Ref: Para. A100)** **(a) Discuss the matter with management and those charged with governance, as appropriate;** **(b) Re-evaluate the integrity of management, and evaluate the effect that this may have on the reliability of representations (oral or written) and evidence in general; and** **(c) Take appropriate actions, including determining the possible effect on the conclusion in the practitioner's report in accordance with this ISRE.**
64	**The practitioner shall disclaim a conclusion on the financial statements, or withdraw from the engagement if withdrawal is possible under applicable law or regulation, as appropriate, if:** **(a) The practitioner concludes that there is sufficient doubt about the integrity of management such that the written representations are not reliable; or** **(b) Management does not provide the required representations required by paragraph 61.**
	Date of and Period(s) Covered by Written Representations
65	**The date of the written representations shall be as near as practicable to, but not after, the date of the practitioner's report. The written representations shall be for all financial statements and period(s) referred to in the practitioner's report.**

The representation document will state that management has fulfilled its responsibilities described in the agreed terms of engagement, confirm important representations made during the engagement, and assert that the information provided was complete (i.e., no missing transactions or concealed events). If management modifies, or does not provide, the requested written representations, it may alert the practitioner to the possibility that one or more significant issues exist.

During the course of the engagement, management will make a number of oral representations (such as the sufficiency of the provision made for bad debts or the absence of any litigation against the entity) in response to the various inquiries and analysis. If, in addition to the representations required by the standard, the practitioner determines that it is necessary to obtain one or more written representations to support other review evidence relevant to the financial statements, then the practitioner can consider requesting these of management or TCWG in the letter of representation or a separate letter.

Written management representations are not to be used as a substitute for performing inquiry and analysis on material financial statement areas or areas where there is a likelihood of material misstatement in the financial statements.

Written representations are obtained as near as practicable to, but not after, the date of the report on the financial statements. Written representations would cover all financial statements and period(s) referred to in the review engagement report.

Factors to consider are included in the following exhibit.

Exhibit 5.1-10A

Letter of Representation	
Format	Written representations are addressed to the practitioner, usually in the form of a letter.
Materiality	Discuss with management the relevance of materiality to the required written representations. Indicate that materiality will not apply to certain representations (such as fraud, noncompliance with laws and regulations, completeness of information provided, and presentation of the financial statements).
Content	Written representations, such as outlined in ISRE 2400.61-62. Also refer to Appendix H, which contains a sample letter of representations.
Effective Date	As of, or just before, the date of the review engagement report.
Signatures	Typically, the chief executive officer and the chief financial officer (or equivalent positions within the entity) sign the letter. In some situations, the practitioner may also wish to obtain specific written representations from other individuals, such as another member of the management team or a director.

Letter of Representation	
If Management Refuses to Sign	(a) Discuss the matter with management and TCWG. (b) Reevaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and evidence in general. (c) Take appropriate actions, including determining the possible effect on the conclusion in the practitioner's report.

Notes:

- If a local law or regulation already requires management to make written public statements about its responsibilities (that are very similar to the representations such as outlined above), such statements need not be obtained again in the written representations. However, an expression of management's responsibilities in law or regulation is not a substitute for the requested written representations, as it would not contain sufficient information for the auditor to be satisfied that all the necessary representations have been consciously made.
- The use of qualifying language, such as "the representations are made to the best of management's knowledge and belief," is acceptable as long as the individual signing has the appropriate responsibility and knowledge about the subject matter of the representations.

Please refer to Appendix H for an example of written representations from management.

Consider Point

Consider the need (possibly required in certain jurisdictions) to have TCWG sign specific written representations. This would be based on the precise responsibilities of TCWG.

5.2 EVALUATE EVIDENCE OBTAINED

Paragraph	Requirement
	Evaluating Evidence Obtained from the Procedures Performed
66	**The practitioner shall evaluate whether sufficient appropriate evidence has been obtained from the procedures performed and, if not, the practitioner shall perform other procedures judged by the practitioner to be necessary in the circumstances to be able to form a conclusion on the financial statements. (Ref: Para. A103)**
67	**If the practitioner is not able to obtain sufficient appropriate evidence to form a conclusion, the practitioner shall discuss with management and those charged with governance, as appropriate, the effects such limitations have on the scope of the review. (Ref: Para. A104–A105)**
	Evaluating the Effect on the Practitioner's Report
68	**The practitioner shall evaluate the evidence obtained from the procedures performed to determine the effect on the practitioner's report. (Ref: Para. A103)**

5.2-1 Supervision and Review

ISRE 2400.25(b) states that the engagement partner is responsible for the direction, supervision, planning, and performance of the review engagement in compliance with professional standards and applicable legal and regulatory requirements.

To ensure that work performed is in compliance with professional standards, firms are required to design and develop quality control policies and procedures that require that the work of less experienced engagement team members be supervised and reviewed by a more experienced engagement team member. Refer to ISQC 1.33.

In an SMP environment, a sole practitioner may be working alone rather than as part of a team. In such circumstances, this requirement would not be relevant. For more information, please refer to IAASB's *Staff Questions & Answers—Applying ISQC 1 Proportionately with the Nature and Size of a Firm*.

Exhibit 5.2-1A

Characteristics of Supervision and Review	Work is performed in accordance with professional standards and other applicable requirements.
	Significant matters are raised for further consideration.
	Appropriate consultations have taken place and the resulting conclusions are documented and implemented.
	Nature, timing, and extent of work performed has been documented and appropriately revised where necessary.
	Work performed supports the conclusions reached and is appropriately documented.
	Evidence obtained is sufficient and appropriate to support the report.
	Objectives of procedures performed have been achieved.
	Sufficient appropriate evidence has been obtained as a basis for the conclusion on the financial statements.
Engagement Quality Control Review	An EQCR, if required, provides an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report. It is unlikely that many review engagements in the SME context will require an EQCR. However, firms should develop suitable criteria (refer to ISQC 1.35) outlining the type of review engagements that would require an EQCR. Examples could include: • Entities above a certain size; • Entities with a large number of financial statement users; • Entities with a high public profile; • Entities with highly complex transactions; • Entities with unusual or controversial accounting policies; and • Entities that operate in an industry unknown to the practitioner.

ISQC 1 does not define the types of working paper review other than the EQCR. For many lower-risk review engagements, the practitioner may well perform the work and then review the work performed.

5.2-2 Has Sufficient Appropriate Evidence Been Obtained?

After completing the review engagement procedures, the practitioner shall evaluate whether sufficient appropriate evidence has been obtained and if not, the practitioner shall perform other procedures judged to be necessary in the circumstances.

Some of the matters to consider are outlined in the following exhibit.

Exhibit 5.2-2A

Consider	Action Required
Materiality	Consider whether the materiality amount determined at the start of the engagement should be revised in light of information subsequently obtained. Then, when evaluating the results of the procedures performed, consider whether there are any matters identified that would cause the financial statements to be materially misstated. If so, additional evidence is required.
Unexpected Results or Inconsistencies	Apply professional skepticism in evaluating the responses and information provided by management. If the information obtained from inquiries does not correspond to the understanding of the entity, is unusual, or conflicts with expectations developed when performing analytical review procedures, consider what additional procedures will be required to either confirm or dispel the concern that a material misstatement could exist in the financial statements.

Consider	Action Required
Identified Misstatements	Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. With this context in mind, identify any uncorrected misstatements from the previous period and consider the impact on the current period. When misstatements are identified in the current period (such as clerical errors, wrong assumptions used in estimates, and misapplication of accounting policies), they can be accumulated (ideally, on a single working paper), and the nature and circumstances of their occurrence considered. If the practitioner becomes aware of further misstatements that could ultimately result in the financial statements being materially misstated, then additional procedures would be required. Consider the implication of any uncorrected misstatements. Management may be asked to correct misstatements as they are identified or at the end of the engagement. If management refuses to correct some or all of the misstatements, obtain an understanding of management's reasons and consider the implications for the conclusion on the financial statements.
Appropriateness of Procedures Performed	In light of the information now available, did the procedures performed provide the evidence anticipated, and were appropriate assumptions used to determine their nature, timing, and extent? If not, additional procedures judged to be necessary in the circumstances would be required.
Documentation Obtained and Conclusions Drawn	Have the results of the procedures been properly documented, and were the conclusions drawn appropriate in the circumstances? Ensure that: (a) The evidence obtained from the procedures is sufficient to support the conclusions reached and there is no over-generalizing (i.e., ignoring a number of small discrepancies identified); (b) Unusual circumstances have not been overlooked; and (c) The appropriate conclusions were drawn.
Effect on Report	The final step in the evaluation process is to determine the effect on the findings and the sufficiency of the evidence obtained on the review engagement report.

In some situations, performing a particular planned procedure will not be possible. For example, a significant member of management might have been away at the time of the review or certain records might not be available. Inability to perform a specific procedure does not constitute a limitation on the scope of the review, provided it was possible to obtain sufficient appropriate evidence by performing other procedures.

Insufficient Evidence

If it is not possible to obtain sufficient appropriate evidence to form a conclusion, the practitioner is required to discuss with management and TCWG (as appropriate):
(a) The nature of, and reasons for, the limitations; and
(b) The effects of such limitations on the scope of the review and the conclusion.

Consider Point

Misstatements

Most quantitative misstatements can be aggregated so that the overall impact on the financial statements can be evaluated. However, some misstatements (such as incomplete or inaccurate financial statement disclosures) and qualitative findings (such as the possible existence of fraud) cannot be aggregated. These misstatements shall be documented and evaluated on an individual basis. However, their impact on the financial statements as a whole should also be assessed when performing the overall review.

5.3 REVIEW DOCUMENTATION

Paragraph	Requirement
	Documentation
93	**The preparation of documentation for the review provides evidence that the review was performed in accordance with this ISRE, and legal and regulatory requirements where relevant, and a sufficient and appropriate record of the basis for the practitioner's report. The practitioner shall document the following aspects of the engagement in a timely manner, sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand: (Ref: Para. A145)** **(a) The nature, timing, and extent of the procedures performed to comply with this ISRE and applicable legal and regulatory requirements;** **(b) Results obtained from the procedures, and the practitioner's conclusions formed on the basis of those results; and** **(c) Significant matters arising during the engagement, the practitioner's conclusions reached thereon, and significant professional judgments made in reaching those conclusions.**
94	**In documenting the nature, timing and extent of procedures performed as required in this ISRE, the practitioner shall record:** **(a) Who performed the work and the date such work was completed; and** **(b) Who reviewed the work performed for the purpose of quality control for the engagement, and the date and extent of the review.**
95	**The practitioner shall also document discussions with management, those charged with governance, and others as relevant to the performance of the review of significant matters arising during the engagement, including the nature of those matters.**
96	**If, in the course of the engagement, the practitioner identified information that is inconsistent with the practitioner's findings regarding significant matters affecting the financial statements, the practitioner shall document how the inconsistency was addressed.**

5.3-1 Documentation

The basic principles to consider when preparing file documentation are to ensure it is:
- Well organized (ideally, use some form of standard file indexing);
- Cross-referenced;
- Clear and concise; and
- Stands alone so that no additional verbal explanations are required to understand:
  - The procedures performed,
  - The results of the procedures and conclusions drawn therefrom as well as any significant matters encountered, and
  - How conclusions on significant matters were reached and the significant professional judgments made in reaching those conclusions.

