CHARTERED
PROFESSIONAL
ACCOUNTANTS
CANADA

# Guide to Review Engagements

GUIDE FOR PRACTITIONERS

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## DISCLAIMER

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# Foreword

CPA Canada undertakes initiatives to support practitioners and their clients in the implementation of standards. As part of these initiatives, CPA Canada has prepared this Guide to provide guidance and help practitioners perform review engagements under Canadian Standard on Review Engagements (CSRE) 2400, *Engagements to Review Historical Financial Statements*.

This Guide provides non-authoritative guidance that has not been adopted, endorsed, approved or otherwise acted upon by the Auditing and Assurance Standards Board, Accounting Standards Board, Public Sector Accounting Board, any CPA Canada board or committee, the governing body or membership of CPA Canada or any provincial Institute/Ordre or the organizations represented by the members of the task force.

A practitioner is expected to use professional judgment in determining whether the material in this publication is both appropriate and relevant to their particular review engagements. This publication is based on CSRE 2400 as issued in April 2016.

CPA Canada expresses its appreciation to the author, Jane Bowen, FCPA, FCA, for developing this Guide and to the members of the Review Engagement Guidance Task Force for their contribution to its preparation. Without the valued and dedicated efforts of the Task Force, this Guide would not have been possible.

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**CHAPTER 1**

# How to Use This Guide

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| 1.1-1 Uses for the Guide | 1.2-1 Organization of Chapters<br>1.2-2 Acronyms Used |

## 1.1 Introduction and Purpose

The Canadian Standard for Review Engagements (CSRE) 2400, *Engagements to Review Historical Financial Statements*, applies to the reviews of historical financial statements (interim and annual) prepared in accordance with both general-purpose and special-purpose reporting frameworks. CSRE 2400, adapted as necessary, also applies to reviews of other historical financial information. This Guide will focus on the responsibilities of a **practitioner** when engaged to perform a review of historical financial statements in accordance with CSRE 2400.

### *Effective Date*

CSRE 2400 was issued March 31, 2016, and is effective for reviews of annual and interim financial statements (except when the interim engagement falls under the scope of Section 7060, *Auditor Review of Interim Financial Statements*) for periods ending on or after December 14, 2017. Early application is not permitted.

CSRE 2400 includes requirements and application guidance for determining the nature and extent of procedures and the form and content of the practitioner's report. It is assumed that the practitioners using this Guide will already have an understanding of the entire text of CSRE 2400. The Guide provides non-authoritative guidance for applying CSRE 2400. It is not to be used as a substitute for reading the standard, but rather as a supplement to support consistent application 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 CSRE 2400.

The purpose of this Guide is to provide:

- practical guidance on the application of the requirements when conducting review engagements

- examples of:
  - typical procedures and some fictional practice scenarios with responses based on the unique facts and circumstances involved and the appropriate use of professional judgment by the practitioner

- Consider Points that address:
  - matters that can easily be overlooked or where practitioners could encounter difficulties with implementation
  - efficiencies to help reduce the time required in performing review engagements.

### 1.1-1 Uses for the Guide

This Guide can be used to:

- assist in an understanding of CSRE 2400 and its implementation
- 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
- improve communication among the engagement team and others

## 1.2 Content and Organization

This Guide has been organized to follow the elements of a review engagement as discussed in Chapter 2. The appendices contain definitions of terms used, sample procedures 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 paragraphs in CSRE 2400 applicable to the topic
c. commentary on the requirements
d. examples of the concepts involved
e. Consider Points (practical guidance)

## 1.2-2 Acronyms Used

| | |
|---|---|
| **AASB** | Auditing and Assurance Standards Board |
| **AcSB** | Accounting Standards Board |
| **AFRF** | Applicable financial reporting framework |
| **ASNFPO** | Accounting Standards for Not-for Profit Organizations (Part III of *CPA Canada Handbook—Accounting*) |
| **ASPE** | Accounting Standards for Private Enterprises (Part II of *CPA Canada Handbook—Accounting*) |
| **CAS** | Canadian Auditing Standards |
| **CSRE** | Canadian Standard on Review Engagements |
| **CSQC 1** | Canadian Standard on Quality Control 1 |
| **EQCR** | Engagement quality control review |
| **F/S** | Financial statements |
| **IFAC** | International Federation of Accountants |
| **IFRS** | International Financial Reporting Standards |
| **IT** | Information technology |
| **TCWG** | Those charged with governance |
| **W/P** | Working paper |

# CHAPTER 2
# Review Engagements — An Overview

**CHAPTER 2: CONTENT**

- Scope and objective of a review engagement
- How a review engagement differs from a compilation or an audit engagement
- Type of work involved in a review engagement



## 2.1 Fundamentals

CSRE 2400 provides an opportunity to meet a market place demand for review engagement services created by factors such as:

- demand from financial institutions for some degree of independent assurance on the entity's financial statements
- desire by entities to engage a practitioner to complete a review engagement to increase the credibility of their financial statements
- possible changes in regulations which may make review engagements an acceptable alternative to an audit engagement

- request to perform a review of the financial information of a non-significant component entity of a group, when the group financial statements are audited; see paragraph 29 of CAS 600, *Special Considerations—Audits of Group Financial Statements (Including the work of Component Auditors)*

## 2.1-1 Scope of CSRE 2400

CSRE 2400 addresses the:

- practitioner's responsibilities when engaged to perform a review of historical financial statements, both annual and interim financial statements, except when the auditor of an entity reviews its interim financial statements in the circumstances described in Section 7060, *Auditor Review of Interim Financial Statements*
- form and content of the practitioner's report.

The scope of CSRE 2400 and its applicability to engagements is summarized in the following exhibit:

**Exhibit 2.1-1A**

| ALL engagements are subject to quality control (i.e., CSQC 1)<br>Applicability of CSRE 2400 | | | | | |
|---|---|---|---|---|---|
| **YES** | **YES*** | **YES** | **YES** | **NO** | **NO** |
| when performing a review of **annual** historical financial statements | when performing a review of **interim** historical financial statements*<br>(*See reference to Section 7060 for those reviews completed for regulatory purposes.) | when performing a review of other **historical financial information**, CSRE 2400 adapted as necessary (see **Note 1** below)<br>**Note:** CRSRE 2400 is not applicable to non-historical financial information. Limited assurance engagements, other than reviews of historical financial information, are performed under other Canadian Standard on Assurance Engagements (CSAEs) | when performing a review of financial statements of a **component** at the request of the group practitioner<br>(See CAS 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)* | when performing a review of compliance with an agreement or regulation<br>Apply Section 8600, *Reviews of Compliance With Agreements And Regulations*<br>(See **Note 2** below.) | when performing, as auditor of an entity, reviews of its interim financial statements in the circumstances described in Section 7060, *Auditor Review of Interim Financial Statements* (i.e., for regulatory purposes |

**Note 1:** Section 8500, *Reviews of Financial Information Other Than Financial Statements*, has been replaced by CSRE 2400.

**Note 2:** Section 8600, Reviews of *Compliance With Agreements And Regulations*, was retained because matters within its scope would not be covered by CSRE 2400. There is a project underway that would eventually replace Section 8600. Section 8100 will also be retained until completion of the AASB's project to replace Section 8600, since Section 8600 is linked to Section 8100.

As indicated above, CSRE 2400 also applies (adapted as necessary) to reviews of other historical financial information. However, this Guide concentrates on reviews of historical general-purpose and special-purpose financial statements.

CSRE 2400 does *not* address:

- reviews of summary financial statements
- reviews performed by the independent auditor of the entity's interim financial statements to be issued under provisions of securities legislation, which are dealt with by Section 7060 (see paragraph 1 of Section 7060)
- Section 7060 is the appropriate standard to comply with when performing, as the auditor of an entity, a review of the entity's interim financial statements for regulatory purposes, as described in Section 7060; however, CSRE 2400 **does** apply when a practitioner is engaged to review interim financial statements in the circumstances other than described in Section 7060, as indicated above
- limited assurance engagements other than reviews of historical financial information performed under Canadian Standard on Assurance Engagements (CSAE), such as CSAE 3000, *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*.

## 2.1-2 Engagement Objectives

| Paragraph | Requirement |
|---|---|
| | **Objectives** |
| 12 | The practitioner's objectives in a review of financial statements under this CSRE are to:<br>(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; (Ref. Para A10) and<br>(b) Report on the financial statements as a whole and communicate as required by this CSRE. |

As seen above in paragraph 12(a) of CSRE 2400, the objective refers to obtaining limited assurance. The following exhibit provides a description of this term to help understand the objective of CSRE 2400, along with a description of an audit to allow for a comparison.

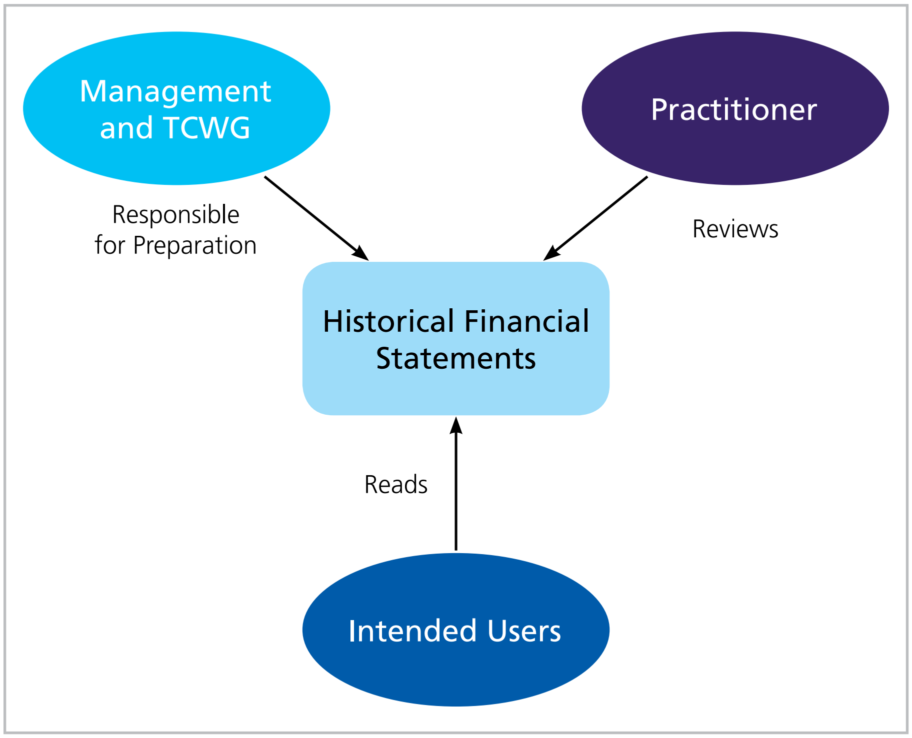
### Exhibit 2.1-2A

| Type of Engagement | Commonly Known As | Description |
|---|---|---|
| **Limited Assurance** | **Review** | • an engagement to form 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<br>• level of assurance obtained where engagement risk is reduced to a level acceptable in the circumstances of the engagement, and less than reasonable assurance provided in an audit<br>• 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<br>• to be meaningful, level of assurance obtained by the practitioner likely to enhance intended users' confidence in the financial statements |
| **Reasonable Assurance** | **Audit** | • an engagement to form an opinion on the financial statements in terms of being presented fairly, in all material respects, in accordance with the AFRF<br>• reasonable assurance is a high level of assurance 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 |

There are three main parties in an assurance engagement for the review of historical general-purpose financial statements, as summarized in the following exhibit:

1. Management/TCWG
2. Practitioner
3. Intended Users

**Exhibit 2.1-2B**




The role of each of the three parties is described in the following chart:

| Party | Description of Role |
|---|---|
| **Management and Those Charged with Governance (TCWG)** | • responsible for preparing the financial statements (including disclosures) in accordance with the AFRF (e.g., ASPE, IFRS, or ASNPO) is the responsibility of management/TCWG<br>• responsible for the internal control necessary to enable the preparation of financial statements free from material misstatement, whether due to fraud or error |

| Party | Description of Role |
|---|---|
| **Practitioner** | • performs procedures and obtains evidence to be able to form a conclusion on whether anything 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 AFRF (e.g., ASPE, IFRS, or ASNPO) |
| **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. |

Reminder: In many smaller entities, there may be no separation between management's role and TCWG.

## 2.1-3 Comparing Compilations, Reviews, and Audits

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

### Exhibit 2.1-3A

| Engagement | Standards | Assurance | Work Efforts | Report |
|---|---|---|---|---|
| **Compilation** | Section 9200 | None | compiling financial statements | Notice to Reader — states no assurance provided |
| **Review** | CSRE 2400 | Limited | • performing procedures to address all material items in the financial statements and focus on addressing areas in the financial statements where material misstatements are likely to arise<br>• procedures are primarily inquiry and analytical | Conclusion |
| **Audit** | CASs | Reasonable | • risk assessment and procedures that respond to the risks identified<br>• procedures more extensive, will include substantive procedures and may include tests of controls | Opinion |

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 assurance users could reasonably expect to take from the 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.

## 2.2 Elements

### 2.2-1 Elements Involved in Performing a Review Engagement

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

**Exhibit 2.2-1A**

| Element | Activity | Purpose | Documentation |
|---|---|---|---|
| **Accepting** | comply with firm's quality control (QC) policies for review engagements | decide if the engagement can be accepted within the parameters of the QC policies, (i.e., determine whether appropriate staff are available to perform review engagement) | • reference firm's QC policies and training provided on QC and review engagements |
| | perform acceptance or continuance procedures | • decide whether engagement should be accepted<br>• obtain acknowledgement from management of their responsibilities | • preliminary observations<br>• independence assessment and other ethical considerations<br>• engagement letter |

| Element | Activity | Purpose | Documentation |
|---|---|---|---|
| **Planning** | • understand the entity and its environment and the AFRF<br>• determine materiality | • identify material items in the F/S including disclosures<br>• identify areas in the F/S where misstatements are likely to arise | • understanding of the entity and environment<br>• materiality<br>• areas in the F/S where misstatements are likely to arise |
| | design inquiries and analytical procedures | focus work efforts on:<br>• material items in the F/S<br>• areas in the F/S where material misstatements are likely to arise | • team planning notes<br>• listing (plan) of procedures to be performed |
| **Performing** | perform planned procedures and any additional procedures required | obtain sufficient appropriate evidence | • results of procedures performed<br>• supporting evidence obtained |
| **Forming an Appropriate Conclusion** | evaluate findings and discuss with management/TCWG | a continuation of ongoing communication and resolution of all relevant matters | • review of final F/S presentation/disclosure<br>• results of discussions<br>• significant judgments |
| | form a conclusion | ensure review conclusion is appropriate | • final conclusions<br>• approval of F/S |
| **Reporting** | prepare an appropriately worded report | | • final review engagement report |

## 2.2-2 Key Steps Involved in Performing a Review Engagement

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

### Exhibit 2.2-2A

| Key Steps Involved | Location within the Guide |
|---|---|
| 1. Determine the **acceptability of the engagement and client** relationship. | Chapter 3 |
| 2. Obtain an **understanding of the entity and its environment and the AFRF** sufficient to first identify areas in the financial statements where material misstatements are likely to arise and then to **design procedures accordingly**. | Chapter 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 and techniques 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 |
| 4. Perform inquiry and **analytical procedures**. | Chapter 5 |
| 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 |
| 6. **Evaluate** the sufficiency and appropriateness of the evidence obtained. | Chapter 5 |
| 7. Form a **conclusion**. | Chapter 6 |
| 8. **Report** on the financial statements. | Chapter 7 |

## 2.2-3 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 (e.g., ASPE, IFRS, ASNPOs) is outlined in the following exhibit taken from Illustration 1 in CSRE 2400

**INDEPENDENT PRACTITIONER'S REVIEW ENGAGEMENT REPORT**

[Appropriate Addressee]

We have reviewed the accompanying financial statements of ABC Company that comprise the balance sheet as at December 31, 20X1, and the statements of income, retained earnings and 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 Canadian accounting standards for private enterprises, 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 based on our review. We conducted our review in accordance with Canadian generally accepted standards for review engagements, which require us to comply with relevant ethical requirements.

A review of financial statements in accordance with Canadian generally accepted standards for review engagements 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 in extent than, and vary in nature from, those performed in an audit conducted in accordance with Canadian generally accepted auditing standards. 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 the financial statements do not present fairly, in all material respects, the financial position of ABC Company as at December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with Canadian accounting standards for private enterprises.

[Practitioner's signature]

[Date of the practitioner's report]

[Practitioner's address]

# CHAPTER 3
# Accepting

## CHAPTER 3: CONTENT

- Requirements to be addressed before a review engagement can be accepted or continued

| 3.1: Is the Firm Ready? | 3.2: Can the Engagement Be Accepted or Continued? | 3.3: Agree Terms of Engagement |
|---|---|---|
| 3.1-1 Understand CSRE 2400<br>3.1-2 Ethical Standards<br>3.1-3 Professional Skepticism<br>3.1-4 Professional Judgment<br>3.1-5 Competence<br>3.1-6 Quality Control | 3.2-1 Rational Purpose<br>3.2-2 Appropriateness of Engagement<br>3.2-3 Ethical Requirements, including Independence<br>3.2-4 Scope Limitations<br>3.2-5 Doubts about Management's Integrity | 3.3-1 Engagement Preconditions<br>3.3-2 Engagement Terms Not Satisfactory<br>3.3-3 Agree Terms of Engagement |

### Outcome

The firm has:

- met the requirements of the firm's system of quality control
- concluded on whether the engagement should be accepted or continued
- **BEFORE** work commences, obtained a signed engagement letter or suitable written agreement.

This Guide will refer to the "practitioner" as the person completing the review engagement in most cases, as in CSRE 2400. However, in the following section the "firm" is used to address the ability to be ready to perform a review engagement. Readers of this Guide may be sole practitioners with no staff, or may have a firm with staff and other partners. Therefore, use this guidance as it applies to you, whether you are a practitioner, engagement partner, engagement team, or a firm.

## 3.1 Is the Firm Ready?

Before a firm can accept and perform a review engagement, it needs to address the matters discussed in this chapter.

### 3.1-1 Understand CSRE 2400

| Paragraph | Requirement |
|---|---|
| | **Conduct of a Review Engagement in Accordance with this CSRE** |
| 16 | The practitioner shall have an understanding of the entire text of this CSRE, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A17) |
| | *Complying with Relevant Requirements* |
| 17 | The practitioner shall comply with each requirement of this CSRE, 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. |
| 18 | The practitioner shall not represent compliance with this CSRE in the practitioner's report unless the practitioner has complied with all the requirements of this CSRE relevant to the review engagement. |

The practitioner needs to understand the entire text of CSRE 2400, including the objectives, definitions, requirements, and application and other explanatory material. The practitioner must also make sure any members of the engagement team have a sufficient understanding. This understanding can be supplemented with the practical guidance contained in this Guide and through appropriate training programs.

The practitioner must comply with all the requirements of CSRE 2400 unless a particular requirement is not relevant.

## CONSIDER POINTS

If a practitioner is completing a review engagement that will be distributed to another country, the practitioner must consider whether laws or regulations in the country in which the entity operates may override any requirements in CSRE 2400. If so, the practitioner must consider whether a review engagement conducted in accordance with CSRE 2400 would actually comply with the foreign laws and regulations. For example, if the foreign laws prescribed wording for a review engagement report which differs significantly from the wording required by CSRE 2400, the practitioner must evaluate if the prescribed wording is appropriate, and if additional explanations in the practitioner's report could mitigate any possible misunderstanding on the assurance obtained from the review of the financial statements. If the prescribed wording of the report under the law is significantly different, and any additional explanations would not prevent any possible misunderstandings, the practitioner may reach a conclusion that the engagement does not comply with CSRE 2400 (see paragraph 32 of CSRE 2400).

In addition, if a practitioner is engaged to do a review engagement outside the jurisdiction in which they are licensed to practice, they should consider whether they are permitted to do so.

## 3.1-2 Ethical Standards

| Paragraph | Requirement |
|---|---|
| | **Ethical Requirements** |
| 19 | The practitioner shall comply with relevant ethical requirements, including those pertaining to independence. (Ref: Para. A18-A19) |

The engagement team and engagement quality control reviewer are subject to the relevant independence and other ethical requirements set out in rules of professional conduct/code of ethics applicable to the practice of public accounting issued by the various professional accounting bodies. Practitioners should refer to the rules of professional conduct/code of ethics in the jurisdiction in which they are practising.

The general relevant principles include independence and other ethical requirements such as:

- integrity
- objectivity
- professional competence and due care
- confidentiality
- professional behaviour

The practitioner must be independent in mind and appearance. The practitioner's compliance with independence requirements, including any safeguards implemented, gives the practitioner the ability to form a conclusion without being affected by influences that might otherwise compromise that conclusion. The practitioner's independence also enhances the practitioner's ability to act with integrity, to be objective and to maintain an attitude of professional skepticism.

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

## 3.1-3 Professional Skepticism

| Paragraph | Requirement |
|---|---|
| | **Professional Skepticism** |
| 20 | 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. A20-A23) |

Professional skepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and being capable of critically assessing evidence. Professional skepticism enhances a practitioner's ability to identify and respond to conditions that may indicate possible misstatement.

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:<br>• is contradictory<br>• questions reliability of management or TCWG represen-tations. | **Draw** appropriate conclusions. |

Maintaining professional skepticism is necessary not only at the start of a review engagement, but throughout the engagement. Professional skepticism will reduce the risks that the practitioner may:

- overlook unusual circumstances
- overgeneralize when drawing conclusions from evidence obtained
- use inappropriate assumptions in determining the nature, timing and extent of the procedures performed in the review

Professional skepticism is also important in the latter part of the review engagement when the practitioner is evaluating the results of the procedures completed in order to draw the appropriate conclusions.

**CONSIDER POINTS**

The practitioner's past experience of the honesty and integrity of the entity's management/TCWG is not expected to be dismissed. However, such "faith" does not relieve the practitioner of the need to maintain professional skepticism or allow the practitioner to be satisfied with evidence that is inadequate for the purpose of the review.

The following exhibit provides examples that illustrate situations where the application of professional skepticism may have uncovered misstatements in the financial statements. The key point is that whenever the practitioner identifies an unusual or suspicious situation, additional procedures need to be performed and the responses need to be considered in light of the practitioner's understanding of the entity and its environment and the AFRF. 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 answers provided by management.

**Exhibit 3.1-3B**
**Examples Where Professional Skepticism Could Have Led to More Questions/Procedures**

| Example 1 |
| --- |
| 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 briefly researched and discovered that apparel sales are down across Canada. 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.<br><br>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.<br><br>Such a variance needs to be further explored, as it could well be indicative of an error. Other analytical procedures that could have been performed include a review of sales by month, changes in the accounts receivable balance, and inquiries about new customers or changes in sales amounts for key customers. |
| **Example 2** |
| In performing the 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.<br><br>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. |

### Example 3

Emma asked the accountant about the changes in the Not-for-Profit Organization's (NFPO) tangible capital assets 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 executive director'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 the executive director had a number of transactions where the NFPO's assets were diverted to her personal use.

### Example 4

Julian was asked to inquire about the adequacy of the sales cut-off 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 spoken comment, so he concluded that the cut-off 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 |
|---|---|
| | **Professional Judgment** |
| 21 | The practitioner shall exercise professional judgment in conducting a review engagement. (Ref: Para. A24-A28) |

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, experience and professional skepticism to the known facts and circumstances of the particular engagement. Where necessary, the appropriate consultation with others will help to make sure that reasonable judgments are made.

The following exhibit provides some examples of the use of professional judgment in a review engagement and some points to consider in the documentation of such judgments.

**Exhibit 3.1-4A**

| Examples of the Uses of Professional Judgment | Judgment | Points to Consider in Documentation of Judgment (use checklist/tool/memo) |
|---|---|---|
| | identifying 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 | listing areas in the financial statements that require the attention of the experienced practitioner, with a supported conclusion |
| | determining materiality for the engagement | listing the users of the financial statements and the benchmark to be applied, with a supported conclusion |
| | identifying the areas in the financial statements where material misstatements are likely to arise | linking the factors from the understanding of the entity and its environment to the areas in the financial statements where material misstatements are likely to arise |
| | using past experience (in performing assurance engagements) and the understanding obtained of the entity and its environment to determine which procedures to perform | listing procedures with explanation as to why they were selected |
| | evaluating information obtained from inquiries and its sufficiency as evidence | listing of the question, those who were asked, when they were asked, their responses, and why these responses are sufficient/relevant |
| | using professional experience to determine the additional work required when the information received causes the practitioner to believe the financial statements may be materially misstated | explanation for any additional work performed (i.e., why the additional procedures were required and when they were completed) |

| | Judgment | Points to Consider in Documentation of Judgment (use checklist/tool/memo) |
|---|---|---|
| **Examples of the Uses of Professional Judgment** | considering management's judgment in applying the entity's AFRF, estimates made by management, and the nature of disclosures in the financial statements | explicit comment/conclusion after considering all disclosures in the financial statements (i.e., this could be part of a wrap-up memo or checklist sign-off) |
| | drawing on professional experience to determine appropriate engagement conclusions based on the information obtained | explicit comment/conclusion after considering all information obtained. For example, the engagement partner should document the conclusions, that is state that based on the procedures performed, nothing has come to their attention to cause them to believe that the financial statements are not in accordance with [fill in the AFRF] (i.e., this could be part of a wrap-up memo/checklist sign-off) |

The exercise of professional judgment should be evident in the documentation. Documentation must be sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand the significant judgments made in reaching those conclusions. This Guide provides some examples of possible documentation in subsequent chapters and the requirements for documentation are included in Chapter 5.

## 3.1-5 Competence

| Paragraph | Requirement |
|---|---|
| | **Engagement Level Quality Control** |
| 22 | The engagement partner shall possess competence in assurance skills and techniques, and competence in financial reporting, appropriate to the engagement circumstances. (Ref: Para. A29) |

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

### *Assurance Skills and Techniques*

Paragraph 22 of CSRE 2400 requires that the partner possess competence in assurance skills and techniques. The following exhibit summarizes the required competencies.

**Exhibit 3.1-5A**

| Required Competencies (see paragraph A29) |
|---|
| applying professional skepticism and professional judgment to planning and performing an assurance engagement, including 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, which may include other types of procedures in addition to inquiry and analytical procedures (such as inspection, recalculation, re-performance, observation, and confirmation). |
| systematic documentation practices |
| application of skills and practices relevant for writing reports for assurance engagements |

**CONSIDER POINTS**

Because a review engagement is primarily 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 decreases significantly) and how to prepare and conduct appropriate inquiries of management.

### *Financial Reporting*

Competence in financial reporting is necessary to make sure the requirements of the AFRF 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. This would commonly be such AFRFs as ASPE or ASNPO.

## 3.1-6 Quality Control

| Paragraph | Requirement |
|---|---|
| 3 | *Relationship with CSQC 1** <br> Quality control systems, policies and procedures are the responsibility of the firm. CSQC 1 applies to firms of professional accountants in respect of a firm's engagements to review financial statements. The provisions of this CSRE regarding quality control at the level of individual review engagements are premised on the basis that the firm is subject to CSQC 1 or requirements that are at least as demanding. (Ref: Para. A2-A4) <br> *CSQC 1, paragraph 4 |
| 23 | The engagement partner shall take responsibility for: (Ref: Para. A30-A33) <br> (a) The overall quality of each review engagement to which that partner is assigned; <br> (b) The direction, supervision, planning and performance of the review engagement in compliance with professional standards and applicable legal and regulatory requirements; (Ref: Para. A34) <br> (c) The practitioner's report being appropriate in the circumstances; and <br> (d) The engagement being performed in accordance with the firm's quality control policies, including the following: <br> (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. A35-A36) <br> (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: <br> a. Perform the review engagement in accordance with professional standards and applicable legal and regulatory requirements; and <br> b. Enable a report that is appropriate in the circumstances to be issued; and <br> (iii) Taking responsibility for appropriate engagement documentation being maintained. |

| Paragraph | Requirement |
|---|---|
| 24 | *Relevant Considerations after Engagement Acceptance* 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. |
| 25 | *Compliance with Relevant Ethical Requirements* Throughout the engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance 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. |
| 26 | *Monitoring* 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 CSQC 1*

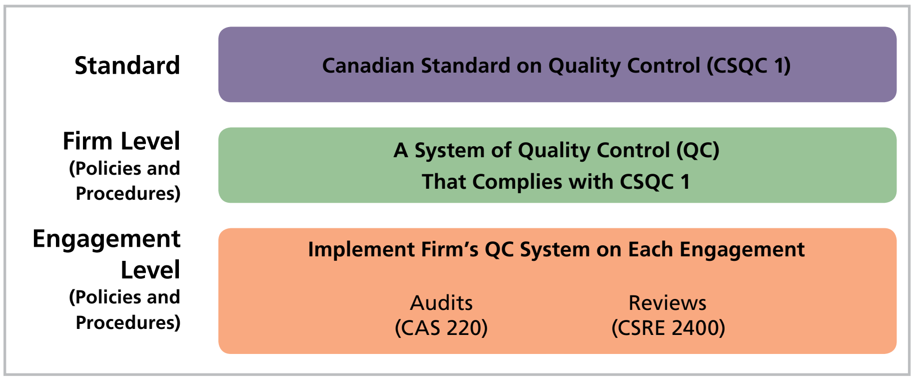
Under CSQC 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

- 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.

CSQC 1 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 comply with the firm's quality control procedures (see paragraphs 22-26 of and A29-A36 of CSRE 2400). Some elements of CSQC1 are documented at the firm level, and some at the engagement level, so not all steps need to be documented on every engagement file, but compliance with both the firm level and engagement level requirements must be completed.

The following exhibit shows CSQC 1 as the foundation upon which the firm develops its firm-wide system of quality control. CSRE 2400 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**



## 3.2 Can the Engagement Be Accepted or Continued?

| Paragraph | Requirement |
|---|---|
| 27 | *Factors Affecting Acceptance and Continuance of Client Relationships and Review Engagements*<br><br>Unless required by law or regulation, the practitioner shall not accept a review engagement if: (Ref: Para. A37)<br>(a) The practitioner is not satisfied:<br>(i) That there is a rational purpose for the engagement; or (Ref: Para. A38)<br>(ii) That a review engagement would be appropriate in the circumstances; (Ref: Para. A39)<br>(b) The practitioner has reason to believe that relevant ethical requirements, including independence, will not be satisfied;<br>(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. A40)<br>(d) The practitioner has cause to doubt management's integrity such that it is likely to affect proper performance of the review; or<br>(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. |

Before a particular review engagement can be accepted or continued, there is a number of matters to be addressed. If certain pre-conditions are not met, the engagement should not be accepted or continued. The matters identified in paragraph 27 of CSRE 2400 are addressed in the following paragraphs of this Guide.