File documentation provides the evidence that:
- The engagement preconditions were met;
- The engagement was appropriately planned, including the determination of materiality;
- An understanding of the entity was obtained, including identification of areas where material misstatements were likely to arise;
- Review procedures were, in fact, performed and the results were obtained (along with supporting evidence reviewed and appropriate conclusions drawn);
- Significant matters arising and conclusion reached during the engagement have been appropriately addressed. This includes how the significant professional judgments were made in reaching those conclusions; and
- The limited assurance conclusion on the financial statements as a whole was appropriate based on the evidence obtained.

The requirement for file completeness in ISRE 2400.93 is for an experienced practitioner, having no previous connection with the engagement, to review the file and understand the work performed, significant matters arising, and conclusions reached.

Refer to the examples of review documentation in Section 5.1 of this chapter.

Consider Point

Use of Checklists

Always take the time necessary to tailor the review procedures to the specific circumstances of the entity being reviewed. Remember that initial inquiry and analytical procedures only need to address areas where material misstatements are likely to arise or that are considered material to the financial statements as a whole.

Some firms use standard checklists to ensure all areas of the financial statements are thoroughly addressed. However, this can result in performing too much work. Not all the inquiries/analysis on a standard checklist will necessarily apply to every engagement. However, checklists may be useful in some circumstances, particularly when a checklist serves to ensure that the practitioner has not overlooked a specific aspect.

It is recommended that procedures relating to immaterial areas are removed along with standardized inquiries that do not address the areas where material misstatements are likely to arise. However, consider adding relevant procedures to areas where material misstatements are likely to arise.

Another point to watch for when using checklists is not just to document that an inquiry was made but to provide appropriate details about the actual response received.

The precise extent and style of file documentation is ultimately a matter for professional judgment but may include the points outlined in the following exhibit.

Exhibit 5.3-1A

Information Prepared by the Practitioner	
Preparation	• The nature of the engagement to be performed and the time frames, etc. • An assessment of independence and engagement risk. • A signed engagement letter.
Understanding the Entity	• The AFRF that will be used. • Information on the four specified areas of understanding required in ISRE 2400 (Revised).
Planning	• Determination of what would be material. • Identification of financial statement areas that are material. • Identification of areas where material misstatements are likely to arise in the financial statements. • Listings of planned inquiries and analytical procedures. • Planning memos or other similar documentation.
Work Performed	• Results obtained from the procedures and the practitioner's conclusions on the basis of those results. This would include: (a) Who performed the work and the date on which the work was completed; (b) Names of the entity personnel interviewed and the interview date; (c) Details of what was discussed, significant matters arising, and the nature of those matters; (d) Results from applying analytical procedures, including: ○ The information used, ○ The explanations provided for variances and unusual items, and ○ Evaluation of the findings in light of other information, such as the understanding of the entity; and (e) Listing of the additional procedures performed as considered necessary in the circumstances. • Listing of identified misstatements and whether or not the misstatements have been corrected. • Any unusual matters considered during the performance of the review, including the disposition of such matters.

Information Prepared by the Practitioner	
Conclusions and Reporting	• The nature, timing, and extent of the procedures performed to comply with ISRE 2400 (Revised) and applicable legal and regulatory requirements. • Significant matters discussed with management and TCWG. • Significant matters arising during the engagement, including the nature of those matters, how conclusions on those matters were reached, and significant professional judgments made in reaching those conclusions. • Who reviewed the work performed for the purpose of quality control for the engagement and the date and extent of the review. • Conclusions reached on the results of the procedures performed and the wording of the review engagement report. • A signed letter of representation from management.

File Organization

There is no prescribed method for organizing engagement files. However, many firms prepare a new engagement file for each period being reviewed and keep a permanent file for reference material that is updated as required. Depending on the circumstances of the engagement, the contents of an engagement file could be organized as outlined in the following exhibit.

Exhibit 5.3-1B

File Type	Typical Contents
Permanent	Understanding obtained of the entity (updated each period).
	Key policies and procedures that affect financial reporting.
	Organization charts.
	Relevant policies, procedures, and other documents, such as inventory count instructions, cutoff procedures, and estimate preparation.
	Continuity schedules for areas such as property, plant, and equipment as well as retained earnings.
	Profit sharing and management agreements.
	Royalty and lease agreements.
	Special correspondence with management.
	Share issues and incorporation documents.
	Relevant corporate records (such as letters patent, bylaws, reorganization information, and shareholders' registers).
Current Period	Reconciliation or agreement of the financial statements with the underlying records.
	Planning memos, etc.
	Inquiries and analysis relating to: • Updating the understanding of the entity; • Material asset, liability, and equity balances; • Areas identified where a material misstatement is likely; and • Revenue and expenses.
	Written management representations.
	File completion documents (e.g., checklists).
	Other correspondence with the client, including engagement letters, review engagement findings, and any recommendations regarding matters such as deficiencies in the client's system of internal control.
	Details of who performed the work on each document on file, the date such work was completed, who reviewed the work performed (for the purpose of quality control), and the date and extent of the review.
	Financial reporting checklists (to ensure appropriate presentation and disclosure in the financial statements).
	Financial statements and review engagement conclusion.

5.3-2 File Assembly

ISQC 1 requires firms to establish time limits that reflect the need to complete the assembly of final engagement files on a timely basis. For example, the time limit for final assembly could be established as 60 days after the date of the engagement report.

Consider Point

The time allowed for final assembly is limited to administrative matters only. It does not relate to any extra time needed for obtaining and documenting the sufficient and appropriate evidence required. Evidence required to support the review engagement report must always be obtained before the report is dated and issued.

6 REPORTING

Accepting → Planning → Performing → Reporting

CHAPTER CONTENT

- How to form an appropriate conclusion on the financial statements as a whole.
- Understanding the elements of the review engagement report.
- How to modify the standard wording when necessary.

6.1 Forming an Appropriate Conclusion 2400.69-71, 95-96	**6.2 Wording of the Report** 2400.72-74, 86-92	**6.3 Modified Conclusions** 2400.75-85
6.1-1 Evaluate Financial Statement Presentation	6.2-1 Report Elements	6.3-1 Circumstances Requiring a Modified Conclusion
6.1-2 Evaluate Identified Misstatements	6.2-2 Emphasis of Matter	6.3-2 The Three Modified Conclusions
6.1-3 Communicate Findings	6.2-3 Other Matter	6.3-3 Content of "Basis for Conclusion"
6.1-4 Inconsistencies	6.2-4 Other Reporting Responsibilities	
	6.2-5 Report Dating	
	6.2-6 Unmodified Conclusion	

Outcome

A conclusion on the financial statements as a whole that is appropriately worded based on the evidence obtained.

6.1 FORMING AN APPROPRIATE CONCLUSION

The final step in performing a review engagement is to form an appropriate conclusion based on the evidence obtained.

6.1-1 Evaluate Financial Statement Presentation

Paragraph	Requirement
	Consideration of the Applicable Financial Reporting Framework in Relation to the Financial Statements
69	**In forming the conclusion on the financial statements, the practitioner shall:** **(a) Evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework; (Ref: Para. A106–A107)** **(b) Consider whether, in the context of the requirements of the applicable financial reporting framework and the results of procedures performed:** **(i) The terminology used in the financial statements, including the title of each financial statement, is appropriate;** **(ii) The financial statements adequately disclose the significant accounting policies selected and applied;** **(iii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;** **(iv) Accounting estimates made by management appear reasonable;** **(v) The information presented in the financial statements appears relevant, reliable, comparable, and understandable; and** **(vi) The financial statements provide adequate disclosures to enable the intended users to understand the effects of material transactions and events on the information conveyed in the financial statements. (Ref: Para. A108–A110)**
71	**If the financial statements are prepared using a fair presentation framework the practitioner's consideration shall also include: (Ref: Para. A109)** **(a) The overall presentation, structure and content of the financial statements in accordance with the applicable framework; and** **(b) Whether the financial statements, including the related notes, appear to represent the underlying transactions and events in a manner that achieves fair presentation or gives a true and fair view, as appropriate, in the context of the financial statements as a whole.**

Many accounting firms use a financial statement presentation and disclosure checklist to ensure all the requirements of the AFRF have been met. Where necessary, these checklists should be customized for the country, industry, and client.

In many instances, the AFRF will be country specific; however, if IFRS for SMEs is used, some standard and illustrative financial statements and disclosure checklists in various languages can be downloaded from the Access the IFRS for SMEs page of the IFRS website.

The evaluation of the financial statements takes into account:

- The requirements of the AFRF; and
- The results of procedures performed.

In addition to the presentation and disclosure requirements in the AFRF, there may be other matters to address in the evaluation of financial statement presentation such as outlined in the following exhibit.

Exhibit 6.1-1A

Other Considerations	Implications
Move to a New Applicable Financial Reporting Framework	Such a transition will likely require retroactive restatement of the opening balances and the financial statements for the prior period along with additional financial statement disclosures specifically relating to the transition. This will require some additional inquiry and analysis in relation to opening balances and application of the new accounting policies.
From a Compilation to a Review Engagement	If the engagement is upgraded from a compilation, consider what inquiry and analysis will be necessary on the opening balances. For example, inquiries could be made as to whether opening balances reflect the application of appropriate accounting policies and analytical procedures could be used to look for any variances in opening balances and changes in the operating results.

Special Purpose Financial Statements

If the financial statements are being prepared using a special purpose financial reporting framework, the details of the framework may only be available to the engaging party and the practitioner.

In these situations, it is important to describe the special purpose financial reporting framework, as the special purpose financial statements may not be appropriate for any use other than the intended use identified at the outset of the engagement.

When reporting on a special purpose framework, it may be desirable to add an Emphasis of Matter paragraph to the review engagement report to outline the purpose of the information and any restrictions on its use. Refer to Section 6.2-2 of this chapter for some sample wording.

6.1-2 Evaluate Identified Misstatements

Paragraph	Requirement
70	**The practitioner shall consider the impact of:** **(a) Uncorrected misstatements identified during the review, and in the previous year's review of the entity's financial statements, on the financial statements as a whole; and** **(b) Qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (Ref: Para. A111–A112)**

As a result of performing review procedures, misstatements may be identified that could result from either errors or fraud. Some examples of such misstatements are listed in the following exhibit.