**CONSIDER POINTS**

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, etc.).

Appendix B of this Guide provides a list of factors to consider related to client acceptance or continuance.

## 3.2-1 Rational Purpose

There should always be a rational (logical) purpose for any assurance engagement, including a client requesting a review engagement (see paragraph 27(a)(i) of CSRE 2400).

A review engagement is typically requested to enhance the degree of confidence that intended users will place in 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
- an 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 3.2-1A**

| | |
|---|---|
| **A Rational Purpose Would NOT Exist** | The firm suspects 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. |
| | A significant scope limitation exists that could include missing or inaccessible information, lack of permission to speak to key people, or the imposition of unrealistic deadlines. |

## 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 (see paragraph 27(a)(ii) of CSRE 2400). 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 Appropriate** | 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 likely to be either unavailable or unreliable. |
| | 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 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. |

## 3.2-3 Ethical Requirements, including 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 (see paragraph 27(b) of CSRE 2400). 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 long-time association with the client. Refer to the rules of professional conduct/code of ethics applicable to the practice of public accounting issued by the professional accounting bodies for further information on the various types of threats and possible safeguards.

### CONSIDER POINTS

An assessment of independence and compliance with relevant ethical requirements must be performed and documented on an annual basis for every client. It is important that staff members performing this assessment have access to all relevant information and clearly understand the independence requirements. It is important to consider independence first since, if any prohibitions are present, then it is not appropriate to go any further. It is more efficient to assess this as early in the acceptance/continuance decision-making process as possible.

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, safeguards may 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, the practitioner may be aware of circumstances that will make it impossible to complete a review engagement because of a scope limitation (see paragraph 27 (c) and 27 (e) of CSRE 2400). If the practitioner knows there will be a disclaimer of an opinion at the outset, it is not practical even to accept the engagement. Some examples of possible scope limitations that may illustrate this possibility are contained in the following exhibit.

**Exhibit 3.2-4A**

| | |
|---|---|
| **Scope Limitations** | unrealistic deadlines imposed by management for performing the engagement |
| | doubts 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 who may have relevant information or evidence |
| | restricted access to certain premises (such as a warehouse or operating location) or restrictions on movement during an inventory count or at the period-end date |
| | doubts about management's integrity; inquiry of management unlikely to be effective and written representations unlikely to be reliable |
| | lack of management commitment to adequate internal control, (e.g., incomplete or messy record keeping) |
| | management's non-acceptance 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 |

## 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 (including principal owners, key management, and TCWG) are untrustworthy, the results of 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, it is not appropriate to accept the engagement (unless required by law or regulation) when the practitioner has cause to doubt management's integrity such that proper performance of the review could be affected (see paragraph 27(d) of CSRE 2400).

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

**Exhibit 3.2-5A**

| | |
|---|---|
| **Information That Could Raise 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 that management might be involved in money laundering or other criminal activities |
| | entity has a reputation for unethical business behaviour |
| | related-party transactions, the purpose of which is unclear |
| | history of management bias in estimates |
| | non-disclosed related parties |
| | highly complex transactions or activities that do not appear to be necessary or have any rational purpose |
| | poor management attitude toward control or maintaining accounting records |
| | management reluctance to provide information necessary to perform the engagement |
| | seemingly well-founded allegations of wrongdoing in the media |
| | history of management not disclosing important information (e.g., contract violations, loan covenants, or litigation) during previous engagements or making misleading or false representations |

## 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* |
| 28 | Prior to accepting a review engagement, the practitioner shall: (Ref: Para. A41)<br>(a) Determine whether the financial reporting framework applied in the preparation of the financial statements is acceptable including, in the case of special purpose financial statements, obtaining an understanding of the purpose for which the financial statements are prepared and of the intended users; and (Ref: Para. A42-A48)<br>(b) Obtain the agreement of management that it acknowledges and understands its responsibilities: (Ref: Para. A49-A52)<br>(i) For preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation;<br>(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<br>(iii) To provide the practitioner with:<br>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;<br>b. Additional information that the practitioner may request from management for the purpose of the review; and<br>c. Unrestricted access to persons within the entity from whom the practitioner determines it necessary to obtain evidence. |

These engagement preconditions are designed to make sure that before any work commences management understands 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.

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

These requirements, as outlined in the following exhibit, should be discussed with management and TCWG to make sure they understand and acknowledge 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 POINTS**

Some smaller entities may make the mistake of assuming that the practitioner is responsible for the preparation and fair presentation of the financial statements given their expertise in accounting and financial reporting. It is important that the practitioner 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.

**Reminder:** The communication starts in this early stage of the review engagement and will continue through the engagement. The phrase "two-way communication" is often used to describe the interaction between the practitioner and management/TCWG. Not all such communications are required to be in a formal written form. Additional communications will be discussed in later chapters.

### *Acceptability of the Financial Reporting Framework*

The choice of the AFRF may be prescribed by law or regulation. However, the choice 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 purpose for which the financial statements are prepared and the intended users. This action 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 and therefore provides the criteria the practitioner uses to review the financial statements.

Most financial statements are prepared in accordance with a general purpose framework designed to meet the common financial needs of a wide range of users. IFRS, ASPE, ASNPOs 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
- 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 are often, but not always 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 revenue or expenditures, or provide that specific accounting policies be adopted in specified circumstances.

### Exhibit 3.3-1C

| General Purpose Financial Statements | | Special Purpose Financial Statements | |
|---|---|---|---|
| **General purpose framework** (Designed to meet the common financial needs of a wide range of users) | | **Special purpose framework** (Designed to meet the financial information needs of specific users) | |
| **Fair Presentation Framework** (i.e., a financial reporting framework that requires compliance with the requirements of the framework) | **Compliance Framework** (i.e., a financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgements regarding “fair presentation” in accordance with the framework) | **Fair Presentation Framework** (i.e., a financial reporting framework that requires compliance with the requirements of the framework) | **Compliance Framework** (i.e., a financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgements regarding “fair presentation” in accordance with the framework) |
| **Example** financial statements prepared in accordance with ASPE | **Example** financial statements prepared for a general purpose by management of the entity in accordance with the Financial Reporting Framework (XYZ Law) of Jurisdiction X (i.e. that is, a financial reporting framework, encompassing law or regulation, designed to meet the common financial information needs of a wide range of users, but which is not a fair presentation framework) | **Example 7 in CSRE 2400 Reporting Examples**<br>• financial statement prepared in accordance with the cash receipts and disbursements basis of accounting<br>• financial statement prepared in accordance with ASPE for a specified user | **Example 6 in CSRE 2400 Reporting Examples** financial statements prepared in accordance with the financial reporting provisions of a contract (for purposes of this illustration, a compliance framework) |

| General Purpose Financial Statements | Special Purpose Financial Statements |
|---|---|
| | an Emphasis of Matter paragraph must be included in the review engagement report to alert the readers that the financial statement are prepared under a special purpose framework and the practitioner may consider it appropriate to indicate the practitioner's report is intended solely for the specific users.(i.e., limit distribution to the specific user) (see paragraph 98 of CSRE 2400) |

### *Internal Control*

Management must acknowledge its responsibility for preparing financial statements that are free from material misstatement, whether due to fraud or error.

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. Examples of internal control processes are outlined in the following exhibit.

**Exhibit 3.3-1D**

| | |
|---|---|
| **Examples of Internal Control Processes** | 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 |
| | authorization, recording, and processing of transactions (e.g., shipping logs to make sure 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 to both control access and protect data within the accounting books and records |
| | management processes for preparing estimates, journal entries, and for ensuring key information is captured and communicated on a timely basis for decision making |

### CONSIDER POINTS

Smaller entities may not have sophisticated processes for financial reporting. In many cases, controls over financial reporting can be established through:

- 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 risks of error and the risk of employee fraud
- maintenance of accounting records prepared accurately and on a timely basis
- simple processes and procedures to address matters such as revenue recognition, cut-off, inventory counts, and journal entries.

Remember that management's agreement that it acknowledges and understands its responsibility for such internal control as it determines is necessary for the preparation of financial statements free from material misstatements is one of the preconditions for accepting a 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, effective communication is needed between the practitioner and the entity's management/TCWG to make sure 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 make sure management understands exactly what the practitioner will need, such as:

- access, if necessary, to all information (records, documentation, and other matters) relevant to the preparation of the financial statements
- any additional information the practitioner may request from management
- unrestricted access to persons within the entity from whom the practitioner determines it is necessary to obtain evidence

## 3.3-2 Engagement Terms Not Satisfactory

| Paragraph | Requirement |
|---|---|
| 29 | 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 and, where appropriate, 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 CSRE. Accordingly, the practitioner shall not include any reference within the practitioner's report to the review having been conducted in accordance with this CSRE. |
| 30 | 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 and, where appropriate, those charged with governance, and shall determine:<br>(a) Whether the matter can be resolved;<br>(b) Whether it is appropriate to continue with the engagement; and<br>(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 whether a resolution is possible.

If a resolution is still not possible, the engagement should not be accepted.

## 3.3-3 Agree Terms of Engagement

| Paragraph | Requirement |
|---|---|
| | *Agreeing the Terms of Engagement* |
| 34 | The practitioner shall agree the terms of the engagement with management or those charged with governance, as appropriate, prior to performing the engagement. |
| 35 | The agreed terms of engagement shall be recorded in an engagement letter or other suitable form of written agreement, and shall include: (Ref: Para. A54-A56, A58)<br>(a) The intended use and distribution of the financial statements, and any restrictions on use or distribution where applicable;<br>(b) Identification of the applicable financial reporting framework;<br>(c) The objective and scope of the review engagement;<br>(d) The responsibilities of the practitioner;<br>(e) The responsibilities of management, including those in paragraph 28(b); (Ref: Para. A49-A52, A57)<br>(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<br>(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 interest of all parties (TCWG, management, and the practitioner) that the terms of engagement be clearly documented in an engagement letter 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.
- Consider the need to review any complex or potentially controversial terms with legal counsel.

### *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 3.3-1E**

| | |
|---|---|
| **Other Matters to Consider for Possible Inclusion in the Engagement Letter** | use and distribution of the practitioner's 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 |
| | reporting time frames |
| | fees and billing arrangements |
| | engagement termination |
| | release of summarized financial statements |
| | other services (where relevant) |

Appendix 1 of CSRE 2400 includes a sample engagement letter.

### *Recurring Engagements*

| Paragraph | Requirement |
|---|---|
| | *Recurring Engagements* |
| 36 | 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. A59) |

It is not necessary to obtain a new engagement letter for each period if there have been no changes in the circumstances affecting the engagement.

**CONSIDER POINTS**

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 reminds management about the terms of engagement on a timely basis. Review your quality assurance manual to make sure your own policy is designed to mitigate your firm's assessed risks.

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 management misunderstands the objective and scope of the review engagement |
| | any revised or special terms of the engagement |
| | recent change of senior management of the entity |
| | significant change in the ownership of the entity |
| | significant change in the nature or size of the entity's business |
| | change in legal or regulatory requirements affecting the entity |
| | significant change in the AFRF as it relates to the entity |

### Acceptance of a Change in the Engagement Terms

| Paragraph | Requirement |
|---|---|
| | *Acceptance of a Change in the Terms or Nature of the Review Engagement* |
| 37 | 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. A60-A62) |
| 38 | 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. A63-A64) |
| 39 | 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*

A reasonable justification for a change in the engagement terms may result from a change in circumstances affecting the need for the service or a misunderstanding about the nature of a review engagement. In addition, a restriction on the scope of the review engagement that the practitioner concludes there is a reasonable justification may exist, but a careful assessment must be made to ensure this scope limitation is not to avoid a modified review engagement report. When the practitioner concludes that there is reasonable justification in the engagement terms, a revised engagement letter or other suitable form of written agreement is required.

### *Reasonable Justification Does Not Exist*

If reasonable justification for a change in the terms or nature of the review engagement does not exist, the practitioner shall not agree to a change in the terms of engagement. For example, the practitioner is unable to obtain sufficient appropriate evidence for a material item in the financial statements, and management asks for the engagement to be changed to a related services engagement to avoid the expression of a modified conclusion by the practitioner. **Reminder:** 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* |
| 31 | The practitioner's report issued for the review engagement shall refer to this CSRE only if the report complies with the requirements of paragraph 94. |
| 32 | 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 CSRE. 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. A53,A165) |
| 33 | 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 CSRE. Accordingly, the practitioner shall not include any reference within the practitioner's report to the review having been conducted in accordance with this CSRE. (Ref: Para. A53, A165) |

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

Standardized wording in the review engagement report provides consistency in the report and communicates that the review of the financial statements has been conducted in accordance with Canadian generally accepted standards for review engagements.

In some cases those situations where the wording of the practitioner's report is prescribed by law or regulation it must comply with elements of the practitioner's report as described in paragraph 94 of CSRE 2400, and discussed in Chapter 7 of this Guide. If the report requested does not comply with CSRE 2400 the practitioner must assess if additional explanations are needed in the prescribed report to avoid any misunderstanding by the users of the report. If the prescribed report, even with the additional explanation could lead to possible misunderstanding, the practitioner should not accept the engagement.

# CHAPTER 4
# Planning

## CHAPTER 4: CONTENT

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

| 4.1: Ongoing Communications | 4.2: Understand the Entity and Its Environment | 4.3: Determine and Apply Materiality | 4.4: Design Appropriate Procedures |
|---|---|---|---|
| 4.1-1 Those Charged with Governance<br>4.1-2 Modes of Communication | 4.2-1 Why Obtain an Understanding of the Entity and Its Environment?<br>4.2-2 Scope<br>4.2-3 How to Obtain an Understanding of the Entity and Its Environment<br>4.2-4 Planning of Work Effort | 4.3-1 Calculate Materiality<br>4.3-2 Apply<br>4.3-3 Revise | 4.4-1 Types of Procedure |

### Outcome

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

## 4.1 Ongoing Communications

| Paragraph | Requirement |
|---|---|
| 40 | *Communication with Management and Those Charged with Governance*<br>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. A65-A71) |

Effective communication on a review engagement involves the practitioner, the engagement team, management, and those charged with governance (TCWG). As with any assurance engagement, good communication is timely and requires the ongoing use of professional judgment to make sure no confusion exists in the messages or information provided/received by the parties involved. Effective communication is especially true in a review engagement where so much of the sufficient and appropriate evidence obtained comes directly from effective inquiry.

### 4.1-1 Those Charged with Governance

For effective communication, the practitioner determines the appropriate person(s) with whom to communicate within the entity's governance structure (i.e., TCWG).

In smaller entities, 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.

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

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.

Effective two-way communication recognizes that:

- the practitioner is responsible for communicating all matters concerning the review engagement of sufficient importance to merit the attention of management or TCWG
- management or TCWG will provide the practitioner with access to all information that is relevant to the preparation of the financial statements, additional information that the practitioner may request for the purpose of the review and unrestricted access to persons within the entity from whom the practitioner determines it necessary to obtain evidence.

### CONSIDER POINTS

When it is appropriate to communicate with TCWG and that communication involves more than one person (i.e., a board of directors), it is important to communicate to all members. If communication is directed to one member such as the chairperson, the practitioner must have evidence that the information has been communicated to all members of the group.

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<br>• briefing to assist in understanding the entity and specific requirements<br>• planning discussions<br>• determining materiality<br>• responding to questions on work to be performed<br>• providing feedback on work already performed<br>• sharing information on findings and other matters<br>• asking and responding to questions related to the review of working papers |
| **Engagement Team** | • sharing of information throughout the engagement, particularly concerning linked areas<br>• asking questions and discussing the information obtained<br>• providing feedback and supervision on work performed, as needed |
| **Practitioner/Engagement Team with Entity Personnel, Management, and TCWG** | • sharing information to assist in understanding the entity<br>• engagement planning<br>• making inquiries, including analysis of financial results, and obtaining responses<br>• discussing the need for additional procedures where necessary<br>• requesting specific information<br>• writing formal correspondence, such as the terms of engagement (engagement letter) and management representations<br>• discussing engagement findings and identifying misstatements<br>• discussing details of any journal entries prepared by the client (if applicable)<br>• discussing any specific matters arising during the engagement |

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 make sure they are appropriately included in the engagement timetable.

It will also be necessary to make sure both management and TCWG fully appreciate and understand the need for their co-operation and availability with respect to the practitioner and engagement team. Outcomes of effective two-way communication are provided in the following exhibit.

**Exhibit 4.1-2B**

| | |
|---|---|
| **Outcomes of Effective Two-Way Communication** | Develop constructive working relationships. |
| | Avoid misunderstandings of the terms and 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, such as 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 them up. |
| | 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 that may lead to modification of the practitioner's conclusion or withdrawal from the engagement altogether. |

It is important to recognized that the responsibility to communicate with both management and TCWG does not change when different persons are responsible for management and governance, or it is a single person. The only effect would be on the form or timing of the communication (i.e., some communications may be combined when reporting to an owner-manager in a SME).

In some situations, laws or regulation may:

- restrict communication of certain matters with TCWG, such as a communication that might prejudice an investigation 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 (e.g., misstatements identified or not corrected) or to provide a third party with a copy of the practitioner's written communications with TCWG (e.g., a management letter); in these situations, consider the need to obtain the prior consent of management or TCWG before doing so.

## 4.2 Understand the Entity and Its Environment

| Paragraph | Requirement |
|---|---|
| 43 | *The Practitioner's Understanding*<br>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. A85-A87) |

### 4.2-1 Why Obtain an Understanding of the Entity and Its Environment?

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

**Exhibit 4.2-1A**

| 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 | **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 procedures | **designing procedures** (customized as much as possible) that appropriately address the reasons identified as the reason a material misstatement is likely to arise |

### *Likely to Arise*

CSRE 2400 requires a practitioner to obtain an understanding of the entity and its environment in order to identify areas in the financial statements where material misstatements are likely to arise.

Areas in the financial statements where material misstatements are likely to arise include areas prone to misstatement due to matters such as estimation uncertainty, complexity, or need for judgment (e.g., hard-to-value inventories, etc.).

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

**Exhibit 4.2-1B**

| | |
|---|---|
| **Benefits of Understanding the Entity and Its Environment** | frame of reference for planning and performing the review engagement and making professional judgments about financial statement areas where misstatements are likely to arise |
| | establishment of 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 |
| | evaluation of 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 [2400.77 and 2400.78] |

The practitioner's understanding is obtained and applied on an iterative basis throughout the performance of the engagement and is updated as conditions and circumstances change.

### CONSIDER POINTS

Avoid the temptation, particularly on recurring engagements, to skip the understanding of the entity and its environment on the assumption that enough information was acquired in previous years and that nothing has changed. This approach can result in the performance of a standard set of procedures with little or no thought given to areas in the financial statement where misstatements are likely to arise. That is, without the update of the understanding of the entity and its environment, the procedures will not be directed to the appropriate areas, which could lead to an ineffective review (too little effort on the areas where misstatements are likely to arise) or an inefficient review (too much effort on areas where it is not likely misstatements are likely to arise). Obtaining an understanding of the entity and its environment is not a discrete task that can be completed early in the engagement and then put aside. It is important to keep learning about the entity and its environment throughout the engagement and be alert to possible areas in the financial statements where material misstatements are likely to arise not previously identified or to where the original assessment of possible misstatements needs updating. When changes in conditions and circumstances occur, the documentation must be updated and any implications, such as a change in procedures, must be addressed.

## 4.2-2 Scope

| Paragraph | Requirement |
|---|---|
| 44 | The practitioner's understanding shall include the following: (Ref: Para. A88-A90, A99, A101)<br>(a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework;<br>(b) The nature of the entity, including:<br>(i) Its operations;<br>(ii) Its ownership and governance structure;<br>(iii) The types of investments that the entity is making and plans to make;<br>(iv) The way that the entity is structured and how it is financed; and<br>(v) The entity's objectives and strategies;<br>(c) The entity's accounting systems and accounting records; and<br>(d) The entity's selection and application of accounting policies. |

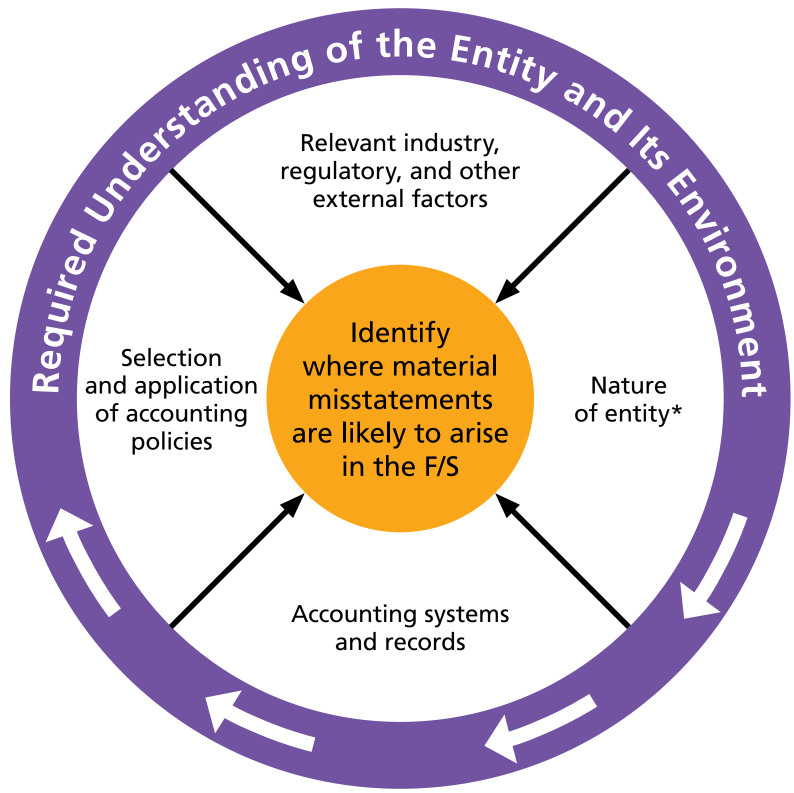
The required level of understanding of the entity and its environment should be sufficient to meet the practitioner's objectives for the engagement to:

- obtain limited assurance primarily by performing inquiry and analytical procedures about whether the financial statements as a whole are free from material misstatement
- 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 appropriate AFRF
- report on the financial statements as a whole and communicate to management and TCWG (see paragraph 12 of CSRE 2400).

The extent of this understanding will be based on professional judgment; however, the depth and breadth of the understanding required is less than that possessed by management.

Some of the main areas of understanding of the entity and its environment are illustrated in the following exhibit.

**Exhibit 4.2-2A**




*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 4.2-2B**

| | |
|---|---|
| **Other Areas of Understanding the Entity and Its Environment to Consider** | **"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<br><br>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 |

| | |
|---|---|
| **Other Areas of Understanding the Entity and Its Environment to Consider** | 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. The presence of fewer employees in smaller entities may influence how management exercises oversight (e.g., 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. |
| | **financial reporting obligations** or requirements of the entity and whether they 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** generally recognized as having a direct effect on the determination of material amounts and disclosures in the financial statements (e.g., tax and pension laws and regulations, environmental issues, etc.) |
| | **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 possible misstatements** in its financial reporting and potential fraud scenarios (management and employees), and how compliance is assured with the financial reporting |
| | entity's **procedures for recording, classifying, and summarizing transactions**, accumulating information for inclusion in the financial statements, and disclosing related information |
| | types of matters that required **accounting adjustments** in prior periods |

### CONSIDER POINTS

In a review engagement, the practitioner obtains an understanding of accounting systems and accounting records, such as the entity's policies and procedures for:

- recording, classifying, and summarizing transactions
- accumulating information for inclusion and disclosure in the financial statements.

There is no requirement, such as 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 and Its Environment

Failure to obtain an appropriate understanding of the entity and its environment 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 inadequate disclosure in the financial statements. For example, if inquiries were not made about the customer base, the practitioner may be unaware of matters such as:

- customers in financial difficulty and having trouble paying their bills, which could impact the provision for doubtful receivables
- large new customers receiving significant discounts or other preferential treatment which could affect financial ratios and revenue recognition policies
- customers which result in a significant contribution to salespersons' bonuses, which could cause sales to be recorded in the wrong period
- loss of customers to competitors offering better value in terms of price or quality which could result in excess inventory that needs to be written down to realizable value and could indicate the entity may be in financial difficulty.

### CONSIDER POINTS

**Environmental legislation** may require 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.

## 4.2-3 How to Obtain an Understanding of the Entity and Its Environment

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 4.2-3A**

| Action Step | Description |
|---|---|
| **Make Inquiries of Management** | Identify who in the entity is the most qualified person to provide the needed information in relation to each of the four specified areas of understanding (**Exhibit 4.2-2A**), and then for the other areas outlined above (**Exhibit 4.2-2B**).<br><br>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 and it environment. While not specifically required by CSRE 2400, 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 areas.<br><br>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. |
| **Preliminary Analytical Procedures** | Compare the current period to the prior period for expectations and internal consistency. |

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 unless the practitioner becomes aware of a matter(s) that causes the practitioner to believe the financial statements may be materially misstated.

## 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 (e.g., 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 for accuracy and to see that they reflect all the entity's transactions?
- How do you make sure all (i.e., completeness) revenue is recorded?
- 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 (e.g., bad publicity, lawsuits, poor cash flow, resident complaints, or regulatory issues) or any financial issues (e.g., need for new capital investment or inability to attract employees with the required skills)?
- Has there been a change of, or inconsistent use of, accounting policies?
- Are there any difficult or complex areas involved in the entity's financial reporting (e.g., 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 | Reason/Nature of Possible Material Misstatement |
|---|---|
| **Accounts Receivable** | A new part-time accounts receivable clerk was hired during the year. This person is prone to making accounting errors |
| **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. |
| **Physical Assets (PPE)** | There is a significant investment in property, plant, and equipment, with many additions and disposals during the period. |
| **Revenue** | 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. |
| **Disclosures** | The family of a former resident is suing the home for the poor treatment their mother allegedly received in her last days. |

## 4.2-4 Planning of Work Effort

Now that an understanding of the entity and its environment, the AFRF is known, and materiality has been determined, the next step is to identify the areas in the financial statements where material misstatements are likely to arise. This planning is a critical step in performing an efficient and effective review engagement. Time spent in planning can focus work efforts toward areas where material misstatements are likely to arise and away from insignificant matters.

| Paragraph | Requirement |
|---|---|
| 45 | *Identifying Areas in the Financial Statements Where Material Misstatements Are Likely to Arise*<br>Based on the practitioner's understanding, the practitioner shall identify areas in the financial statements where material misstatements are likely to arise. |

**CONSIDER POINTS**

It is important to remember that areas in the financial statements where material misstatements are likely to arise may include items below the quantitative amount of materiality, or matters that do not directly relate to financial statement line items, due to omission, qualitative factors, or related to disclosures.

**Exhibit 4.2-4A**

| | |
|---|---|
| **Uses of Planning** | Focus partner/staff attention on engagement objectives. |
| | Identify ways in which the entity could assist the engagement such as by preparing certain working papers and analyses. |
| | Identify where material misstatements are likely to arise and material financial statement items and disclosures and then develop an appropriate response. |
| | Develop a coherent set of procedures to achieve the engagement objectives. This includes removal (based on professional judgment) of those procedures considered unnecessary for this engagement such as from standard checklists. |
| **Benefits of Planning** | Brief team members properly on the engagement objectives and expectations. |
| | Anticipate problem areas to the extent possible to avoid surprises. |
| | Focus procedures on areas in the financial statements where material misstatements are likely to arise. |
| | Make sure the engagement is properly organized, staffed, and managed. |

Many review engagements performed by practitioners will involve relatively small engagement teams or may be carried out by a single practitioner. Ideally, the planning discussions will involve the whole engagement team; it is most important, however, that senior engagement personnel be involved. The partner and senior staff usually have the most information about the entity and possess the necessary professional competence and judgment to make key decisions.

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

**Exhibit 4.2-4B**

| | |
|---|---|
| **Topics for Planning Discussions** | entity as a whole (operations, personnel, etc.) and what has changed in 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 (e.g., related-party transactions, complex estimates, litigation or claims, and going-concern events/conditions) |
| | lessons learned from previous engagements (e.g., matters noted in the file for carry forward, difficult areas, nature and amount of misstatements identified, and management's response to any recommendations made) |
| | changes in the AFRF (e.g., new accounting standards) |
| | potential for improving engagement quality and file documentation, and the efficiency/effectiveness of procedures performed |
| | indicators of management or employee fraud |
| | what staff will be required to do and why |
| | results documented in a planning memo |
| **Content of Planning Memo If Prepared** | nature of the engagement and any special requests |
| | guidance on what should be considered material |

| | |
|---|---|
| **Content of Planning Memo If Prepared** *(continued)* | overall strategy (e.g., significant risk factors to consider, timing, and approach to the engagement), with a focus on areas where material misstatements are likely to arise. |
| | detailed plan of action (i.e., the 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 POINTS

All staff members should be briefed about the understanding of the entity and its environment and materiality before they start work.

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, (e.g., 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 and preparing lead sheets.

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

### Example of Excerpts from a Memorandum Addressing Key Aspects of the Understanding of the Entity and Its Environment and Review Engagement Planning

Entity: T*he 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.

## Example of Excerpts from a Memorandum Addressing Key Aspects of the Understanding of the Entity and Its Environment and Review Engagement Planning

**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.
- 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 $18,000 has been based on 5% of income from continuing operations.
- Last year's materiality was $15,000.

**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 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 in the financial statements where material misstatements are likely to arise are:
    1. 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 cut-off procedures at year end.
    2. receivables due to size of balance and estimates for doubtful accounts
    3. revenue/sales due to the possibility of unrecorded sales or revenue recognition not in accord with the entity's significant accounting policies
    4. cost of sales due to potential misclassifications of expense accounts and treatment of foreign currency amounts
    5. income tax provision, include SR&ED accrual
- Be alert for possible related parties and any going-concern uncertainties.
- Based on conversation with Mr. Green, the company expects growth of approximately 5% this year. Given the changes in technology and the shape of the industry in general, we need to inquire about any major changes that could occur in inventory, receivables, and payables.

**Example of Excerpts from a Memorandum Addressing Key Aspects of the Understanding of the Entity and Its Environment and Review Engagement Planning**

- Additional bank financing may be required to finance planned research and development.
- 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.

**Procedures to Be Performed**

Refer to forms A-ZZ in the file.