Exhibit 6.1-2A

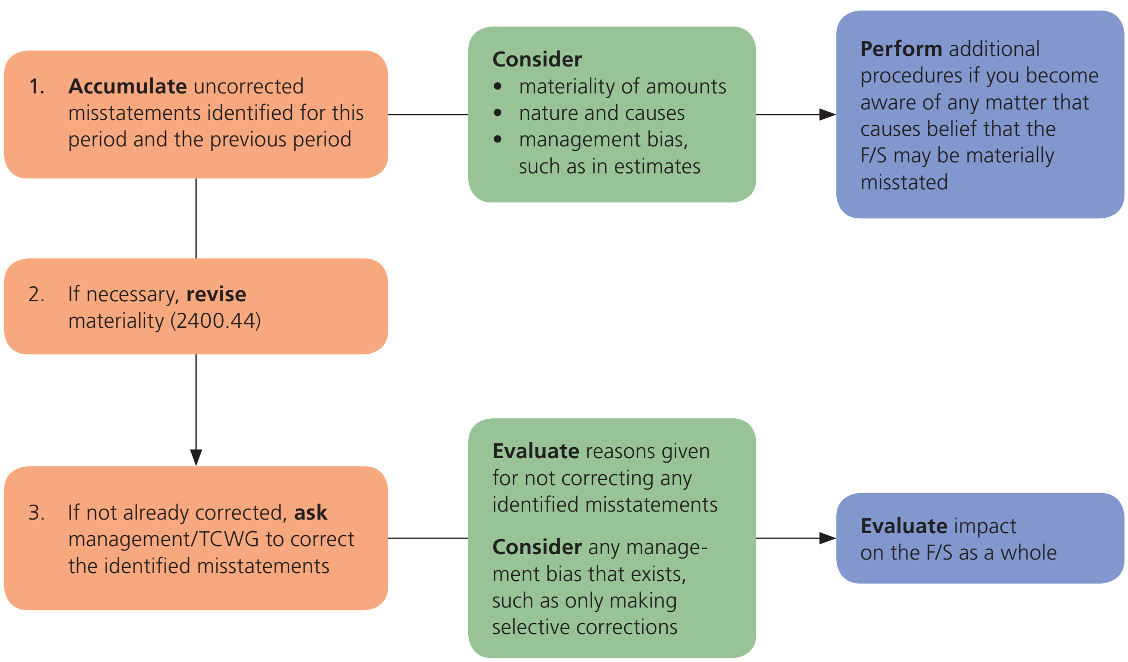
Nature	Description
Errors	An unintentional inaccuracy in gathering or processing data from which the financial statements are prepared. An unintentional omission of an amount or disclosure. An incorrect accounting estimate arising from unintentionally overlooking some information, a clear misinterpretation of facts, or clerical miscalculations.
Fraud	Falsification (including forgery) or alteration of accounting records or supporting documentation from which the financial statements are prepared. Misrepresentation in, or intentional omission from, the financial statements of events, transactions, or other significant information. Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

Nature	Description
Fraud *(continued)*	Management override of controls that otherwise may appear to be operating effectively. This includes such techniques as: • Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives. • Inappropriately adjusting assumptions and changing judgments used to estimate account balances. • Using undisclosed related party transactions, including transactions not on the normal commercial terms. • Omitting, advancing, or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period. • Concealing or not disclosing facts that could affect the amounts recorded in the financial statements. • Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity. • Altering records and terms related to significant and unusual transactions.

Document and accumulate misstatements identified (such as those detailed in Exhibit 6.1-2A above), unless clearly trivial, with details of their nature and circumstances of their occurrence. Toward the end of the engagement, evaluate the impact of the identified misstatements (both for the current period and those brought forward from the previous period) as outlined in the following exhibit illustrating how professional skepticism might be applied when management is reluctant to rectify misstatements.

Exhibit 6.1-2B

Evaluating Identified Misstatements



Note: ISRE 2400 (Revised) does not actually require the practitioner to request the correction of misstatements. However, such a request would generally be regarded as best practice.

Example

During the course of performing a review engagement, the practitioner Sarah Potting identified the following misstatements:

	Effect on Earnings
Error in inventory costing	(€2,397)
Possible over provision in allowance for doubtful receivables	€8,500
Possible over provision in allowance for inventory obsolescence	€5,300
Fixed asset that was expensed	€7,320
Receivable not recorded at period end	€1,853
	€20,576

Materiality for this engagement had been set at €25,000, and there have been no circumstances that would require a change to this amount.

In evaluating the identified misstatements, the following observations were made:
- Most of the misstatements had the effect of decreasing reported earnings.
- The estimates for doubtful receivables and inventory obsolescence were quite conservative. This could be an indicator of management bias to reduce the earnings for the year. Sarah considered this possibility of management bias in respect to other financial statement areas but concluded that, as there were no major estimates other than amortization rates (that had not changed), there was minimal opportunity.
- The fixed asset that was expensed was a secondhand delivery van. The accountant indicated he had made an error.
- The inventory costing error and the missed receivable balance also seemed to result from clerical errors.

After being asked to correct these errors, management agreed to correct the inventory costing error, the fixed asset addition, and the receivable not recorded but was unwilling to reduce the allowance for doubtful receivables and inventory obsolescence, as management felt strongly that they would be needed. Sarah then pointed out that conservative provisions had also been made in the previous year and they were not required at all. Management agreed but indicated that the provisions would be required this year.

In Sarah's judgment, the uncorrected errors in the financial statements could be approximately €13,800, which was roughly half of the materiality for the financial statements as a whole. However, in the previous year, the overstatement of the same two provisions was €8,000, which has the effect of reducing the overstatement of earnings this year to approximately €5,800 (€13,800 – €8,000).

She concluded that, although there may be some indication of management bias in the estimates, the financial statements as a whole were not materially misstated and the conclusion in the review engagement report did not need to be modified.

6.1-3 Communicate Findings

Paragraph	Requirement
95	**The practitioner shall also document discussions with management, those charged with governance, and others as relevant to the performance of the review of significant matters arising during the engagement, including the nature of those matters.**

As indicated in Chapter 4, Section 4.1-1, effective and continuous two-way communication between the practitioner, engagement team, management, and TCWG is an important element in every engagement. This will help minimize any (particularly last-minute) surprises.

Some of the matters that could be communicated are outlined in the following exhibit.

Exhibit 6.1-3A

Matters to Discuss and Document	Use and application of significant accounting policies.
	The calculation and reasonableness of management estimates.
	Material uncertainties that may cast significant doubt on the entity's ability to continue as a going concern.
	Significant difficulties encountered on the engagement, such as missing evidence or unavailable documents or personnel.
	Any disagreements with management and how they were resolved.
	Whether or not identified misstatements were corrected.
	The wording of the practitioner's conclusion on the financial statements.
	Other relevant matters.

Whenever discussions take place (with management, TCWG, or others) of significant matters arising during the engagement, they shall be documented. This would include:

- The nature of the matters discussed;
- The main points of discussion;
- The conclusions reached; and
- Any significant professional judgments made in reaching those conclusions.

6.1-4 Inconsistencies

Paragraph	Requirement
96	**If, in the course of the engagement, the practitioner identified information that is inconsistent with the practitioner's findings regarding significant matters affecting the financial statements, the practitioner shall document how the inconsistency was addressed.**

When exercising professional skepticism in performing review engagement procedures, the practitioner may become aware of information that is inconsistent with other findings. If the inconsistency causes the practitioner to believe the financial statements may be materially misstated, additional procedures will be required to address the matter. Refer to Chapter 5, Section 5.1-8.

6.2 WORDING OF THE REPORT

Paragraph	Requirement
	Form of the Conclusion
72	The practitioner's conclusion on the financial statements, whether unmodified or modified, shall be expressed in the appropriate form in the context of the financial reporting framework applied in the financial statements.
	The Practitioner's Report
86	The practitioner's report for the review engagement shall be in writing, and shall contain the following elements: (Ref: Para. A118–A121, A142, A144) (a) A title, which shall clearly indicate that it is the report of an independent practitioner for a review engagement; (b) The addressee(s), as required by the circumstances of the engagement; (c) An introductory paragraph that: (i) Identifies the financial statements reviewed, including identification of the title of each of the statements contained in the set of financial statements and the date and period covered by each financial statement; (ii) Refers to the summary of significant accounting policies and other explanatory information; and (iii) States that the financial statements have been reviewed; (d) A description of the responsibility of management for the preparation of the financial statements, including an explanation that management is responsible for: (Ref: Para. A122–A125) (i) Their preparation in accordance with the applicable financial reporting framework including, where relevant, their fair presentation; (ii) Such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; (e) If the financial statements are special purpose financial statements: (i) A description of the purpose for which the financial statements are prepared and, if necessary, the intended users, or reference to a note in the special purpose financial statements that contains that information; and (ii) If management has a choice of financial reporting frameworks in the preparation of such financial statements, a reference within the explanation of management's responsibility for the financial statements to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances; (f) A description of the practitioner's responsibility to express a conclusion on the financial statements including reference to this ISRE and, where relevant, applicable law or regulation; (Ref: Para. A126–127, A143) (g) A description of a review of financial statements and its limitations, and the following statements: (Ref: Para. A128) (i) A review engagement under this ISRE is a limited assurance engagement; (ii) The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained; and (iii) The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (ISAs), and, accordingly, the practitioner does not express an audit opinion on the financial statements; (h) A paragraph under the heading "Conclusion" that contains: (i) The practitioner's conclusion on the financial statements as a whole in accordance with paragraphs 72–85, as appropriate; and (ii) A reference to the applicable financial reporting framework used to prepare the financial statements, including identification of the jurisdiction of origin of the financial reporting framework that is not International Financial Reporting Standards or International Financial Reporting Standard for Small- and Medium-Sized Entities issued by the International Accounting Standards Board, or International Public Sector Accounting Standards issued by the International Public Sector Accounting Standards Board; (Ref: Para. A129–A130)

Paragraph	Requirement
86 *(continued)*	**(i) When the practitioner's conclusion on the financial statements is modified:** **(i) A paragraph under the appropriate heading that contains the practitioner's modified conclusion in accordance with paragraphs 72 and 75–85, as appropriate; and** **(ii) A paragraph, under an appropriate heading, that provides a description of the matter(s) giving rise to the modification; (Ref: Para. A131)** **(j) A reference to the practitioner's obligation under this ISRE to comply with relevant ethical requirements;** **(k) The date of the practitioner's report; (Ref: Para. A138–A141)** **(l) The practitioner's signature; and (Ref: Para. A132)** **(m) The location in the jurisdiction where the practitioner practices.**

6.2-1 Report Elements

The major elements of the practitioner's report are summarized in the following exhibit.

Exhibit 6.2-1A

	Report Elements and Paragraph Reference in ISRE 2400 (Revised)
Review Engagement Report	Title and appropriate addressee: paragraph 86(a) and (b)
	Introductory paragraph: paragraph 86(c)
	Description of management's responsibility: paragraph 86(d)
	Description of practitioner's responsibility: paragraph 86(f)
	Description of a review and its limitations: paragraph 86(g)
	Engagement conclusion: paragraph 86(h) and (i)
	Obligation to comply with relevant ethical requirements: paragraph 86(j)
	Date, signature, and location of practitioner: paragraph 86(k) to (m)

Special Purpose Financial Statements

If the financial statements are special purpose financial statements, the Management Responsibility paragraph would also include:

- A description of the purpose for which the financial statements are prepared and, if necessary, the intended users or reference to a note in the special purpose financial statements that contains that information; and
- Reference to management's responsibility for determining that the AFRF was acceptable in the circumstances (applicable if management had a choice of financial reporting frameworks).

Signature of the Practitioner

The signature can be the name of the practitioner's firm, the personal name of the individual practitioner, or both as appropriate for the particular jurisdiction. In certain jurisdictions, there may also be additional requirements.

Consider Point

Some firms use their letterhead for the review engagement report and then assume (because it contains their address) that the report complies with the requirements. However, this may not be acceptable, as the actual requirement is to disclose the location in the jurisdiction where the practitioner practices as part of the report itself.

6.2-2 Emphasis of Matter

Paragraph	Requirement
	Emphasis of Matter and Other Matter Paragraphs in the Practitioner's Report
	Emphasis of Matter Paragraphs
87	**The practitioner may consider it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the practitioner's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. In such cases, the practitioner shall include an Emphasis of Matter paragraph in the practitioner's report, provided the practitioner has obtained sufficient appropriate evidence to conclude that the matter is not likely to be materially misstated as presented in the financial statements. Such paragraph shall refer only to information presented or disclosed in the financial statements.**
88	**The practitioner's report on special purpose financial statements shall include an Emphasis of Matter paragraph alerting users of the practitioner's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. (Ref: Para. A133–A134)**
89	**The practitioner shall include an Emphasis of Matter paragraph immediately after the paragraph that contains the practitioner's conclusion on the financial statements under the heading "Emphasis of Matter," or other appropriate heading.**

Typical examples of an Emphasis of Matter paragraph are outlined in the following exhibit.

Exhibit 6.2-2A

Emphasis of Matter	Going-concern uncertainties.
	Uncertainty relating to exceptional litigation or regulatory action.
	Subsequent events, such as the sale of part of the business or an acquisition.
	A major catastrophe.
	Other significant uncertainties and inconsistencies.
	Early application (where permitted) of a new accounting standard.

An Emphasis of Matter paragraph is also required for special purpose financial statements to alert users that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose.

An Emphasis of Matter paragraph is not to be used as a substitute for:

- Modifying the conclusion on financial statements that are materially misstated; or
- Management making the required disclosures in the financial statements.

When an Emphasis of Matter or Other Matter paragraph is to be included in the report, first discuss the need for the paragraph and the wording with management and, where appropriate, TCWG.

Example

Emphasis of Matter:

As discussed in Note *[number]* to the financial statements, ABC Company is a defendant in a major lawsuit alleging infringement of certain patent rights. As the extent of liability (if any) cannot be determined at this time, no provision has been made in the financial statements.

6.2-3 Other Matter

Paragraph	Requirement
	Other Matter Paragraphs
90	**If the practitioner considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the practitioner's judgment, is relevant to users' understanding of the review, the practitioner's responsibilities or the practitioner's report and this is not prohibited by law or regulation, the practitioner shall do so in a paragraph in the practitioner's report with the heading "Other Matter" or other appropriate heading.**

In some situations, there may be matters relevant to the users' understanding of the practitioner's responsibilities, the work performed, and the report that are not disclosed in the financial statements. If providing this information is not prohibited by law or regulation, another paragraph can be positioned following the paragraph containing the practitioner's conclusion on the financial statements and the Emphasis of Matter paragraph, if any. The paragraph would be placed under the heading "Other Matter."

Typical examples of an Other Matter paragraph are outlined in the following exhibit.

Exhibit 6.2-3A

Other Matter	Inability of the practitioner to withdraw from the engagement.
	Restrictions on the distribution of the practitioner's report.
	Special purpose information or information presented to a third party. Typical wording could be as follows: "This report is intended to be used solely for *[indicate specific use]* and is not to be referred to, or distributed to, any person not a member of management of *[XYZ Limited]* or *[name of person to whom the report is addressed]*."

6.2-4 Other Reporting Responsibilities

Paragraph	Requirement
	Other Reporting Responsibilities
91	**A practitioner may be requested to address other reporting responsibilities in the practitioner's report on the financial statements that are in addition to the practitioner's responsibilities under this ISRE to report on the financial statements. In such situations, those other reporting responsibilities shall be addressed by the practitioner in a separate section in the practitioner's report headed "Report on Other Legal and Regulatory Requirements," or otherwise as appropriate to the content of the section, following the section of the report headed "Report on the Financial Statements." (Ref: Para. A135–A137)**

In some jurisdictions, the practitioner may have additional responsibilities to report on other matters that are supplementary to the responsibilities outlined in ISRE 2400 (Revised). Examples of these responsibilities are outlined in the following exhibit.

Exhibit 6.2-4A

Other Reporting Responsibilities	Reporting on certain matters if they come to the practitioner's attention during the course of the review of the financial statements.
	Performing and reporting on additional specified procedures.
	Expressing a conclusion on specific matters, such as the adequacy of accounting books and records.

Where the relevant law or regulation permits or requires the practitioner to report on these other responsibilities, the results of such work would be included in a separate section in the practitioner's report and headed "Report on Other Legal and Regulatory Requirements," or otherwise as appropriate to the content of the section, and following the section of the report headed "Report on the Financial Statements."

Address these other reporting responsibilities in a separate section of the practitioner's report to clearly distinguish them from the practitioner's responsibility under ISRE 2400 (Revised) to report on the financial statements.

Example

Report on Other Legal and Regulatory Requirements:

As required by the *[act or regulation requiring disclosure]*, we report that the accounting principles used in these financial statements have been applied on a consistent basis with that of the preceding year.

6.2-5 Report Dating

Paragraph	Requirement
	Date of the Practitioner's Report
92	**The practitioner shall date the report no earlier than the date on which the practitioner has obtained sufficient appropriate evidence as the basis for the practitioner's conclusion on the financial statements, including being satisfied that: (Ref: Para. A138–A141)** • **All the statements that comprise the financial statements under the applicable financial reporting framework, including the related notes where applicable, have been prepared; and** • **Those with the recognized authority have asserted that they have taken responsibility for those financial statements.**

The date on the review engagement report informs users that:

(a) The effect of events and transactions (of which the practitioner became aware) between the date of the financial statements and the date of the practitioner's report have been considered. Refer to Chapter 5, Section 5.1-9.

(b) Sufficient appropriate evidence has been obtained by the practitioner that management has accepted responsibility for the financial statements, including the related notes.

The following exhibit outlines the steps involved in obtaining evidence of financial statement approval.

Exhibit 6.2-5A

Identify Who Has the Authority to Accept Responsibility	The recognized authority to assert that they have taken responsibility for the financial statements, including the related notes, could be: • The owner or owner-manager; • TCWG, such as a board of directors; or • Other individuals or bodies specified in local regulations.
Obtain Evidence of Approval	Evidence could include: • A written confirmation of approval from the owner or owner-manager; • Minutes from the meeting (i.e., a directors meeting) where the financial statements were approved; and • Other equivalent documentation.

Note: For the purposes of ISRE 2400 (Revised), final approval by shareholders is not necessary before the report can be dated. Approval by those with the recognized authority (such as the directors) is sufficient, assuming this occurs before the date of shareholder approval.

6.2-6 Unmodified Conclusion

Paragraph	Requirement
	Unmodified Conclusion
73	**The practitioner shall express an unmodified conclusion in the practitioner's report on the financial statements as a whole when the practitioner has obtained limited assurance to be able to conclude that nothing has come to the practitioner's attention that causes the practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework.**
74	**When the practitioner expresses an unmodified conclusion, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate: (Ref: Para. A113–A114)** **(a) "Based on our review, nothing has come to our attention that causes us to believe that the financial statements do not present fairly, in all material respects (or do not give a true and fair view), … in accordance with the applicable financial reporting framework," (for financial statements prepared using a fair presentation framework); or** **(b) "Based on our review, nothing has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework," (for financial statements prepared using a compliance framework).**

An unmodified conclusion, as outlined in Chapter 2, Section 2.3-2, can be issued on financial statements when the practitioner:

- Has obtained the limited assurance as required by ISRE 2400 (Revised); and
- Is not, on the basis of the procedures performed, aware of any matters that would cause the practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with the AFRF.

6.3 MODIFIED CONCLUSIONS

When it is not possible to obtain the limited assurance as required by ISRE 2400 (Revised), a modified conclusion is necessary.

Paragraph	Requirement
	Modified Conclusion
75	**The practitioner shall express a modified conclusion in the practitioner's report on the financial statements as a whole when:** **(a) The practitioner determines, based on the procedures performed and the evidence obtained, that the financial statements are materially misstated; or** **(b) The practitioner is unable to obtain sufficient appropriate evidence in relation to one or more items in the financial statements that are material in relation to the financial statements as a whole.**
76	**When the practitioner modifies the conclusion expressed on the financial statements, the practitioner shall:** **(a) Use the heading "Qualified Conclusion," "Adverse Conclusion," or "Disclaimer of Conclusion," as appropriate, for the conclusion paragraph in the practitioner's report; and** **(b) Provide a description of the matter giving rise to the modification, under an appropriate heading (for example, "Basis for Qualified Conclusion," "Basis for Adverse Conclusion," or "Basis for Disclaimer of Conclusion," as appropriate), in a separate paragraph in the practitioner's report immediately before the conclusion paragraph (referred to as the basis for conclusion paragraph).**

Paragraph	Requirement
	Financial statements are materially misstated
77	**If the practitioner determines that the financial statements are materially misstated, the practitioner shall express:** **(a) A qualified conclusion, when the practitioner concludes that the effects of the matter(s) giving rise to the modification are material, but not pervasive to the financial statements; or** **(b) An adverse conclusion, when the effects of the matter(s) giving rise to the modification are both material and pervasive to the financial statements.**
78	**When the practitioner expresses a qualified conclusion on the financial statements because of a material misstatement, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:** **(a) "Based on our review, except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements do not present fairly, in all material respects (or do not give a true and fair view), … in accordance with the applicable financial reporting framework," (for financial statements prepared using a fair presentation framework); or** **(b) "Based on our review, except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework," (for financial statements prepared using a compliance framework).**
79	**When the practitioner expresses an adverse conclusion on the financial statements, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:** **(a) "Based on our review, due to the significance of the matter(s) described in the Basis for Adverse Conclusion paragraph, the financial statements do not present fairly, in all material respects (or do not give a true and fair view), … in accordance with the applicable financial reporting framework," (for financial statements prepared using a fair presentation framework); or** **(b) "Based on our review, due to the significance of the matter(s) described in the Basis for Adverse Conclusion paragraph, the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework," (for financial statements prepared using a compliance framework).**
80	**In the basis for conclusion paragraph, in relation to material misstatements that give rise to either a qualified conclusion or an adverse conclusion, the practitioner shall:** **(a) Describe and quantify the financial effects of the misstatement if the material misstatement relates to specific amounts in the financial statements (including quantitative disclosures), unless impracticable, in which case the practitioner shall so state;** **(b) Explain how disclosures are misstated if the material misstatement relates to narrative disclosures; or** **(c) Describe the nature of omitted information if the material misstatement relates to the non-disclosure of information required to be disclosed. Unless prohibited by law or regulation, the practitioner shall include the omitted disclosures where practicable to do so.**
	Inability to obtain sufficient appropriate evidence
81	**If the practitioner is unable to form a conclusion on the financial statements due to inability to obtain sufficient appropriate evidence, the practitioner shall:** **(a) Express a qualified conclusion if the practitioner concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive; or** **(b) Disclaim a conclusion if the practitioner concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.**

Paragraph	Requirement
82	**The practitioner shall withdraw from the engagement if the following conditions are present: (Ref: Para. A115–A117)** **(a) Due to a limitation on the scope of the review imposed by management after the practitioner has accepted the engagement, the practitioner is unable to obtain sufficient appropriate evidence to form a conclusion on the financial statements;** **(b) The practitioner has determined that the possible effects on the financial statements of undetected misstatements are material and pervasive; and** **(c) Withdrawal is possible under applicable law or regulation.**
83	**When the practitioner expresses a qualified conclusion on the financial statements due to inability to obtain sufficient appropriate evidence, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:** **(a) "Based on our review, except for the possible effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements do not present fairly, in all material respects (or do not give a true and fair view), … in accordance with the applicable financial reporting framework," (for financial statements prepared using a fair presentation framework); or** **(b) "Based on our review, except for the possible effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework," (for financial statements prepared using a compliance framework).**
84	**When disclaiming a conclusion on the financial statements the practitioner shall state in the conclusion paragraph that:** **(a) Due to the significance of the matter(s) described in the Basis for Disclaimer of Conclusion paragraph, the practitioner is unable to obtain sufficient appropriate evidence to form a conclusion on the financial statements; and** **(b) Accordingly, the practitioner does not express a conclusion on the financial statements.**
85	**In the basis for conclusion paragraph, in relation to either the qualified conclusion due to inability to obtain sufficient appropriate evidence or when the practitioner disclaims a conclusion, the practitioner shall include the reason(s) for the inability to obtain sufficient appropriate evidence.**

6.3-1 Circumstances Requiring a Modified Conclusion

There are two types of circumstances that require a modified conclusion:

- When financial statements are materially misstated; and
- When there is an inability to obtain sufficient appropriate evidence.