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

Reviewed by: *Francois à Dionnet* Date: *January 15, 20XX*

## 4.3 Determine and Apply Materiality

| Paragraph | Requirement |
| --- | --- |
| 41 | *Materiality in a Review of Financial Statements*<br>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. A72-A83) |

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

Since materiality is determined on the basis of both the financial statements and the practitioner's perception of the needs of the intended 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 procedures. For example, information about the entity gained during the engagement may cause the practitioner to reassess their original perception of the needs of the intended users. Findings from procedures may cause the financial statements to be amended prior to their finalization by management. Thus, in practice, determination of materiality is unlikely to be a discrete phase of a review engagement (see **Section 4.3-3 Revise** of this chapter for a further discussion of revising materiality).

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 may seem to have minimal impact on the measurement of the elements in the financial statements. However, such qualitative matters could be considered serious if it casts doubt on the integrity of management and could have a significant impact on the decision-making of the users of the financial statements. Also, what would appear to be an isolated incidence of minor fraud may need to be further investigated, because it could indicate more widespread fraudulent activity. In conclusion, materiality, the practitioner's identification of areas in the financial statements where material misstatements are likely to arise, and the resultant procedures are influenced by the qualitative, not just quantitative, factors.

## 4.3-1 Calculate Materiality

Examples of misstatements in the financial statements include departures from the AFRF including:

- accounting estimates that do not appear reasonable
- inadequate, or omitted, disclosures in the financial statements

A misstatement, or the aggregate of all misstatements, including omissions, is material if the misstatement could reasonably be expected to change or influence the decision of an informed group of financial statement users (e.g., creditors, bankers, investors, donors, tax authorities, and regulators). 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 immaterial and what is 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 bank covenant 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 4.3-1A

| Action Step | Description |
|---|---|
| **Identify the Intended Financial Statement Users** | Who are the most likely common users of the financial statements?<br><br>The entity's bank is probably the most common user. However, other stakeholder groups who may make reasonable economic decisions based on the financial statements include TCWG, investors not involved in day-to-day operations, minority shareholders, 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 (e.g., 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 laws and regulations, revenue/expense allocations, and industry-specific disclosures.<br><br>In this context, it is reasonable to assume that users:<br>• have a reasonable knowledge of business, economic activities, and accounting and have a willingness to study the financial statements with reasonable diligence<br>• understand that financial statements are prepared, presented, and reviewed to levels of materiality<br>• recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events<br>• make reasonable economic decisions on the basis of the information in the financial statements. |

| Action Step | Description |
|---|---|
| **Consider the Level of Misstatement That Would Be Material to Users** | Based on the information obtained about users, exercise 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. |
| **Consider Benchmarks** | Benchmarks 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.<br>• **For profit-oriented entities**, a percentage of income before taxes from continuing operations could be used after any adjustment to normalize the base (e.g., bonuses or nonrecurring items). Other possible benchmarks would include a percentage of revenue, expenditures, assets, or equity.<br>• **For not-for-profit entities**, a percentage of revenue, expenditures, or assets could be used. |
| **Document the Materiality Amount and Reasoning** | Include in the file documentation:<br>• amount established for materiality<br>• factors considered in determining materiality<br>• details of any revision to materiality as the engagement progressed. |

## CONSIDER POINTS

Materiality for the financial statements as a whole relates to the needs of the intended users; it does not relate to the level of assurance being provided or the likelihood that material misstatements exist. 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 (see **Section 4.3-3 Revise** of this chapter).

When factual misstatements other than those that are clearly trivial are identified, practitioners will request that management correct those misstatements regardless of the size. If management refuses, the reasons need to be carefully considered and documented. The request to correct the misstatements is required, the conclusion on whether the corrections are required in order to not modify the practitioner's report is a separate issue. (see Chapters 6 and 7 of this Guide).

### Example

Damien Maguire owns a sporting goods store with 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 Users*
The major user will be the owner-manager and his family, plus the bank, which needs to know the amount of inventory 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 paid to Damien based on the results.

*Calculation of Materiality*
The following bases for determining materiality were considered:

- 5% to 10% of normalized profits before tax: This provides a materiality amount of between $6,450 and $12,900.
- 1% to 2% of revenue: This provides a materiality amount of between $6,200 and $12,400.
- 0.5% to 1% of total assets: This provides a materiality amount of between $2,150 and $4,300.

Given that the stated users would be primarily interested in the profitability of the entity, the practitioner uses professional judgment to determine that a materiality amount of $10,000 would be appropriate for this engagement. This is based on just under 8% of normalized profits before tax.

## 4.3-2 Apply

Once established, the materiality amount will serve as a benchmark for planning the procedures to be performed and for evaluating the evidence obtained. The common applications of materiality are outlined in the following exhibit.

**Exhibit 4.3-2A**

| | |
|---|---|
| **Common Applications of Materiality** | Communicate to the team members what materiality threshold will be used. [2400.41] |
| | Determine what financial statement items, including disclosures, are material. [2400.46(a)] |
| | Identify areas in the financial statements where material misstatements are likely to arise [2400.43] so that work efforts may be focused on them. [2400.46(b)] |
| | Provide a context for evaluating the information obtained as a result of performing the planned procedures. |

| | |
|---|---|
| **Common Applications of Materiality** | Assess whether the information obtained causes the practitioner to believe the financial statements may be materially misstated and, if so, plan what additional procedures will be 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. |
| | Consider any new information obtained that could require a revision to the initial determination of materiality. |
| | Compare to accumulated misstatements identified during the review, other than those that are clearly trivial [2400.58]. |

## CONSIDER POINTS

**Documentation of Misstatements**

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

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

**Clearly Trivial Misstatements**

Materiality is useful for determining 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. The practitioner is required to accumulate misstatements identified during the review, other than those that are clearly trivial (see paragraph 58 of CSRE 2400).

**Examples of the Applications of Materiality**

*Identify Material Balances*
Based on the calculated materiality amount, the following items in the statement of financial position and income statement have been identified as being material for the purposes of the review engagement. These include inventory, receivables, payables, bank indebtedness, property, plant and equipment, a loan to a related party and revenue.

*Apply in Planning*
In planning the inquiries and analytical 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 in the financial statements where material misstatements are likely to arise.

### 4.3-3 Revise

| Paragraph | Requirement |
|---|---|
| 42 | 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. A84) |

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 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 $12,000 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 $12,000 to $24,000.

## 4.4 Design Appropriate Procedures

| Paragraph | Requirement |
|---|---|
| | *Designing and Performing Procedures* |
| 46 | 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. A91-A95, A99, A101)<br>(a) To address all material items in the financial statements, including disclosures; and<br>(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 CSRE 2400, including:

- all material items in the financial statements, including disclosure
- areas in the financial statement where material misstatements are likely to arise
- specified areas (e.g., related-party transactions, going concern, fraud, and non-compliance) (see paragraphs 49-53 of CSRE 2400)

## 4.4-1 Types of Procedures

To achieve the objectives of the engagement, the 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<br>expanding inquiries, where appropriate, to obtain nonfinancial data evaluating responses provided by management<br>evaluating responses provided by management |
| **Analytical Procedures** | identifying inconsistencies or variances from expected trends, values, or norms in the financial statements (e.g., the level of congruence of the financial statements with key data, including key performance indicators)<br>obtaining or updating the practitioner's understanding of the entity and its environment, including being able to identify areas in the financial statements where material misstatements are likely to arise<br>providing additional evidence in relation to other inquiries or other analytical procedures already performed<br>evaluating identified inconsistencies through further inquiries and other procedures |

| Type of Procedure | Nature of Procedure |
|---|---|
| **Additional Procedures (as required)** | designing and performing additional procedures where a matter(s) causes the practitioner to believe the financial statements may be materially misstated. These procedures are to be sufficient for:<br>• a conclusion to be reached that the matter(s) is not likely to cause the financial statements as a whole to be materially misstated<br>• determine that the matter(s) causes the financial statements as a whole to be materially misstated<br><br>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 (e.g., 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.<br><br>evaluating other information obtained and/or responses provided by management |

The following expands on the example introduced earlier in this chapter and now includes the possible procedures to demonstrate the linkage between the nature of the possible material misstatement and the procedure to address the areas in the financial statements where material misstatements are likely to arise:

| Areas in the Financial Statement | Nature of Possible Material Misstatement | Possible Procedures to Address the Areas in the Financial Statements Where Material Misstatements Are Likely to Arise |
|---|---|---|
| **Accounts Receivable** | *A new part-time accounts receivable clerk was hired during the year. This person is prone to making accounting errors.* | Perform additional analysis on account balances of error-prone areas in time frame after new clerk was hired to identify any errors. |

| Areas in the Financial Statement | Nature of Possible Material Misstatement | Possible Procedures to Address the Areas in the Financial Statements Where Material Misstatements Are Likely to Arise |
|---|---|---|
| **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.* | Inquire about the controls over inventory, the count procedures, and the results of the physical count. Also, inquire into the reasons for major variances. |
| **Physical Assets (PPE)** | *There is a significant investment in property, plant, and equipment, with many additions and disposals during the period.* | Inquire about the controls over physical assets, the procedures used to record additions and disposals, and the relevant accounting policy. Also, inquire about the nature and amount of the additions and disposals during the period. |
| **Revenue** | *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.* | Perform analytical procedures on the revenue 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 who receive special services to see whether such services were regularly billed. |
| **Disclosures** | *The family of a former resident is suing the home for the poor treatment their mother allegedly 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 POINTS**

*Dual Purpose Inquiries*
The responses to inquiries such as those outlined above will not only help in obtaining the required understanding of the entity and its environment, but also may comprise part of the evidence required to form a conclusion on the financial statements.

**CONSIDER POINTS**

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

*Planning*
Time taken to plan the engagement can often result in much more time saved in execution. For example:

- Plan the work so that the time-consuming areas (e.g., where complexities or judgments are involved) 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 and its environment could also be used as part of the evidence for areas in the financial statements where material misstatements are likely to arise (i.e., dual-purpose inquires).

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

*Work on Client Premises*
Can more work be performed on 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 from other clients involved in the same industry to save time in identifying areas in the financial statements where material misstatements are likely to arise?

*Checklists*
If checklists are used, can they be customized to eliminate the "not applicable" procedures and include customized or specific procedures for the areas in the financial statements where material misstatements are likely to arise, such that the checklists only include procedures necessary to obtain sufficient appropriate evidence as the basis for a conclusion on the financial statements?

*Automation*
Can some of the required work be automated (e.g., analysis of certain accounts)?

Additional guidance on how to perform the types of procedures discussed in this Chapter is contained in Chapter 5 of this Guide.

# CHAPTER 5
# Performing

| CHAPTER 5: CONTENT | | |
|---|---|---|
| • How to perform inquiry and analytical procedures<br>• When additional procedures are required<br>• How to evaluate evidence obtained<br>• What documentation is required | | |
| **5.1 Perform Procedures** | **5.2 Evaluate Evidence Obtained from the Procedures Performed** | **5.3 Engagement Documentation** |
| 5.1-1 Analytical Procedures<br>5.1-2 Making Inquiries<br>5.1-3 Related Parties<br>5.1-4 Fraud and Non-Compliance with Laws and Regulations<br>5.1-5 Going Concern<br>5.1-6 Other Matters<br>5.1-7 Additional Procedures<br>5.1-8 Subsequent Events<br>5.1-9 Written Representations | 5.2-1 Has Sufficient Appropriate Evidence Been Obtained?<br>5.2-2 Supervision and Review | 5.3-1 Documentation<br>5.3-2 File Assembly |
| **Outcome** | | |
| Sufficient appropriate evidence has been obtained and documented in the engagement file. | | |

## 5.1 Perform Procedures

| Paragraph | Requirement |
|---|---|
| 46 | 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. A91-A95, A99, A101)<br>(a) To address all material items in the financial statements, including disclosures; and<br>(b) To focus on addressing areas in the financial statements where material misstatements are likely to arise. |

As introduced in Chapter 4, the practitioner must design and perform inquiry and analytical procedures as indicated in paragraph 46 of CSRE 2400 included above. The procedures consist primarily of inquiry and analysis and include other procedures considered necessary in the circumstances. The nature, timing and extent of procedures to be performed will be based on professional judgment.

Generally, the practitioner is entitled to accept the results of the initially completed inquiry and analytical procedures as long as the results are consistent with the understanding obtained of the entity and its environment. However, 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

| Paragraph | Requirement |
|---|---|
| 48 | 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. A101-A103) |

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

Analytical procedures are used to:

- obtain or update the practitioner's understanding of the entity and its environment, including being able to identify areas in the financial statements where material misstatements are likely to occur
- 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
- provide corroborative evidence in relation to other inquiries or analytical procedures already performed
- serve as additional procedures when the practitioner becomes aware of matter(s) that cause the practitioner to believe the financial statements may be materially misstated. An example of such an additional procedure is a comparative analysis of monthly revenue and cost figures across profit centres, branches or other components of the entity, to provide evidence of financial information contained in line items or disclosures in the financial statements.

Common analytical procedures include:

- 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
- comparing recorded amounts to predicted values calculated from other sources.

The practitioner must consider whether the information or data to be used for analytical procedures is satisfactory. The intended purpose of the procedure is based on the practitioner's understanding of the entity and its environment. The determination of whether the information or data is satisfactory is influenced by the nature and source of the information or data, and by the circumstances in which the information or data is obtained. The following considerations may be relevant:

- source of the information available (i.e., information may be more reliable when obtained from external, independent sources)
- comparability of the information (i.e., broad industry data may need to be supplemented or adjusted to be comparable to data of an entity that produces and sells specialized products)
- nature and relevance of the information (i.e., whether the entity's budgets are established as results to be expected rather than as goals to be achieved)
- knowledge and expertise involved in the preparation of the information, and related controls designed to ensure its completeness, accuracy and validity. Such controls may include, for example, controls over the preparation, review and maintenance of budgetary information.

Some typical analytical procedures for selected account balances are contained in **Appendix D**. Analytical procedures are normally required to address all material financial statement items (including disclosures) and focus on areas in the financial statements where material misstatements are likely to arise.

The following example illustrates how the initial analytical procedure of comparing the amounts in the inventory balance led to further inquiry and a more detailed review of the count sheets.

**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%). 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 was more in line with expectations. Given the size 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

The practitioner uses inquiry as one method of obtaining the understanding of the entity and its environment and will continue to use inquiry throughout the engagement.

As indicated above in paragraph 46 of CSRE 2400, the practitioner must use inquiry as a means of obtaining sufficient appropriate evidence. Inquiries along with analytical procedures are used to:

- address all material financial statement items
- focus on areas in the financial statements where material misstatements are likely to arise, including disclosures.