These two circumstances are outlined in the following exhibit.

Exhibit 6.3-1A

Action	Circumstance
A Modified Conclusion Is Necessary When:	**Financial Statements Are Materially Misstated** Based on the evidence obtained, the financial statements as a whole are not free from material misstatement. This includes: • Uncorrected misstatements that are material; • Inappropriate accounting principles or inconsistent application; and • Failure to disclose information that results in a material misstatement.
	Inability to Obtain Sufficient Appropriate Evidence The practitioner is unable to obtain sufficient appropriate evidence to conclude that the financial statements as a whole are free from material misstatement. This could include: • Circumstances beyond the control of the entity, such as a fire that damaged accounting records; • Circumstances relating to the nature or timing of the practitioner's work, such as unavailability of expected information; or • Limitations imposed by management, such as management not allowing access to a key person within the entity.

The type of modification required to address the particular circumstances (qualified conclusion, adverse conclusion, or disclaimer of conclusion) is based on the following factors:

- The nature of the matter giving rise to the modification; and
- The pervasiveness of its effects or possible effects on the financial statements.

This is illustrated in the following exhibit.

Exhibit 6.3-1B

Nature of Matter	Pervasiveness of Effects on F/S	
	Material but NOT Pervasive	**Material AND Pervasive**
F/S Materially Misstated	Qualified Conclusion	Adverse Conclusion
Inability to Obtain Necessary Evidence	Qualified Conclusion	Disclaimer of Conclusion

6.3-2 The Three Modified Conclusions

The appropriate use of the three types of modified conclusions is described in the following exhibit.

Exhibit 6.3-2A

Type	Applicability
Qualified Conclusion	Matter is *not* material or pervasive enough to require an adverse conclusion or a disclaimer of conclusion. Include a Basis for Qualified Conclusion paragraph that describes the matter. In the Qualified Conclusion paragraph, use the wording in paragraph 2400.83.
Adverse Conclusion	Effects of misstatements are both material and pervasive to the financial statements. Include a Basis for Adverse Conclusion paragraph (before the Adverse Conclusion paragraph) that describes the matter. In the Adverse Conclusion paragraph, use the wording in paragraph 2400.81.
Disclaimer of Conclusion	Effect of undetected misstatements, if any, could be both material and pervasive. Include a Basis for Disclaimer of Conclusion paragraph (before the Disclaimer of Conclusion paragraph) that describes the matter. In the Disclaimer of Conclusion paragraph, use the wording in paragraph 2400.84.

The only alternative to issuing an adverse conclusion or disclaimer of conclusion would be to withdraw from the engagement altogether (where withdrawal is permissible by law or regulation) and not issue a report at all.

Withdrawal from Engagement Is Required When: *(assuming withdrawal is possible under applicable law or regulation)*	Management imposes a scope limitation after accepting the engagement, so that sufficient appropriate evidence cannot be obtained, and the practitioner has determined that the possible effects on the financial statements of undetected misstatements are material and pervasive. This is required because review procedures are, by their nature, limited, and a scope limitation would defeat the purpose of the engagement. For example, if the client decided not to answer questions about the inventory (a material amount in the financial statements that would impact other items and disclosures and is, therefore, pervasive), it would not be possible to draw a conclusion on the financial statements.

6.3-3 Content of "Basis for Conclusion"

The Basis for Conclusion paragraph provides a concise description of the matter, giving rise to the modification under a heading such as: "Basis for Qualified Conclusion," "Basis for Adverse Conclusion," or "Basis for Disclaimer of Conclusion" as appropriate. This forms a separate paragraph in the practitioner's report immediately preceding the conclusion paragraph.

The following requirements apply when drafting the Basis for Conclusion paragraph.

Exhibit 6.3-3A

Type	Required Description
Material Misstatement Exists	Describe and quantify the financial effects of the misstatement if the material misstatement relates to specific amounts in the financial statements (including quantitative disclosures). If this is impracticable, state that quantification is impractical.
	If the material misstatement relates to narrative disclosures: • Explain how financial statement disclosures are misstated. • Make reference to a more extensive discussion of the matter in a note to the financial statements (as necessary).
	If information is omitted: • Describe the nature of omitted information if the material misstatement relates to the nondisclosure of information that is required to be disclosed. • Include the omitted disclosures (where practicable to do so) unless prohibited by law or regulation.
Inability to Obtain Sufficient Appropriate Evidence	Describe the circumstances and reasons that led to the inability to obtain evidence. Make reference to a more extensive discussion of the matter in a note to the financial statements (as necessary).

Please refer to Appendix I for examples of modified conclusions.

APPENDICES

APPENDIX A

Description of Terms Used in the Guide

The following terms and descriptions are included in ISRE 2400 (Revised).

Term	Description
analytical procedures	Evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.
engagement risk	The risk that the practitioner expresses an inappropriate conclusion when the financial statements are materially misstated.
general purpose financial statements	Financial statements prepared in accordance with a general purpose framework.
general purpose framework	A financial reporting framework designed to meet the common financial needs of a wide range of users. The financial reporting framework may be a fair presentation framework or a compliance framework.
inquiry	Inquiry consists of seeking information of knowledgeable persons from within or outside the entity.
limited assurance	The level of assurance obtained where engagement risk is reduced to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for expressing a conclusion in accordance with this ISRE. The combination of the nature, timing, and extent of evidence-gathering procedures is at least sufficient for the practitioner to obtain a meaningful level of assurance. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the financial statements.
practitioner	A professional accountant in public practice. The term includes the engagement partner or other members of the engagement team, or, as applicable, the firm. Where this ISRE expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner," rather than "practitioner," is used. "Engagement partner" and "firm" are to be read as referring to their public sector equivalents where relevant.
professional judgment	The application of relevant training, knowledge, and experience, within the context provided by assurance, accounting, and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the review engagement.
relevant ethical requirements	Ethical requirements the engagement team is subject to when undertaking review engagements. These requirements ordinarily comprise Parts A and B of the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code), together with national requirements that are more restrictive.
special purpose financial statements	Financial statements prepared in accordance with a special purpose framework.

Other Terms

In addition to the terms set out in ISRE 2400.17 described above, there are a number of other terms that are used in this Guide.

The following terms and descriptions are used in the glossary of terms in ISQC 1 and the ISAs.

Term (*Source*)	Description
accounting estimate (*Glossary*)	An approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation.
engagement team (*Glossary*)	All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external experts engaged by the firm or a network firm.
error (*Glossary*)	An unintentional misstatement in financial statements, including the omission of an amount or a disclosure.
fraud (*Glossary*)	An intentional act by one or more individuals among management, those charged with governance, employees, or third parties involving the use of deception to obtain an unjust or illegal advantage.
going-concern assumption (*ISA 570.2*)	Under the going-concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going-concern basis, unless management either intends to liquidate the entity or cease operations or has no realistic alternative but to do so.
materiality (*ISA 200.6*)	Misstatements, including omissions, are considered to be material if they individually or in the aggregate could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.
misstatement (*Glossary*)	A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud. Where the *auditor* expresses an opinion on whether the financial statements are presented fairly, in all material respects, or gives a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the *auditor's* judgment, are necessary for the financial statements to be presented fairly, in all material respects, or to give a true and fair view.
management (*Glossary*)	The person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).
related party (*Glossary*)	A related party is usually defined in the applicable financial reporting framework. Examples would include: • A person or another entity that has control or significant influence (directly or indirectly) over the reporting entity; • Another entity over which the reporting entity has control or significant influence; or • An entity under common control with the reporting entity through having: (a) Common controlling ownership; (b) Owners who are close family members; or (c) Common key management. However, entities that are under common control by a state (that is, a national, regional, or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.
those charged with governance (*Glossary*)	The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel (for example, executive members of a governance board of a private or public sector entity or an owner-manager).
special purpose framework (*Glossary*)	A financial reporting framework designed to meet the financial information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework.

APPENDIX B

Client Acceptance/Continuance Checklist

PSC = procedure successfully completed

Engagement Risk Assessment	Response and Comments	W/P ref.	PSC? (Y/N) (Initials)
1. Quality Control Would accepting this engagement contravene any of the firm's quality assurance policies?			
2. Management Integrity Inquire about events or circumstances that cast doubt on the integrity of management or TCWG. Consider: • Ethical or regulatory infringements. • Poor reputation for honesty, ethics, and ethical behavior. • Problems encountered on previous engagements. • Allegations of illegal acts or fraud in the press or on the Internet. • Management bias in estimates or non-disclosed related parties. • Poor attitude toward control or maintaining records. • Ongoing investigations. • Close association with people/companies with questionable ethics.			
3. Predecessor Accountant • What reasons has the prospective client provided regarding the change in accountants? • Have any other accountants recently declined to serve the prospective client? If so, explain why. • Have we reviewed the predecessor's working papers? If so, describe any matters identified that impact engagement acceptance. If not, explain why.			
4. Engagement Risk Factors Identify whether any risks exist that would impact engagement acceptance. Consider the following: • Doubts about the entity's ability to continue in existence. • Users of financial statements. • Negative industry trends. • Participation in high-risk business ventures. • Poor accounting systems and records. • High media interest in entity and management. • Unrealistic reporting time frames. • Unusual or overly complex corporate/operational structures or transactions. • Ability to pay a fair fee.			
5. Firm Competencies Does the firm have the necessary resources available to complete the engagement? Consider: • Availability of firm personnel with appropriate experience and industry knowledge. • Use of external experts (where required). • Availability of a suitably qualified EQCR (where required by firm policies).			

<table>
<tr><th>Engagement Risk Assessment</th><th>Response and Comments</th><th>W/P ref.</th><th>PSC? (Y/N) (Initials)</th></tr>
<tr><td>6. Independence
• Are we satisfied there are no existing prohibitions that would preclude the firm or any staff member from performing the engagement?
• Are we satisfied there are no significant threats to the firm's independence? If threats are identified, outline the nature of the safeguards put in place.</td><td></td><td></td><td></td></tr>
<tr><td>7. Engagement Preconditions
• Is an AFRF to be used in the preparation of the financial statements?
• Has management acknowledged its understanding and responsibility for the following:
(a) The preparation of financial statements in accordance with the AFRF;
(b) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
(c) To provide us with:
○ Access to all information relevant to the preparation of the financial statements,
○ Additional information we may request from management for the purpose of the audit, and
○ Unrestricted access to persons within the entity from whom we determine it is necessary to obtain audit evidence?
• If the engagement is to be accepted, has an engagement letter been requested and has a signed copy been obtained and put on file (prior to the commencement of the engagement)?</td><td></td><td></td><td></td></tr>
<tr><td>8. Other Required Procedures (Specify)</td><td></td><td></td><td></td></tr>
<tr><td colspan="4">Based on the information obtained above, this engagement should be rated as follows (circle one):
Low Risk Moderate Risk High Risk Not Accepted

Comments:</td></tr>
<tr><td colspan="4">Will an EQCR be required on this engagement? YES NO</td></tr>
<tr><td colspan="4">I have read the responses to the questions above and agree with the conclusion.

Prepared by ____________________ Date ____________________
Reviewed by ____________________ Date ____________________</td></tr>
</table>

APPENDIX C

Sample Engagement Letter

Note: This sample letter is based on the example contained in ISRE 2400 (Revised). Additional material that may be included in the letter has been italicized and contained within brackets.

[LETTERHEAD]

[Date]

To *[the appropriate representative of management or TCWG with the authority to sign on behalf of the entity]*

[Person
Entity's name
Street address
City, Country]

Dear __________:

You have requested that we review the general purpose financial statements of *[entity's name]*, which comprise the statement of financial position as at *[December 31, 20XX]*, the statement of comprehensive income, the statement of changes in equity, the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information. We are pleased to confirm our acceptance and our understanding of this review engagement by means of this letter.

Our review will be conducted with the objective of expressing our conclusion on the financial statements that, if unmodified, will be as follows:

> "Based on our review, nothing has come to our attention that causes us to believe that the financial statements do not present fairly, in all material respects, *[or do not give a true and fair view of]* the financial position of the company as at *[date]* and its financial performance for the year then ended in accordance with *[the applicable financial reporting framework]*."

The form and content of our conclusion may need to be amended in light of the findings obtained from our review.

Our Responsibilities

We will conduct our review in accordance with International Standard on Review Engagements (ISRE) 2400, *Engagements to Review Historical Financial Statements*. ISRE 2400 (Revised) requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements as a whole are not prepared, in all material respects, in accordance with the applicable financial reporting framework. ISRE 2400 (Revised) also requires us to comply with relevant ethical requirements.

A review of financial statements prepared in accordance with ISRE 2400 (Revised) is a limited assurance engagement. We will perform procedures, primarily consisting of making inquiries of management and others within the entity (as appropriate) and applying analytical procedures, and then evaluate the evidence obtained. We will also perform additional procedures if we become aware of matters that cause us to believe the financial statements as a whole may be materially misstated. These procedures are performed to enable us to express our conclusion on the financial statements in accordance with ISRE 2400 (Revised). The procedures selected will depend on what we consider necessary, applying our professional judgment based on our understanding of *[entity's name]* and its environment and our understanding of the IFRS and its application in the industry context.

A review is not an audit of the financial statements, therefore:

(a) There is a commensurate higher risk than there would be in an audit that any material misstatements that exist in the financial statements reviewed may not be revealed by the review even though the review is properly performed in accordance with ISRE 2400 (Revised).

(b) In expressing our conclusion from the review of the financial statements, our report on the financial statements will expressly disclaim any audit opinion on the financial statements.

[Report Amendments]

The form and content of our report may need to be amended in light of our findings obtained from the review.

[Use and Distribution of our Report]

The review engagement report on the financial statements is solely for the use of [entity's name] and those to whom our report is specifically addressed by us. We make no representations of any kind to any third party in respect of these financial statements and we accept no responsibility for their use by any third party.

We ask that our name be used only with our consent and that any information to which we have attached a communication be issued with that communication unless otherwise agreed to by us.

[Inclusion of Financial Statements in Annual Reports or on a Website]

Management is responsible for the accurate reproduction of the financial statements and other related information contained in an annual report or other public document (electronic or paper-based). This includes any incorporation by reference to either full or summarized financial statements that we have reviewed. We are not required to read the information contained on your website or to consider the consistency of other information on the electronic site with the original document.

If reproduction or publication of our review engagement report (or reference to our report) is planned in an annual report or other document, including electronic filings or posting of the report on a website, a copy of the entire document to be reproduced or published is to be submitted to us in sufficient time for our review before the publication or posting process begins.

Management's Responsibilities

Our review will be conducted on the basis that *[management and, where appropriate, TCWG]* acknowledge and understand that they have the responsibility:

(a) For the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;

(b) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(c) To provide us with:

   (i) Access to all information, of which management is aware, that is relevant to the preparation and fair presentation of the financial statements (such as records, documentation, and other matters),

   (ii) Additional information that we may request from management for the purpose of the review, and

   (iii) Unrestricted access to persons within *[entity's name]* from whom we determine it is necessary to obtain evidence.

As part of our review, we will request from *[management and, where appropriate, TCWG]* written confirmation concerning representations made to us in connection with the review.

[Preparation of Schedules]

We understand that [you] or [your employees] will prepare certain schedules and locate specified documents for our use before our engagement is planned to commence on February 14, 20XX.

The requested schedules and documents are as follows:

[(a) Schedules and analyses; and]
[(b) Other specified documents.]

This assistance will facilitate our work and help to minimize our costs. Any failure to provide these working papers or documents on a timely basis may impede our services and require us to suspend our services or withdraw from the engagement.

[Working Papers]

The working papers, files, other materials, reports, and work created, developed, or performed by us during the course of the engagement are the property of our Firm, constitute confidential information, and will be retained by us in accordance with our Firm's policies and procedures.

[File Inspections]

In accordance with professional regulations (and by our Firm's policy), our client files may periodically be reviewed by practice inspectors and by other engagement file reviewers to ensure that we are adhering to our professional and Firm's standards. File reviewers are required to maintain confidentiality of client information.

[Dispute Resolution] *(where permissible under local requirements)*

You agree that:

(a) Any dispute that may arise regarding the meaning, performance, or enforcement of this engagement will, prior to resorting to litigation, be submitted to mediation; and

(b) You will engage in the mediation process in good faith once a written request to mediate has been given by any party to the engagement.

Any mediation initiated as a result of this engagement shall be administered under the laws of ___________ by [name of mediation organization] according to its mediation rules. The results of any such mediation shall be binding only upon agreement of each party to be bound. The costs of any mediation proceeding shall be shared equally by the participating parties.

[Indemnity]

[Check to ensure this indemnity wording is allowable and, if so, that it complies with local rules and regulations. Also consider obtaining legal advice.]

[Entity's name] hereby agrees to indemnify, defend (by counsel retained and instructed by us), and hold harmless our Firm (and its partners, agents, or employees) from and against any and all losses, costs (including solicitors' fees), damages, expenses, claims, demands, or liabilities arising out of (or in consequence of):

(a) The breach by [entity's name] (or its directors, officers, agents, or employees) of any of the covenants made by [entity's name] herein, including, without restricting the generality of the foregoing, the misuse of, or the unauthorized dissemination of, our engagement report or the financial statements in reference to which the engagement report is issued or any other work product made available to you by our Firm.

(b) The services performed by us pursuant to this engagement unless, and to the extent that, such losses, costs, damages, and expenses are found by a court of competent jurisdiction to have been due to the negligence of our Firm. In the event that the matter is settled out of court, we will mutually agree on the extent of the indemnification to be provided by your company.

[Time Frames]

We will use all reasonable efforts to complete the engagement as described in this letter within the agreed upon time frames. However, we shall not be liable for failures or delays in performance that arise from causes beyond our control, including the untimely performance by [entity's name] of its obligations.

[Fees at Regular Billing Rates]

Our professional fees will be based on our regular billing rates, plus direct out-of-pocket expenses and applicable taxes, and are due when rendered. Fees for any additional services will be established separately.

[Or]

[Estimated Fees]

We estimate that our fees for these services will be €[amount] for the review engagement €plus direct out-of-pocket expenses and applicable taxes. This fee estimate is based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered.

If significant additional time is necessary, we will discuss the reasons with you and agree on a revised fee estimate before we incur the additional costs.

Fees will be rendered as work progresses and are payable on presentation.

[Retainer]

Prior to commencing our services, we require that you provide us with a retainer in the amount of €[amount]. The retainer will be applied against our final invoice and any unused portion will be returned to you upon our collection of all outstanding fees and costs related to this engagement.

[Billing]

Our fees and costs will be billed monthly and are payable upon receipt. Invoices unpaid 30 days past the billing date may be deemed delinquent and are subject to an interest charge of [numeral] percent per month. We reserve the right to suspend our services or to withdraw from this engagement in the event that any of our invoices are deemed delinquent. In the event that any collection action is required to collect unpaid balances due to us, you agree to reimburse us for our costs of collection, including lawyers' fees.

[Termination]

If we elect to terminate our services for nonpayment or for any other reason provided for in this letter, our engagement will be deemed to have been completed upon written notification of termination even if we have not completed our report. You will be obligated to compensate us for all time expended and to reimburse us for all of our out-of-pocket costs through to the date of termination.

[Costs of Responding to Government or Legal Processes]

In the event we are required to respond to a subpoena, court order, government agency, or other legal process for the production of documents and/or testimony relative to information we obtained and/or prepared during the course of this engagement, you agree to compensate us at our normal hourly rates for the time we expend in connection with such response and to reimburse us for all of our out-of-pocket costs (including applicable taxes) incurred.

[Other Services]

In addition to the review engagement services referred to above, we will [as permitted locally] prepare other special reports as required. Management will provide the information necessary to complete these reports and will file them with the appropriate authorities on a timely basis.

[Insert details of any other additional services to be provided relating to regulatory requirements.]

[Use of Information]

It is acknowledged that we will have access to all personal information in your custody that we require to complete our engagement. Our services are provided on the basis that:

(a) You represent to us that management has obtained any required consents for collection, use, and disclosure to us of personal information required under applicable privacy legislation; and

(b) We will hold all personal information in compliance with our Privacy Statement.

[Communications]

In connection with this engagement, we may communicate with you or others via telephone, facsimile, post, courier, and email transmission. As all communications can be intercepted or otherwise used or communicated by an unintended third party, or may not be delivered to each of the parties to whom they are directed and only to such parties, we cannot guarantee or warrant that communications from us will be properly delivered only to the addressee. Therefore, we specifically disclaim and waive any liability or responsibility whatsoever for interception or unintentional disclosure of communications transmitted by us in connection with the performance of this engagement. In that regard, you agree that we shall have no liability for any loss or damage to any person or entity resulting from: communications, including any consequential, incidental, direct, or indirect communications; special damages, such as loss of revenues or anticipated profits; or disclosure or communication of confidential or proprietary information.