The practitioner must make sure all inquiries listed below in paragraph 47 of CSRE 2400 are completed. However, it is important to remember that there is an iterative aspect to a review engagement. The process of completing a review engagement is not a linear series of steps; inquiry can take place in the various steps of the engagement. Other inquiry is often needed.

| Paragraph | Requirement |
|---|---|
| 47 | The practitioner's inquiries of management and others within the entity, as appropriate, shall include the following: (Ref: Para. A96-A99)<br>(a) How management makes the significant accounting estimates required under the applicable financial reporting framework;<br>(b) The identification of related parties and related party transactions, including the purpose of those transactions;<br>(c) Whether there are significant, unusual or complex transactions, events or matters that have affected or may affect the entity's financial statements, including:<br>(i) Significant changes in the entity's business activities or operations;<br>(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;<br>(iii) Significant journal entries or other adjustments to the financial statements;<br>(iv) Significant transactions occurring or recognized near the end of the reporting period;<br>(v) The status of any uncorrected misstatements identified during previous engagements; and<br>(vi) Effects or possible implications for the entity of transactions or relationships with related parties;<br>(d) The existence of any actual, suspected or alleged:<br>(i) Fraud or illegal acts affecting the entity; and<br>(ii) Non-compliance 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;<br>(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;<br>(f) The basis for management's assessment of the entity's ability to continue as a going concern; (Ref: Para. A100)<br>(g) Whether there are events or conditions that appear to cast doubt on the entity's ability to continue as a going concern;<br>(h) Material commitments, contractual obligations or contingencies that have affected or may affect the entity's financial statements, including disclosures; and<br>(i) Material non-monetary transactions or transactions for no consideration in the financial reporting period under consideration. |

When making inquiries, there are certain techniques or principles that help practitioners obtain sufficient appropriate evidence. These are outlined in the following exhibit:

**Exhibit 5.1-2A**

| Technique/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 (e.g., sales managers, production managers, and IT personnel) may have important, and possibly unexpected, information to share. |
| **Use the Understanding Obtained of the Entity and Its Environment 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.<br><br>Then, consider the actual response received:<br>• If the response is too general, be prepared to ask additional probing questions to obtain the details required.<br>• 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.<br><br>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 (e.g., "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. |

| Technique/Principle | Description |
|---|---|
| **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 cut-off 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 cut-off procedures?" If they answer, "We don't have specific cut-off procedures," then you can pursue that line of questioning further.<br><br>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. |

| Technique/Principle | Description |
| --- | --- |
| **Avoid Making Assumptions in a Question** | A question such as "Why is the gross margin 35%?" assumes that the gross margin is 35%, 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 Results** | Document the inquiries as soon as possible following the meeting. Otherwise, many of the details of the discussion will be lost.<br><br>Take notes of key points arising during the meeting. |
| **Evaluate Information Obtained** | Read through the inquiry documentation and:<br>(a) Consider the inter-relationships of the data obtained with information obtained on other financial statement areas.<br>(b) Cross-reference data to corroborating information already obtained.<br>(c) Identify areas where material misstatements are likely to arise for purposes of designing review procedures.<br>(d) Identify areas where inquiries have made you aware that a material misstatement may exist.<br>(e) Identify any additional inquiries or information required.<br>(f) Conclude as to whether or not the objectives of the inquiry were achieved. |

### CONSIDER POINTS

In a review engagement, making inquiries and documenting the 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 make sure they:
- address the material items in the financial statements, including disclosures, and focus on areas in the financial statements where material misstatements are likely to arise
- take into account the principles and techniques 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:
- Consider combining ,when possible, inquiries related to understanding the entity and its environment with specific financial statement areas or disclosures.
- Review the proposed inquiries to ensure they are proportionate to the likelihood of material misstatement.
- If standard checklists are used, ensure they are appropriately customized.
- 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. When reviewing the exhibit, note the following:
- The inquiries outlined in the exhibit would only be required where the financial statement item is material or areas in the financial statements where material misstatements are likely to arise have been identified.
- 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, narrative, or citation) are matters for the judgment of the individual practitioner in adhering to the requirements of CSRE 2400.

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).

As indicated above, the exhibit outlines one way of documenting the inquiries made, but there may be many others that would also be acceptable. However, whatever form of documentation is used, it should include the inquiries that took place, when and with whom, and the information obtained.

### Exhibit 5.1-2B

### A) Balance Sheet Area

| **Accounts Receivable** | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(sample text)* | **Notes for the File** *(sample text)* |
| **Unrecorded Transactions/ Terms** | | |
| Ask staff dealing with receivables about instances where:<br>(a) certain customers were given preferential treatment<br>(b) terms of sale have been modified<br>(c) related-party transactions were involved<br>(d) internal credit limits were significantly overridden. | *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% 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.* | *Meeting held on Nov. 30, 20XX, with accounting clerk and sales manager. Information obtained:*<br>*(a) No customers have preferential treatment.*<br>*(b) Terms of sale are only modified for special large orders, usually with Bigentity Ltd.*<br>*(c) No related-party transactions were involved.*<br>*(d) Credit checks are rarely bypassed and credit limits are rarely overridden.* |

| Accounts Receivable | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(sample text)* | **Notes for the File** *(sample text)* |
| **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.<br>(b) Inquire about the composition of bad debts expense to understand the nature and amount of invoices written off or recovered during the period.<br>(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. | *(a) Based on the 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% is recorded in the accounting records if the client is still solvent. Accounts where the client is in bankruptcy are fully written off.*<br>*(b) Based on the review of the allowance and bad debts expense, only three accounts amounting to $3,500 that were written off were subsequently recovered.*<br>*(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.* | *A meeting was held on Nov. 30,20XX, with the accounting clerk and owner-manager. Information obtained:*<br>*(a) Accounts over 45 days are followed up monthly.*<br>*(b) Accounts over 90 days are sent to a collection agency and a provision of 50% is made if the entity is solvent or 100% 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.*<br>*(c) Only $3,500 was recovered from accounts written off during the year.* |

| Accounts Receivable | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(sample text)* | **Notes for the File** *(sample text)* |
| **Adequacy of Cut-Off** | | |
| 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. Record your conclusions as to whether this would have led to a proper cut-off. Where deficiencies are identified, document procedures. | *The cut-off 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 cut-off procedures documented on W/P X-X.* |

## B) Income Statement Area

| Income Statement | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(sample text)* | **Notes for the File** *(sample text)* |
| **Sales Revenue** | | |
| Inquire about, and document, the following:<br>(a) composition of sales, new customers, and sales trends<br>(b) any changes in the revenue recognition policies<br>(c) credit and collection policies<br>(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<br>(e) sales commission structure<br>(f) sales completeness<br>(g) cut-off procedures. | *I met with Armin, the sales manager, and discussed the following:*<br>*(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.*<br>*(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—Based on response from 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.* | *A meeting was held on Nov. 30, 20XX, with sales manager. Information obtained:*<br>• *no new product lines.*<br>• *sales sluggish in year but no price increases, reduced prices, or extended credit terms.*<br>• *no volume discounts.*<br>• *two new large customers.*<br>• *no changes in:*<br>— *credit and collection policies*<br>— *revenue recognition policy; revenue only recognized when the complete order shipped*<br>— *sales commissions* |

| Income Statement | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(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.*<br>(d) ***[asked if credit and collection policies have changed]*** *Based on 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% of the order) is not received before the next order, the customer is put on COD terms.*<br>(e) ***[asked to review the sales commission structure with Armin]*** *Sales commission — Went through commission structure on W/P 510-3 with Armin. No major changes noted.* | • *Sales cut-off 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 | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(sample text)* | **Notes for the File** *(sample text)* |
| | *(f)* ***[asked Armin how he knows that all sales have been recorded and that sales persons are not recording sales early]*** *Sales completeness—Based on 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.* | |

| Income Statement | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(sample text)* | **Notes for the File** *(sample text)* |
| | ***[asked how this is over-ridden]*** *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 his desk and the only invoice copy with notes was an invoice prepared and sent on January 31. Based on response from Armin, the items were still in inventory on December 31.* *(g)* ***[asked Armin how the company determines that sales are recorded in the correct accounting period at year end]*** *Armin indicated that cut-off 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.* | |

| Income Statement | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(sample text)* | **Notes for the File** *(sample text)* |
| **Expenses** | | |
| Obtain an understanding of expense accounts, including changes from the prior period for:<br>(a) gross margin expectations and changes to the gross margin (overall and/or by product/function)<br>(b) composition of, and changes to, payroll expense (overall)<br>(c) payroll deductions and benefits<br>(d) other key expense items or variances. | *I met with Roger (the owner-manager) and Armin (the sales manager) and discussed the following:*<br>*(a)* ***Gross margin: [asked Roger and Armin about the gross margin and changes this period]*** *The company prices products to achieve a 40% gross margin in general. Some key customers are given preferential pricing due to the volume they purchase. The discounts vary from 3% to 5%, 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% was in line with expectations based on the sales mix. This is consistent with the four-year average of 38%. The margin is in line with our expectations and explanations.* | *A meeting was held on Nov. 30, 20XX, with the owner-manager and sales manager. Information obtained:*<br>*(a) Gross margin—Current year's gross margin of 37% is in line with prior year and management expectations (i.e., most contracts aim for a 40% margin).*<br>*(b) Payroll expense—Company still has three full-time, salaried employees and five hourly employees. No one was hired and no one left during the year. Increase of 2% in payroll expense over prior year is in line with pay increase of 2.5%.*<br>*(c) Payroll deductions—Payroll outsourced to third-party provider. Deductions are in line with statutory rates.* |

| Income Statement | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(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% 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 terminated; or 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% increase in payroll expense from the prior year.* | (d) *Increase in advertising and promotion this year was due to increased focus on rising sales. Consulting expenses were higher this year due to ISO 9001 consultant hired.* |

| Income Statement | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(sample text)* | **Notes for the File** *(sample text)* |
| | ***[asked Roger how he determines that all employees are paid the correct rate and how the company determines 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.*<br>*(c)* ***Payroll benefits:*** *See W/P 720-4 on payroll deduction analysis.* ***[asked Roger how the company determines 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 the bank) versus doing the payroll themselves. He was not aware of any significant changes to the statutory rates.* | |

| Income Statement | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(sample text)* | **Notes for the File** *(sample text)* |
| | ***[asked Roger whether there are any other payroll benefits (e.g., 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.*<br>*(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 | | |
|---|---|---|
| **Possible Inquiries** | **Discussions (written/email/oral)** *(sample text)* | **Notes for the File** *(sample text)* |
| **Unrecorded Assets and Liabilities** | | |
| Inquire about, and document, whether:<br>(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<br>(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. Based on the discussion with the accountant, she had reviewed the repairs and maintenance account for any capital items. She found no misstatements.*<br>*(b) Based on the discussion with the accountant, all customer deposits have been booked.* | *A meeting was held on Nov. 30, 20XX, with the accountant and owner-manager. Information obtained:*<br>*(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.*<br>*(b) All customer deposits have been excluded from revenue and booked as deposits.* |

## 5.1-3 Related Parties

| Paragraph | Requirement |
|---|---|
| | **Procedures to Address Specific Circumstances**<br>**Related Parties** |
| 49 | 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. |

| Paragraph | Requirement |
|---|---|
| 50 | 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:<br>(a) The nature of those transactions;<br>(b) Whether related parties could be involved; and<br>(c) The business rationale (or lack thereof) of those transactions. |

General purpose financial reporting frameworks generally require disclosure of information relating to related parties and include a definition or discussion of related parties. For example, Part II of the *CPA Canada Handbook—Accounting*, Section 3840, *Related Party Transactions*, provides a definition and requirements for both the measurement and disclosure of matters related to related parties and related-party transactions.

As part of understanding of the entity and its environment and the specific inquiry requirements in paragraph 47(b) of CSRE 2400, practitioners are required to make inquiries about the existence of related parties and related-party transactions, including the purpose of those transactions. During the review, the practitioner must be alert for indications of related parties and related-party transactions that have not been identified from the preliminary inquiry. In addition, if significant transactions are identified that are outside the normal course of operation of the business, further inquiries are required.

The following exhibit provides a summary of some of the possible procedures or actions the practitioner can perform with respect to the identification of related parties and related-party transactions.

**Exhibit 5.1-3A**

| Procedure/Action | Description |
|---|---|
| **Inquire as to Management's Understanding of What Constitutes a Related Party** | Make sure 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 they understand 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 the existing related-party relationships 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** | Make sure the engagement team is aware of the list 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:<br>(a) nature of those transactions<br>(b) whether related parties could be involved<br>(c) business rationale (or lack thereof) of those transactions. |
| **Evaluate the Results** | Document the findings and consider the need for:<br>(a) additional procedures to be performed if the financial statements could be materially misstated<br>(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

CL Limited sells a range of tires for commercial delivery vehicles. A related party, PT Incorporated, sells automotive parts. There has been no history of transactions between the companies.

In performing the procedures this year, 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 more than two years old) had been sold at full value. The practitioner made inquiries about this transaction and found the sale was made to a subsidiary of PT Incorporated. Because this company had not previously been disclosed as a related party, the practitioner decided to perform some additional inquiries and procedures to identify any other undisclosed related parties.

The practitioner also asked for the business rationale behind the sale to PT Incorporated:

- Why would PT Incorporated pay full price for two-year-old tires that are not a popular size?
- What would PT Incorporated 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, the practitioner also:

- made sure the transactions (sale and receivable) were disclosed and measured in accordance with the AFRF
- inquired about the valuation of the tires
- obtained a written assurance from the management of CL Limited that the sale to PT Incorporated was final and would not be reversed in the subsequent period.

## 5.1-4 Fraud and Non-Compliance with Laws and Regulations

| Paragraph | Requirement |
|---|---|
| | **Procedures to Address Specific Circumstances**<br>**Fraud and Non-Compliance with Laws or Regulations** |
| 51 | When there is an indication that fraud or non-compliance with laws or regulations, or suspected fraud or non-compliance with laws or regulations, has occurred in the entity, the practitioner shall:<br>(a) Communicate that matter to the appropriate level of senior management or those charged with governance, as appropriate;<br>(b) Request management's assessment of the effect(s), if any, on the financial statements;<br>(c) Consider the effect, if any, of management's assessment of the effects of fraud or non-compliance with laws or regulations communicated to the practitioner on the practitioner's conclusion on the financial statements and on the practitioner's report; and<br>(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. A104) |

As part of understanding the entity and its environment and of the specific inquiry requirements in paragraph 47(d) of CSRE 2400, practitioners are required to make inquiries about any actual, suspected, or alleged:

- fraud or illegal acts affecting the entity
- non-compliance with provisions of laws and regulations that directly affect material amounts and disclosures in the financial statements.

Professional skepticism is an important aspect of completing a review engagement under CSRE 2400, and is particularly important for being alert for conditions that may indicate possible fraud or non-compliance with laws or regulations.

The following exhibit provides a summary of some possible procedures or actions the practitioner can complete with respect to the review of matters related to fraud and non-compliance with laws and regulations ("illegal acts").

**Exhibit 5.1-4A**

| Procedure/Action | Description |
|---|---|
| **Update the Understanding of the Entity and Its Environment** | Note any actual, suspected, or alleged fraud or illegal acts.<br>Note any instances of non-compliance with significant laws and regulations. If so, what are the financial reporting implications?<br>Note any dealings with a lawyer during the period to discuss any legal issues. |
| **If Fraud or Non-compliance 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 identified inconsistencies 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 non-compliance with the appropriate level of senior management or TCWG. |

| Procedure/Action | Description |
|---|---|
| **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 |
| **Inquire about Litigation Claims and Instances of Noncompliance** | Inquire about the existence of any litigation, claims, and non-compliance with laws and regulations during the period. Also consider whether the results of performing other procedures provide indications of litigation, claims, and non-compliance with laws and regulations.<br><br>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).<br><br>If there are outstanding issues that may have a material impact on the financial statements, consider the following:<br>• additional inquiry<br>• review minutes of meetings of TCWG<br>• review correspondence between the entity and external legal counsel<br>• review legal expense accounts<br>• review correspondence with relevant regulatory, licensing, and taxation authorities.<br><br>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.<br><br>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. |

### CONSIDER POINTS

Where the practitioner identifies a misstatement that may be indicative of fraud, the implications of such a misstatement in relation to other aspects of the engagement 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 (see **Chapter 7** of this Guide).