[Conclusion]

This engagement letter includes the relevant terms that will govern the engagement for which it has been prepared. The terms of this letter supersede any prior oral or written representations or commitments by or between the parties. Any material changes or additions to the terms set forth in this letter will only become effective if evidenced by a written amendment to this letter, signed by all of the parties.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our review of the financial statements, including our respective responsibilities.

We appreciate the opportunity of *[providing service/continuing to be of service]* to your company.

Yours truly,

Signed ____________________________

Acknowledged and agreed on behalf of *[entity's name]* by:

Signed ____________________________

____

[Name and title of the addressee]

Date ____________________________

APPENDIX D

Checklist for Understanding the Entity

PSC = procedure successfully completed

Understand the Entity to Identify Areas in the Financial Statements Where Material Misstatements Are Likely to Arise		Comments	W/P ref.	PSC? (Y/N) (Initials)
Required Areas to Address				
1.	Relevant industry, regulatory, and other external factors, including the AFRF.			
2.	The nature of the entity, including: (a) Its operations; (b) Its ownership and governance structure; (c) The types of investments that the entity is making and plans to make; (d) The way the entity is structured and how it is financed; and (e) The entity's objectives and strategies.			
3.	The entity's accounting systems and accounting records.			
4.	The entity's selection and application of accounting policies.			
Required Areas of Inquiry				
1.	**Estimates** How are estimates prepared? What assumptions are used in supporting evidence?			
2.	**Related Parties** Who are the related parties? Were there any related party transactions during the period? If so, what is the purpose of those transactions? *(Consider asking management to prepare a list of related party transactions before the start of each engagement.)*			
3.	**Significant Events and Transactions** Are there any significant, unusual, or complex transactions, events, or matters that have affected (or may affect) the entity's financial statements? Address: (a) Significant changes in business activities or operations; (b) Significant changes to contract terms, such as finance and debt contracts or covenants; (c) Significant journal entries or other adjustments to the financial statements; (d) Significant transactions occurring or recognized near the end of the reporting period; (e) The status of any uncorrected misstatements identified during previous engagements; and (f) Effects or possible implications for the entity of transactions or relationships with related parties.			

	Understand the Entity to Identify Areas in the Financial Statements Where Material Misstatements Are Likely to Arise	Comments	W/P ref.	PSC? (Y/N) (Initials)
4.	**Fraud and Noncompliance** Has there been any actual, suspected, or alleged: (a) Fraud or illegal acts affecting the entity? (b) Noncompliance with provisions of laws and regulations that directly affect material amounts and disclosures in the financial statements, such as tax and regulatory requirements?			
5.	**Subsequent Events** Are there any events occurring between the date of the financial statements and the date of the practitioner's report that require adjustment of, or disclosure in, the financial statements?			
6.	**Going Concern** Are there any going-concern uncertainties? If so, what is the basis for management's assessment of going concern?			
7.	**Commitments** Are there any material commitments, contractual obligations, or contingencies that affect the entity's financial statements, including disclosures?			
8.	**Nonmonetary Transactions** Are there any material nonmonetary transactions or transactions for no consideration in the financial reporting period under consideration?			
Optional Areas of Inquiry				
1.	**Minutes and Decisions** What actions were taken at meetings of owners (TCWG and committees thereof) or other meetings that may affect the financial statements?			
2.	**Regulatory Agencies** Has the entity received (or does the entity expect to receive or obtain) communications from regulatory agencies that may affect the financial statements?			
3.	**Inconsistencies** Obtain explanations for inconsistencies identified from other management inquiries, analytical procedures, or evidence reviewed.			

Prepared by ____________________ Date ________________________

Reviewed by ____________________ Date ________________________

Examples of Analytical Procedures

Cash

Compare the total cash balance and changes in individual bank/cash balances to the prior period.

Obtain explanations for unexpected balances and significant changes.

Accounts Receivable

- Based on the change in revenue from the prior period, develop an expectation for the current period's trade receivable balance.
- Compare each type of accounts receivable (e.g., trade, sales tax, or other accounts receivable) to the prior period.
- Calculate the number of days' sales in accounts receivable (where meaningful). Compare results with the previous period and payment terms.
- Compare the ratio of bad debts expense to revenues with the previous period.
- Obtain explanations for unexpected balances and significant changes.
- Depending on the results of the above, consider whether any further review procedures should be performed.
- If additional procedures are required, consider:
  (a) Extending the analytical procedures to the previous three or four years to understand trends; and
  (b) Analyzing sales by month, by customer, etc., to understand changes in sales trends and their impact on accounts receivable.

Short-Term Investments

Compare the following:

- Total investments to the previous period (overall).
- Composition of each investment type or classification to the previous period. Review the entity's investment policy to ensure the types of investments are permissible.
- Average return on investments to the prior period.
- Effective interest rate earned on interest-bearing investments to the contracted rate in the instrument.

Obtain explanations for unexpected balances/significant changes and document your findings.

Loans and Advances

Compare the following:

- Loans and advances compared to the previous period (overall).
- Composition of loans and advances compared to the previous period.
- Effective interest rate(s) compared to the stated rate(s) of interest charged.

Obtain explanations for unexpected balances/significant changes and document your findings.

Obtain details of any new or extinguished loans and advances.

Long-Term Investments

Compare the following:

- Long-term investments to the previous period (overall).
- Composition of long-term investments to the previous period.
- Income from long-term investments to the previous period, including dividends or the investor's share of the income, or losses of the investee (equity method).

Obtain explanations for unexpected balances/significant changes and document your findings.

Property, Plant, and Equipment

Compare the following:

- Property, plant, and equipment compared to the previous period (overall).
- Composition (cost, additions, disposals, retirements, etc.) of property, plant, and equipment compared to the previous period.
- Amortization expense compared to the previous period.
- Additions during the period compared to the approved capital budget (if available).

Obtain explanations for unexpected balances / significant changes and document your findings.

Inventory

Compare the following changes or trends relating to inventory:

- Inventory balance compared to the previous period (overall).
- Inventory by location compared to the previous period.
- Composition of inventory (raw materials, work in progress, finished goods, etc.) compared to the previous period.
- Aging of the inventory. (Note that deterioration in the aging of inventory could indicate obsolete or excess inventory requiring a write-down.)
- Cost of sales and gross profit (as a percentage of sales) in the past three fiscal periods.
- Inventory turnover in the past three fiscal periods.
- Number of days' sales in inventory.

Obtain explanations for unexpected balances/significant changes and document your findings.

Depending on the results of the above, consider whether any further review procedures should be performed. If additional procedures are required, consider:

- Extending the analytical procedures to the previous three or four years to understand trends; and
- Analyzing inventory levels, sales, and cost of sales by month to understand changes in inventory trends.

Accounts Payable

Compare the following:

- Accounts payable and accrued liabilities compared to the previous period (overall).
- Composition of accounts payable and accrued liabilities (trade payables, accrued payroll, etc.) compared to the previous period. Consider the effects of payment term changes, discounts, major new vendors, or competition.
- Key ratios to prior periods:
  - (a) Days' purchases in accounts payable ([trade accounts payable]/[costs of goods sold] × 365).
  - (b) Quick ratio ([current assets/inventory]/[current liabilities]).
  - (c) Current ratio ([current assets]/[current liabilities]).

Obtain explanations for unexpected balances/significant changes and document your findings.

Long-Term Debt

Compare the following:

- Total long-term debt balance to the previous period.
- Composition of long-term debt to the previous period.
- Key ratios compared to prior periods:
  - (a) Debt-to-equity ratio ([long-term debt]/[total equity]).
  - (b) Debt ratio ([total liabilities]/[total assets]).
  - (c) Times interest earned ([earnings before income and taxes]/[interest]).

Obtain explanations for unexpected balances/significant changes and document your findings.

Revenue and Expenses

Obtain or prepare comparative grouping schedules for all items in the income statement and compare them with those of the prior period and with the budget (where available).

Compute changes and ratios and discuss and document material changes compared to previous periods:

- Changes to key financial ratios and key performance indicators.
- Changes in sales (overall) and sales by function (product line, geographic region, etc.).
- Consider comparing the sales by month and/or sales by customer to prior periods.
- Sales returns, credit memos, etc., as a percentage of sales.
- Gross margins (overall) and gross margins by function.
- Payroll expense (overall).
- Payroll deductions and benefits as a percentage of payroll compared to historical and statutory rates.
- Expense items by key groupings and categories.
- Interrelationships between items such as commissions as a percentage of sales and freight-in as a percentage of purchases.
- Interest expense compared to average balance of related loan and stated rate.
- Any other significant ratios.

Obtain explanations for the variances identified above and document the results.

Revenue *(Comparison of a predicted amount to the recorded amount in accounting records)*

Where revenue components have an identifiable relationship, consider performing what is often called a *substantive analytical procedure* or *proof in total*. (Typical applications include apartment rentals, daycare revenue, and fitness club fees.)

- Obtain the number of one-, two-, and three-bedroom units in the building.
- Inquire about the approved rental rates for each type of unit for the period.
- Obtain the number of vacancies in the year and compare to the prior year.
- Compare the expected revenue from full occupancy ([number of units] × [rental rate]) and subtract the lost revenue from vacancies, etc.
- Compare the expected revenue to the actual revenue.

Obtain explanations for the variances identified above and document the results.

APPENDIX F

Going-Concern Events and Conditions

This listing is drawn from ISRE 2400 (Revised), paragraph A93. It is not all inclusive and the significance of such events or conditions can often be mitigated by other factors.

Events or Conditions That May Cast Significant Doubt About the Going-Concern Assumption	
Category	**Comments**
Financial	
1. Net liability or net current liability position.	
2. Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment, or excessive reliance on short-term borrowings to finance long-term assets.	
3. Indications of withdrawal of financial support by creditors.	
4. Negative operating cash flows indicated by historical or prospective financial statements.	
5. Adverse key financial ratios.	
6. Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.	
7. Arrears or discontinuance of dividends.	
8. Inability to pay creditors on due dates.	
9. Inability to comply with the terms of loan agreements.	
10. Change from credit to cash-on-delivery transactions with suppliers.	
11. Inability to obtain financing for essential new product development or other essential investments.	
Operating	
1. Management intentions to liquidate the entity or to cease operations.	
2. Loss of key management without replacement.	
3. Loss of a major market, key customer(s), franchise, license, or principal supplier(s).	
4. Labor difficulties.	
5. Shortages of important supplies.	
6. Emergence of a highly successful competitor.	
Other	
1. Noncompliance with capital or other statutory requirements.	
2. Pending legal or regulatory proceedings against the entity that, if successful, may result in claims that the entity is unlikely to be able to satisfy.	
3. Changes in law or regulation or in government policy expected to adversely affect the entity.	
4. Uninsured or underinsured catastrophes when they occur.	