### 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 strong, so there is no concern about continuing to use the going concern basis of accounting. 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.

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 |
|---|---|
| | **Procedures to Address Specific Circumstances**<br>**Going Concern** |
| 52 | 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. |
| 53 | If, during the performance of the review, the practitioner becomes aware of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, the practitioner's procedures to determine whether a material uncertainty exists shall include: (Ref: Para. A105)<br>(a) Inquiries of management about:<br>(i) Whether management has identified any material uncertainty;<br>(ii) Plans for future actions affecting the entity's ability to continue as a going concern;<br>(iii) The feasibility of those plans; and<br>(iv) Whether management believes the outcome of those plans will improve the situation regarding the entity's ability to continue as a going concern;<br>(b) Consideration of management's responses in light of all relevant information of which the practitioner is aware as a result of the review; and<br>(c) Evaluation of whether management's responses provide an appropriate basis to:<br>(i) Support the preparation of the financial statements on a going concern basis; and<br>(ii) Conclude whether the financial statements are materially misstated, or are otherwise misleading, as a result of inadequate disclosure with respect to a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. |

As part of understanding the entity and its environment and the specific inquiry requirements of paragraph 47(f) of CSRE 2400 practitioners are required to make inquiries about going-concern uncertainties.

Most financial reporting frameworks require the use of the going-concern assumption, also known as the going-concern basis of accounting, 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, but not limited to 12 months after the reporting period. If there are serious doubts about the entity's ability to continue as a going concern, the financial statements could 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 be worth a significantly lower percentage of their net book value if sold at auction.

**CONSIDER POINTS**

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 and whether there are events and conditions that appear to cast doubt on the entity's ability to continue as a going concern.

The period to be covered by this assessment is often, but not limited to, 12 months from the period end; however, first, check whether the AFRF or laws/regulations specify a different period.

The following exhibit provides a summary of some of the possible procedures or actions the practitioner can complete with respect to the review of matters related to the going concern assessment and any implications for the financial statements.

**Exhibit 5.1-5A**

| Procedure/Actions | Description |
|---|---|
| **1. Inquire about any events or conditions that may cast significant doubt on the entity's ability to continue as a 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 paragraph A105 of CSRE 2400) that may cast significant doubt on the entity's ability to continue as a going concern. |

| Procedure/Actions | Description |
|---|---|
| **2. If the practitioner does not become aware of any events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, 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 events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, make additional inquiries of management.** | Inquire about:<br>• whether management has identified any material uncertainty<br>• management's plan of action<br>• feasibility of such a plan<br>• whether management believes the outcome of the plan will improve the situation.<br><br>If management has not developed a plan, discuss the nature of the uncertainty and request that a plan of action be developed. |
| **4. Consider management's responses in light of all other relevant information. Evaluate and document the results of those inquiries.** | Evaluate whether management's responses provide an appropriate basis to:<br>• continue to present the financial statements on a going-concern basis<br>• conclude whether the financial statements are materially misstated or are otherwise misleading as a result of inadequate disclosure with respect to a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.<br><br>This includes the understanding obtained of the entity and its environment and the identified areas in the financial statement where material misstatements are likely to arise. |
| **5. Consider any implications on the review engagement report.** | Include an Emphasis of Matter paragraph, if disclosure is adequate (see Chapter 7 of this Guide). |

In evaluating management's action plans in response to a material uncertainty about events or conditions that cast doubt on the company's ability to continue as a going concern (see paragraph A100 of CSRE 2400), 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?

## 5.1-6 Other Matters

### *Accounting Estimates*

As part of understanding the entity, paragraph 47(a) of CSRE 2400 requires the practitioner to make inquiries about how management makes the significant accounting estimates required under the AFRF.

Significant accounting estimates, including fair value accounting estimates, may be relevant to the identification of the areas in the financial statement where material misstatements are likely to arise. A practitioner may be concerned that management bias or a high degree of estimation uncertainty are causing estimates to be consistently at one end of a range of what would be reasonable.

Even though CSRE 2400 does not include explicit requirements in regard to accounting estimates and fair values, like the guidance on related parties, going concern, fraud and non-compliance with laws and regulations discussed in this Chapter, the review of significant accounting estimates is important. The following exhibit provides a summary of some of the possible procedures or actions the practitioner can complete with respect to the review of management's estimates and fair value.

**Exhibit 5.1-6A**

| Procedure/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 areas in the financial statements where material misstatements are likely to arise. |
| **Understand the Basis of Calculation** | Through inquiry, obtain an understanding of the measurement techniques used and the significant drivers (e.g., interest rates, commodity prices, etc.) that affect estimates and the assumptions used.<br>Also inquire about:<br>• whether management used an expert to develop estimates<br>• changes or trends in the current period that impact the drivers identified above<br>• 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:<br>• magnitude of the accounting estimates<br>• accuracy of preparation<br>• consistency with prior-period estimates (inquire about differences)<br>• indicators of possible management bias or employee fraud. |

### *Work Performed by Others (Experts)*

| Paragraph | Requirement |
|---|---|
| | Use of work performed by others |
| 54 | 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 that the work performed is adequate for the practitioner's purposes. (Ref: Para. A92) |

The practitioner is required to take steps to be satisfied with the adequacy of the work performed by others. The practitioner may rely on an expert for such matters as the valuation of property, plant and equipment, or the collectability of a government credit such as the scientific research and experimental development (SR&ED) tax incentives. 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 5.1-6B**

| 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:<br>• likelihood of a material misstatement in the matter to which that expert's work relates<br>• significance of the expert's work in the context of the review engagement<br>• practitioner's knowledge of, and experience with, previous work performed by that expert<br>• 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.<br>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:<br>• respective roles and responsibilities<br>• 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 and its environment. |

### *Initial Review Engagements—Opening Balances*

| Paragraph | Requirement |
|---|---|
| | Initial review engagements—opening balances |
| 55 | When performing an initial review engagement, the practitioner shall obtain sufficient appropriate evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements. (Ref: Para. A106). |

The opening balances may contain misstatements that materially affect the current period's financial statements. In obtaining sufficient appropriate evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements, the practitioner may consider the following:

- determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated
- determining whether the opening balances reflect the consistent application of appropriate accounting policies
- evaluating whether procedures performed in the current period provide evidence relevant to the opening balances
- performing procedures to obtain evidence regarding the opening balances (see paragraph A106 of CSRE 2400).

### *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. A107) |

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:

- relevant accounting records, such as the general ledger

- summary record or schedule, such as a trial balance. This does not mean the accounting trial balance must be included in the working paper file.

### *Reviews for Component Auditors*

In some situations, a group auditor may request (pursuant to paragraph 29 of CAS 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*) that a review engagement be performed with respect to a non-significant 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, contained in CAS 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 CSRE 2400, practitioners 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.

Some of the requirements for the group auditor are outlined in the following exhibit.

**Exhibit 5.1-6C**

| Group Auditor 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:<br>• whether the component reviewer understands, and will comply with, the relevant ethical requirements, including independence<br>• component reviewer's professional competence<br>• involvement required by the group engagement team<br>• regulatory environment that actively oversees the work of the component reviewer.<br><br>(see paragraphs 19 and A32 of CAS 600) |

| Group Auditor Requirement | Commentary |
| --- | --- |
| **Issue Group Instructions** | The group auditor will often provide instructions on a timely basis to the component practitioner that addresses matters such as:<br>• 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<br>• ethical requirements relevant to the group audit, including independence<br>• materiality to be used for performing the review of the component. Note, however, that this does not override the requirements of CSRE 2400.41.<br>• Identified significant risks of material misstatement of the group financial statements<br>• listing of related parties prepared by group management<br>• details of specific procedures to be performed, such as analysis of certain accounts, obtaining details of significant transactions, and intercompany reconciliations.<br>(See paragraphs 40-41, A40 and Appendix 5 of CAS 600 for more details. Appendix 5 of CAS 600 induces a listing of required and additional matters included in the group engagement team's letter of instruction.) |

## 5.1-7 Additional Procedures

| Paragraph | Requirement |
| --- | --- |
| | *Performing 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. A108-A112)<br>(a) Conclude that the matter(s) is not likely to cause the financial statements as a whole to be materially misstated; or<br>(b) Determine that the matter(s) causes the financial statements as a whole to be materially misstated. |

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

However, when performing inquiry and analytical 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, paragraph 57 of CSRE 2400 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 cut-off, it is suspected that certain shipments of goods in the current period 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, timing 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 being performed in greater detail or being focused on the particular matter that causes the practitioner to believe the financial statements may be materially misstated. 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 confirmations, that will provide evidence regarding the matter.

Judgment about the nature, timing, and extent of additional procedures to be performed is guided by:

- information obtained from the practitioner's evaluation of the results of procedures already performed
- the practitioner's updated understanding of the entity and its environment obtained through the course of the engagement
- persuasiveness of evidence needed to address the matter that causes the practitioner to believe that the financial statements may be materially misstated.

The following exhibit, based on paragraph A112 of CSRE 2400, demonstrates how the practitioner becomes aware of a matter requiring additional procedures to be performed.

### Exhibit 5.1-7A

**Need for Additional 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.

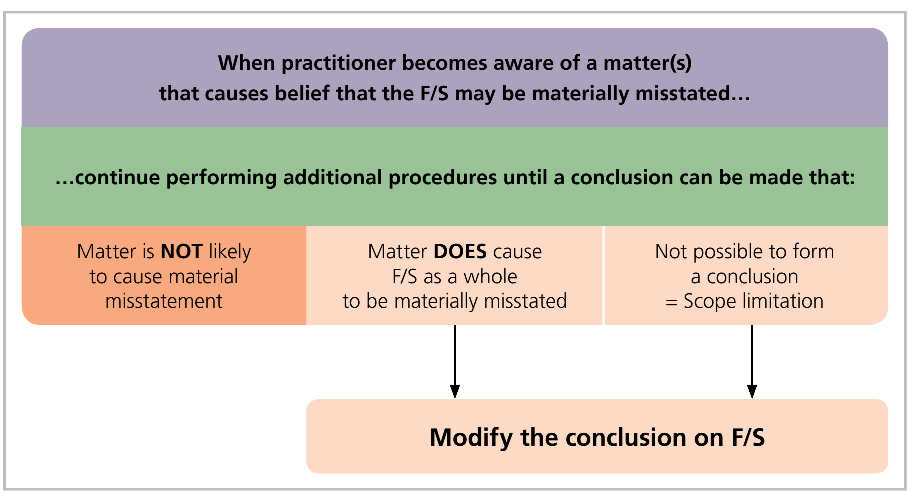
**Practitioner evaluates management's response to the additional inquiries**

| 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 and a conclusion is formed that the financial statements as a whole are materially misstated. |
| **C.** Practitioner continues to believe that the A/R balance is likely to be materially misstated, but the results do not provide sufficient appropriate evidence to determine that A/R 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 financial statements as a whole to be materially misstated, or to determine that the matter does cause the financial statements 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 financial statements.

The following exhibit summarizes the key steps in the judgment process discussed above.

### Exhibit 5.1-7B



**CONSIDER POINTS**

*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 5.1-7C**

| Excessive Inventory Provisions | |
|---|---|
| **Cause for Concern** | **Potential Material Misstatement in Financial Statements** |
| Sales manager indicated there were no inventory items with poor sales.<br>Management seemed evasive in its reasons for making provisions on specific stock items.<br>The CEO has indicated in the past that she wants to minimize income taxes. | The provision recorded for slow-moving and obsolete inventory could be much higher than actually required. |

| Examples of Additional Procedures |
|---|
| Inquire about any discounts, promotions, or price decreases on the inventory items subject to provision. |
| Inquire and/or review sales of inventory after period end subject to provision. If sales have been made, consider the volume size and the discount terms. |
| Inquire of 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. |
| Identify any new developments (e.g., new technologies, innovations, or competitors' products) that could make a particular stock item obsolete. |
| Physically inspect the condition of stock items (subject to provisions). |

| Improper Sales Cut-off | |
|---|---|
| **Cause for Concern** | **Potential Material Misstatement in Financial Statements** |
| In reviewing subsequent events, the practitioner noted a sharp increase in sales that occurred in the month following the period end.<br>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 cut-off error). |
| **Examples of Additional Procedures** | **Issue resolved?** ***If yes, stop.*** |
| Review the adequacy of the entity's cut-off policies/procedures and their 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.<br>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.*** |
| 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 cut-off. | |
| Identify relationships with other accounts (e.g., 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. | |
| 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.<br>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.<br>A number of credit notes relating to sales made just prior to year end were issued immediately following year end.<br>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. | |
| Select 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 whether 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. | |

## 5.1-8 Subsequent Events

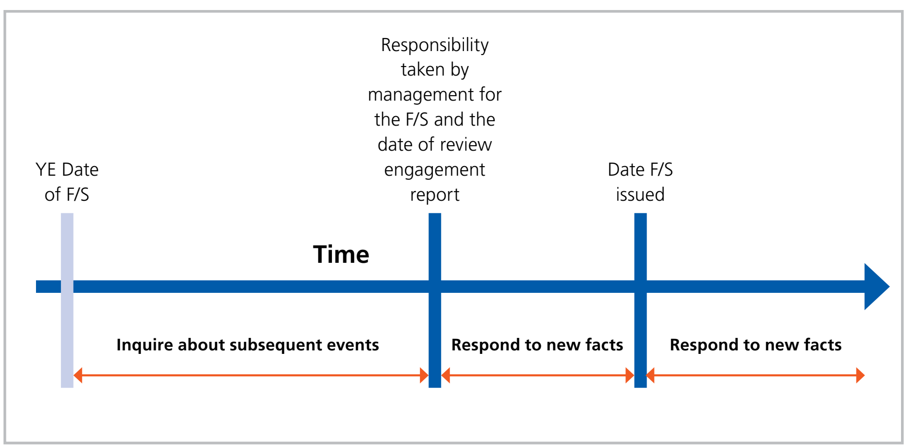
| Paragraph | Requirement |
|---|---|
| | **Subsequent Events** |
| 60 | *Events Occurring between the Date of the Financial Statements and the Date of the Practitioner's Report*<br>If the practitioner becomes aware of events occurring between the date of the financial statements and the date of the practitioner's report that require adjustment of, or disclosure in, the financial statements, the practitioner shall request management to correct those misstatements. |

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 date the financial statements are issued
- facts that become known after the date the financial statements are issued for use by third parties.

The following exhibit illustrates the key dates involved with the review of subsequent events.

### Exhibit 5.1-8A



Paragraph 47(e) of CSRE 2400 requires 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. Some of the inquires that could be made are noted in the following exhibit.