APPENDIX G

Sample File Completion Checklist

PSC = procedure successfully completed

		Comments	W/P ref.	PSC? (Y/N) (Initials)
General				
1.	**Quality Control** Was the engagement performed in accordance with the firm's quality control policies and procedures?			
2.	**Independence** Were any new threats to independence identified since the commencement of the engagement? If yes, explain how they were addressed.			
3.	**Understanding the Entity** Have we obtained and documented an understanding of the entity, and the AFRF, sufficient to: • Identify areas in the financial statements where material misstatements are likely to arise? • Provide a basis for designing procedures to address those areas?			
4.	**Inquiry and Analytical Procedures** Were the procedures designed and performed sufficient to obtain appropriate evidence with respect to: • All material items in the financial statements, including disclosures? • Areas in the financial statements where material misstatements are likely to arise?			
5.	**Additional Procedures** Did we become aware of a matter(s) that caused us to believe the financial statements may be materially misstated? If yes, were additional procedures designed and performed that were sufficient for us to either: • Conclude that the matter(s) was not likely to cause the financial statements to be materially misstated? • Determine that the matter(s) causes the financial statements to be materially misstated?			
6.	**Going Concern** Did we become aware of any events or conditions that may cast significant doubt about the entity's ability to continue as a going concern? If yes, did we inquire of management about plans for future actions, evaluate the responses, and form a conclusion regarding the entity's ability to continue as a going concern?			

		Comments	W/P ref.	PSC? (Y/N) (Initials)
7.	**Completion of Procedures** Have all planned inquiries/analysis and any additional procedures required been completed and the results and conclusions reached documented in the working papers?			
8.	**Subsequent Events** Did we become aware of events occurring between the date of the financial statements and the date of the report that require adjustment of, or disclosure in, the financial statements? If yes, did we request management to correct those misstatements or make additional disclosures in the financial statements?			
9.	**Identified Misstatements** • Was management asked to correct all identified misstatements other than those considered clearly trivial? • If management declined to correct any of the identified misstatements, were the reasons provided considered acceptable?			
10.	**Written Representations** Is there a signed letter of management representations on file that addresses the requirements outlined in ISRE 2400 61-64?			
11.	**File Review** • Have all working papers been reviewed, initialed, and dated? • Have the file reviewer's queries been cleared? • Have all outstanding engagement issues/ questions been resolved with management and the details documented?			
12.	**Communication** Have we communicated with management or TCWG, as appropriate, all matters concerning the review engagement that, in our professional judgment, are of sufficient importance to merit their attention?			
13.	**Financial Statement Approval** Has management (and/or TCWG) accepted responsibility for the final financial statements? If so, provide the date: ____________________			
14.	**Variance to Budget** Has the total time spent on the engagement been recorded and explanations provided for significant variances from the budget?			
Financial Statement Presentation and Disclosure				
1.	**Trial Balance** Has the trial balance and account groupings been agreed to the final financial statements?			
2.	**Financial Reporting Framework** Do the financial statements clearly describe the AFRF without any imprecise, qualifying, or limiting language?			

		Comments	W/P ref.	PSC? (Y/N) (Initials)
3.	**Terminology** Is the terminology used, including the title of each financial statement, appropriate?			
4.	**Accounting Policies** Are the accounting policies (selected and applied): • Adequately disclosed in the significant accounting policies? • Consistent with the AFRF, appropriate in the circumstances, and applied consistently?			
5.	**Estimates** Do the accounting estimates made by management appear reasonable?			
6.	**Disclosures** • Does the information presented in the financial statements appear relevant, reliable, comparable, and understandable? • Do the financial statements provide adequate disclosures to enable the intended users to understand the effects of material transactions and events on the information conveyed in the financial statements? • Is it necessary to include any additional disclosures beyond those specifically required by the AFRF?			
7.	**Fair Presentation Framework** • Are the overall presentation, structure, and content of the financial statements in accordance with the AFRF? • Do the financial statements, including the related notes, appear to represent the underlying transactions and events in a manner that achieves fair presentation or gives a true and fair view, as appropriate, in the context of the financial statements as a whole?			
Reporting				
1.	**ISRE 2400 (Revised) Requirements** Are the form, content, and date of the review engagement report in accordance with the requirements of ISRE 2400 (Revised)?			

Prepared by ____________________ Date ________________________

Reviewed by ____________________ Date ________________________

APPENDIX H

Example of Written Representations from Management

Note: Additional material that may be included in the letter has been italicized and contained within brackets.

[LETTERHEAD]

[Date] (same or very close to date of Review Engagement Report)

To *[the accounting firm*
Accountant(s)
Street address
City, Country]

Dear ___________:

This representation letter is provided in connection with your review of the financial statements of *[entity's name]* for the year ended December 31, 20XX, for the purpose of obtaining limited assurance, primarily by performing inquiry and analytical procedures, about whether the financial statements as a whole are free from material misstatement.

We acknowledge that we are responsible for the fair presentation of the financial statements in accordance with *[AFRF]* and for the design and implementation of internal control to prevent and detect fraud and error.

We understand that your review procedures consisted primarily of inquiry and analytical procedures, which are not designed to identify (nor can they necessarily be expected to disclose) fraud, shortages, errors, or other irregularities, should any exist.

Certain representations in this letter are described as being limited to matters that are material. An item, regardless of its monetary value, is considered material if it is probable that its omission from, or misstatement in, the financial statements would influence the decision of a reasonable person relying on the financial statements.

We confirm that (to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves):

Financial Statements

(a) We have fulfilled our responsibilities as set out in the terms of the review engagement dated *[date]* for the preparation of the financial statements in accordance with *[AFRF]*; in particular, the financial statements are fairly presented in accordance therewith.
(b) Significant assumptions used by us in making accounting estimates, *[including those measured at fair value]*, are reasonable.
(c) Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of *[AFRF]*.
(d) All events subsequent to the date of the financial statements and for which *[AFRF]* require adjustment or disclosure have been adjusted or disclosed.
(e) The effects of uncorrected misstatements are immaterial (both individually and in the aggregate) to the financial statements as a whole. A list of the uncorrected misstatements is attached to this representation letter.
(f) *[Any other written representations required to support other review evidence relevant to the financial statements.]*

Information Provided

(a) We have provided you with:
   (i) Access to all information, of which we are aware, that is relevant to the preparation of the financial statements (such as records, documentation, and other matters);
   (ii) Additional information that you have requested from us for the purpose of conducting our review;
   (iii) Unrestricted access to persons within the entity from whom you determined it necessary to conduct your review; and
   (iv) All information relevant to the use of going-concern assumption in the financial statements.

(b) We have documented all transactions in the accounting records and they are reflected in the financial statements.

(c) We have disclosed to you all information, of which we are aware, in relation to fraud or suspected fraud and that affects the entity and involves:

(d) Management;

(e) Employees who have significant roles in internal control; or

(f) Others where the fraud could have a material effect on the financial statements.

(g) We have disclosed to you all information in relation to allegations of fraud or suspected fraud affecting the entity's financial statements communicated by employees, former employees, analysts, regulators, or others.

(h) We have disclosed to you all known instances of noncompliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements.

(i) We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.

(j) We have disclosed all material commitments, contractual obligations, or contingencies that have affected or may affect the entity's financial statements.

(k) We have reflected in the financial statements all material nonmonetary transactions or transactions for no consideration undertaken by the entity in the financial reporting period under consideration.

(l) *[Any other written representations considered necessary.]*

Yours truly,

____

[Name of Chief Executive Officer, or equivalent, and title]

[Name of Chief Financial Officer, or equivalent, and title]

APPENDIX I

Examples of Modified Report Conclusions

Note: The title, addressee, and required paragraphs in the report (such as the introduction, management's responsibility, the practitioner's responsibility, and the nature of a review engagement) have been omitted from these examples.

A. QUALIFIED Conclusion—Inability to obtain evidence on completeness of revenues

Basis for Qualified Conclusion

In common with many not-for-profit organizations, *[name of not-for-profit organization]* derives revenue from donations, the completeness of which is difficult to verify. As a result, we were not able to perform the procedures considered necessary for ensuring the completeness of donation revenue. Accordingly, our procedures were limited to the amounts recorded in the records of *[name of not-for-profit organization]*. Therefore, we were not able to determine whether any adjustments might be necessary to donation revenue, excess of revenues over expenses, cash flows from operations for the year ended *[year-end date]*, and current assets and net assets as at *[year-end date]*.

Qualified Conclusion

Based on our review, except for the possible effects of the matter described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the accompanying financial statements do not present fairly, in all material respects, (or do not give a true and fair view of) *[…]*.

B. QUALIFIED Conclusion—Departure from policy required by financial reporting framework

Basis for Qualified Conclusion

As indicated in Note *[number]* to the financial statements, the company's long-term accounts receivable have been carried at cost, less any provision for uncollectable accounts. This is a departure from *[AFRF]*, which requires the discounting of the long-term accounts receivable. Had management discounted the long-term accounts receivable, the long-term accounts receivable balance would have been reduced by €*[amount]*.

Accordingly, sales would have decreased by €*[amount]*, income before tax, income tax expense, and shareholder's equity would have been reduced by €*[amount]*, €*[amount]*, and €*[amount]*, respectively.

Qualified Conclusion

Based on our review, except for the possible effects of the matter described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the accompanying financial statements do not present fairly, in all material respects, (*or do not give a true and fair view of*) the financial position of *[entity's name]* as at *[date]*, and (of) its financial performance and cash flows for the year then ended, in accordance with *[AFRF]*.

C. ADVERSE Conclusion—Pervasive departure from applicable financial reporting framework

Basis for Adverse Conclusion

As explained in Note *[number]*, the company has recorded certain leases as operating leases in the financial statements. This is a departure from *[AFRF]*, which requires these leases to be accounted for as capital leases. Had the company recorded these leases as capital leases, the amounts presented for assets under capital leases, obligations under capital lease, comprehensive income, and retained earnings would have been materially affected.

Adverse Conclusion

Based on our review, due to the significance of the matter discussed in the Basis for Adverse Conclusion paragraph, the consolidated financial statements do not present fairly (or do not give a true and fair view of) the financial position of *[entity's name…]*.

D. DISCLAIMER of Conclusion—Pervasive scope limitation

Basis for Disclaimer of Conclusion

The company experienced a severe flood during the year, which destroyed many of the company's physical records and computer facilities. Although the company has attempted to rebuild the systems and reconstruct the accounting systems and records, we were unable to conduct significant review procedures that we considered necessary. Consequently, we were unable to determine whether any adjustments might have been necessary with respect to the financial statements of *[entity's name]*.

Disclaimer of Conclusion

Due to the significance of the matters described in the Basis for Disclaimer of Conclusion paragraph, we were unable to obtain sufficient appropriate evidence to form a conclusion on the accompanying financial statements. Accordingly, we do not express a conclusion on these financial statements.

E. DISCLAIMER of Conclusion—Pervasive fraud has occurred

Basis for Disclaimer of Conclusion

As outlined in Note *[number]* to the financial statements, the company identified a material fraud that is subject to an ongoing investigation. Until such time as the extent of the fraud has been determined, it is not possible to determine what adjustments will be necessary with respect to *[revenue, accounts receivable, inventory, cost of sales, or other areas]* the financial statements.

Disclaimer of Conclusion

Due to the significance of the matters described in the Basis for Disclaimer of Conclusion paragraph, we were unable to obtain sufficient appropriate evidence to form a conclusion on the accompanying financial statements. Accordingly, we do not express a conclusion on these financial statements.

Note: As stated in the paragraph three of the preface to the IAASB Handbook, IAASB standards do not override local laws and regulations in a particular country. Review report wording must be considered in light of the laws and regulations in the jurisdiction in which the practitioner is reporting. Accordingly, not all of the examples provided in this Guide may be appropriate in all jurisdictions.

For more information
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