**Exhibit 5.1-8B**

| 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.<br>Matters such as the following could be considered:<br>• new commitments, borrowings, or guarantees<br>• sales or acquisitions of assets that have occurred or are planned<br>• increases in capital or issuance of debt instruments<br>• agreements to merge or liquidate<br>• assets that have been appropriated by government or destroyed<br>• litigation, claims, and contingencies<br>• any unusual accounting adjustments made or contemplated<br>• any events that cast doubt on the appropriateness of the going-concern assumption or other accounting policies<br>• any events affecting the measurement of estimates or provisions in the financial statements<br>• any events relevant to the recoverability of assets.<br>If the practitioner becomes aware of a matter that indicates there may be a material misstatement in the financial statements, additional procedures could include:<br>• reading minutes of meetings (e.g., management and TCWG) held after the date of the financial statements or inquiring about matters discussed at meetings for which minutes are not available<br>• reading any financial reports produced after the period end<br>• reviewing recent correspondence from legal counsel. |

## *Facts that Become Known After the Date of the Practitioner's Report but Before the Date the Financial Statements are Issued*

| Paragraph | Requirement |
|---|---|
| | *Facts that Become Known to the Practitioner After the Date of the Practitioner's Report but Before the Date the Financial Statements Are Issued* |
| 61 | 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:<br>*(a) Discuss the matter with management and, where appropriate, those charged with governance;*<br>*(b) Determine whether the financial statements need amendment; and, if so,*<br>*(c) Inquire how management intends to address the matter in the financial statements.* |
| 62 | If management amends the financial statements after the date of the practitioner's report but before the financial statements are issued, the practitioner shall either:<br>(a) Amend the practitioner's report to include an additional date restricted to that amendment that thereby indicates that the practitioner's procedures on subsequent events are solely restricted to the amendment of the financial statements described in the relevant note to the financial statements; or<br>(b) Extend the procedures on subsequent events to the date of the new practitioner's report and provide a new practitioner's report on the amended financial statements. |
| 63 | 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. |

As indicated above, CSRE 2400 provides guidance for the occasion that a fact becomes known after the financial statements have been issued that requires an amendment to either the financial statements or the practitioner's report. The action required depends on how the matter is addressed.

Note that there is no obligation to perform any procedures regarding the financial statements after the date of the practitioner's report. However, if the practitioner becomes aware of a matter that, if it had been known to the practitioner, it might have caused the practitioner to amend the practitioner's report then the following procedures should be performed or considered, regardless of when the matter becomes known to the practitioner:

- discuss the matter with management (and, where applicable, TCWG)
- determine whether financial statements require amendment
- inquire about how management intends to address the matter in the financial statements

However, if the facts become known before issuance (versus after issuance) the practitioner's response will depend on whether management will amend the financial statements as follows:

<table>
<tr><th colspan="3">Facts Become Known After the Date of the Practitioner's Report but Before Issuance</th></tr>
<tr><th colspan="2">Management Amends the Financial Statement</th><th>Management Does NOT Amend the Financial Statements</th></tr>
<tr>
<td>"Double Date" the Practitioner's Report<br><br>Extend procedures on the subsequent events only.<br><br>Amend the practitioner's report to include an additional date restricted to that amendment which indicates that the practitioner's procedures on subsequent events are solely restricted to the amendment of the financial statements described in the relevant note to the financial statements.</td>
<td>Issue a new Practitioner's Report<br><br>Extend procedures on subsequent events to the date of the new practitioner's report.<br><br>Provide a new practitioner's report on the amended financial statements.</td>
<td>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:<br>• Notify management and TCWG where possible and request that management not release the practitioner's report until amendments have been made.<br>• If the report is released despite this request, take appropriate action (after consulting with legal counsel) to prevent inappropriate reliance on the report.<br>• Consider whether legal advice should be obtained.</td>
</tr>
</table>

## *Facts that Become Known after Date of Practitioner's Report and Date the Financial Statements Have Been Issued*

| Paragraph | Requirement |
|---|---|
| | *Facts that Become Known to the Practitioner After the Financial Statements Have Been Issued (Ref: Para. A115)* |
| 64 | If, after the date the financial statements have been 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 practitioner's report, the practitioner shall:<br>(a) Discuss the matter with management and, where appropriate, those charged with governance;<br>(b) Determine whether the financial statements need amendment; and, if so,<br>(c) Inquire how management intends to address the matter in the financial statements. |
| 65 | If management amends the financial statements subsequent to the date the financial statements are issued, the practitioner shall:<br>(a) Amend the practitioner's report to include an additional date restricted to that amendment that thereby indicates that the practitioner's procedures on subsequent events are solely restricted to the amendment of the financial statements described in the relevant note to the financial statements; or<br>(b) Extend the procedures on subsequent events to the date of the new practitioner's report and provide a new practitioner's report on the amended financial statements. |
| 66 | If, after the financial statements have been issued, management amends the financial statements and the practitioner provides a new or amended practitioner's report on the amended financial statements, the practitioner shall include in the new or amended practitioner's report an Emphasis of Matter paragraph or Other Matter paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the practitioner. |
| 67 | If management does not amend the financial statements in circumstances where the practitioner believes they need to be amended, the practitioner shall take appropriate action to seek to prevent reliance on the practitioner's report. |

If the facts become known after issuance (versus before issuance) the practitioner’s response will depend on whether management amends the financial statements as follows:

<table>
<tr><th colspan="3">Facts Become Known After Issuance</th></tr>
<tr><th colspan="2">Management Amends the Financial Statement</th><th>Management Does NOT Amend the Financial Statements</th></tr>
<tr>
<td>“Double Date” the Practitioner’s Report<br><br>Extend procedures on the subsequent events only.<br><br>Amend the practitioner’s report to include an additional date restricted to that amendment, which indicates that the practitioner’s procedures on subsequent events are solely restricted to the amendment of the financial statements described in the relevant note to the financial statements.</td>
<td>Issue a new Practitioner’s Report<br><br>Extend procedures on subsequent events to the date of the new practitioner’s report.<br><br>Provide a new practitioner’s report on the amended financial statements.</td>
<td>If management does not amend the financial statements the practitioner must take appropriate action to seek to prevent reliance on the practitioner’s report.<br><br>Consider whether legal advice should be obtained.</td>
</tr>
<tr>
<td colspan="2">Include an Emphasis of Matter paragraph or Other Matter paragraph referring to:<br>• the note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements, and<br>• the earlier report provided by the practitioner.<br><br>An Other Matter paragraph may be added if the practitioner considers it necessary to disclose a matter related to the subsequent event other than what is disclosed or presented in the financial statements.</td>
<td></td>
</tr>
</table>

## 5.1-9 Written Representations

| Paragraph | Requirement |
| --- | --- |
| | **Written Representations** |
| 68 | 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. A116-A119)<br>(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<br>(b) All transactions have been recorded and are reflected in the financial statements.<br><br>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. |
| 69 | The practitioner shall request management's written representations that management has disclosed to the practitioner: (Ref: Para. A117)<br>(a) The identity of the entity's related parties and all the related party relationships and transactions of which management is aware;<br>(b) Significant facts relating to any frauds or suspected frauds known to management that may have affected the entity;<br>(c) Known actual or possible non-compliance with laws and regulations for which the effects of non-compliance affect the entity's financial statements;<br>(d) All information relevant to use of the going concern assumption in the financial statements;<br>(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;<br>(f) Material commitments, contractual obligations or contingencies that have affected or may affect the entity's financial statements, including disclosures; and<br>(g) Material non-monetary transactions or transactions for no consideration undertaken by the entity in the financial reporting period under consideration. |

| Paragraph | Requirement |
|---|---|
| 70 | The practitioner shall request a written representation of management about whether they believe the effects of uncorrected misstatements are immaterial, individually or in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation. |
| 73 | *Date of and Period(s) Covered by Written Representations*<br>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 written representations will confirm that management has fulfilled its responsibilities as described in the agreed terms of engagement, as well as confirm other representations about the financial statements 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 (e.g., 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 analyses. If, in addition to the written representations required by the standard, the practitioner determines that it is necessary to obtain other written representations to support evidence relevant to the financial statements, then the practitioner can request these of management or TCWG in the letter of representation or a separate letter.

Written representations are not to be used as a substitute for performing procedures on material financial statement items or areas in the financial statements where material misstatements are likely to arise.

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.

The following exhibit provides a list of some of the factors to be considered in the content of the letter of representation.

**Exhibit 5.1-9A**

| **Letter of Representation** | |
|---|---|
| **Format** | Written representations are addressed to the practitioner, usually in the form of a letter. |
| **Materiality** | Indicate that materiality will not apply to certain representations (e.g., fraud, non-compliance with laws and regulations, completeness of information provided, and presentation of the financial statements). |
| **Content** | Written representations, such as outlined in paragraphs 68-70 of CSRE 2400. CSRE 2400 contains a sample letter of representation. |
| **Date of and Period(s) Covered by Written Representations** | The date is as of, but not after, the date of the review engagement report. |
| **Signatures** | Typically, the CEO or CFO or treasurer, owner, (or equivalent positions within the entity) who is the "party responsible for preparing the financial statements" signs 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. |
| **If Management Refuses to Sign** | (a) Discuss the matter with management and TCWG.<br>(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.<br>(c) Take appropriate actions, including determining the possible effect on the conclusion in the practitioner's report (see paragraph 72 of CSRE 2400 and Chapter 7 of this Guide). |

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.

Appendix 2 of CSRE 2400 includes an example of written representations from management.

**CONSIDER POINTS**

Consider the need to have TCWG sign specific written representations. This would be based on the precise responsibilities of TCWG.

## 5.2 Evaluate Evidence Obtained from the Procedures Performed

| Paragraph | Requirement |
|---|---|
| | **Evaluating Evidence Obtained from the Procedures Performed** |
| 74 | 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. A120) |
| 75 | If the practitioner is not able to obtain sufficient appropriate evidence to form an unmodified conclusion, the practitioner shall discuss with management and, where appropriate, those charged with governance, the effects such limitations have on the scope of the review. (Ref: Para. A121-A122) |

### 5.2-1 Has Sufficient Appropriate Evidence Been Obtained?

After completing the procedures, the practitioner shall evaluate whether sufficient appropriate evidence has been obtained from the procedures performed. If the evidence is not considered sufficient, the practitioner shall perform other procedures judged to be necessary in the circumstances (see paragraphs 74 and A120 of CSRE 2400).

As the practitioner approaches the stage of the review where a conclusion will be formed, a number of the matters should be considered along with the evaluation of the evidence obtained. Some of these matters are outlined in the following exhibit.

**Exhibit 5.2-1A**

| 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. |
| **Unexpected Results or Inconsistencies** | Apply professional skepticism in evaluating the responses and information provided by management. If the practitioner becomes aware of a matter(s) that causes the practitioner to believe the financial statements may be materially misstated then consider what additional procedures will be required. |
| **Identified Misstatements** | In forming a conclusion, the practitioner must evaluate the effect of uncorrected misstatements identified during the review engagement, and the effect of uncorrected misstatements in the prior period (see paragraph 77(b) of CSRE 2400).<br><br>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, evaluate the effect of uncorrected misstatements identified during the review and in the previous period on the financial statements as a whole.<br><br>When misstatements are identified in the current period (e.g., clerical errors, wrong assumptions used in estimates, and misapplication of accounting policies), they must be accumulated (ideally, on a single working paper), and the nature and circumstances of their occurrence considered (see paragraph 58 of CSRE 2400).<br><br>If the practitioner becomes aware of further misstatements that could ultimately result in the financial statements being materially misstated, then additional procedures may be required.<br><br>Consider the implication of any uncorrected misstatements (see paragraph 59 of CSRE 2400). Management must 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. |

| Consider | Action Required |
|---|---|
| **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 will be required. |
| **Documentation Obtained and Results of Procedures** | Have the results of the procedures been properly documented in the circumstances? Ensure that:<br>(a) the evidence obtained from the procedures performed is sufficient and appropriate to support the conclusions reached and there is no over-generalizing (i.e., ignoring a number of small discrepancies identified)<br>(b) unusual circumstances have not been overlooked<br>(c) appropriate conclusions were drawn. |
| **Representation Letter** | Discuss the expected inclusions in the representation letter with management, including a summary of uncorrected misstatements. The practitioner must request a representation of management that they believe the effects of any uncorrected misstatements are immaterial, individually or in aggregate, to the financial statements as a whole. |

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) the effects of such limitations on the scope of the review (see Chapter 7 of this Guide).

**CONSIDER POINTS**

*Misstatements*

Some misstatements (e.g., incomplete or inaccurate financial statement disclosures) and qualitative findings (e.g., the possible existence of fraud) may result in a materially misstated financial statement.

## 5.2-2 Supervision and Review

Paragraph 23(b) of CSRE 2400 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. This requirement must be met as part of planning and the completion of the review procedures, but is also relevant to as the practitioner is starting to form a conclusion on the financial statements.

To ensure work performed is in compliance with professional standards, firms are required to design and develop quality control policies and procedures that require the work of less experienced engagement team members to be supervised and reviewed by a more experienced engagement team member (in accordance with Canadian Standard on Quality Control (CSQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and other Assurance Engagements)*.

A practitioner may be working alone rather than as part of a team. In such circumstances, this would not be relevant.

Characteristics of supervision and review of a review engagement and the engagement quality control review are described in the following exhibit.

**Exhibit 5.2-2A**

| | |
|---|---|
| **Characteristics of Supervision and Review** | The engagement is performed in accordance with professional standards, including the quality assurance policies. |
| | Appropriate consultations have taken place and the resulting conclusions are documented and implemented. |
| | Nature, timing, and extent of procedures performed have been documented and appropriately revised where necessary and support the conclusion reached. |
| | Work performed supports the conclusion 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.<br><br>Some review engagements do not require an EQCR. However, firms should develop suitable criteria outlining the type of review engagements that would require an EQCR. Examples could include entities:<br>• above a certain size<br>• with a large number of financial statement users<br>• with a high public profile<br>• with highly complex transactions<br>• with unusual or controversial accounting policies<br>• that operate in an industry unknown to the practitioner. |

## 5.3 Engagement Documentation

| Paragraph | Requirement |
|---|---|
| | **Documentation** |
| 104 | The preparation of documentation for the review provides evidence that the review was performed in accordance with this CSRE, 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. A168)<br>(a) The nature, timing and extent of the procedures performed to comply with this CSRE and applicable legal and regulatory requirements;<br>(b) Results obtained from the procedures, and the practitioner's conclusions formed on the basis of those results; and<br>(c) Significant matters arising during the engagement, the practitioner's conclusions reached thereon, and significant professional judgments made in reaching those conclusions. |
| 105 | In documenting the nature, timing and extent of procedures performed as required in this CSRE, the practitioner shall record:<br>(a) Who performed the work and the date such work was completed; and<br>(b) Who reviewed the work performed for the purpose of quality control for the engagement, and the date and extent of the review. |
| 106 | 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. |
| 107 | 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
- stands alone so no additional explanations are required to understand:
  - procedures performed
  - results of the procedures and conclusions drawn therefrom as well as any significant matters encountered
  - how conclusions on significant matters were reached and the significant professional judgments made in reaching those conclusions.

File documentation provides the evidence that:

- engagement preconditions were met
- engagement was appropriately planned, including the determination of materiality
- understanding of the entity and its environment was obtained, including identification of areas in the financial statements where material misstatements were likely to arise
- procedures were, in fact, performed and the results were obtained
- significant matters arising during the engagement were appropriately addressed (e.g., how the significant professional judgments were made in reaching those conclusions)
- practitioner's conclusion on the financial statements as a whole was appropriate based on the evidence obtained.

The requirement for the preparation of documentation in paragraph 104 of CSRE 2400 must be sufficient to enable an experienced practitioner, having no previous connection with the engagement, to review the file and understand the work performed, the results obtained, significant matters arising and conclusions reached.

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

## CONSIDER POINTS

*Use of Checklists*

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

Some firms use standard checklists to make sure all areas in the financial statements are 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 make sure the practitioner has not overlooked a specific aspect.

To be efficient and effective, add relevant customized procedures to the checklists that focus on addressing areas in the financial statements where material misstatements are likely to arise. Also remove (or do not complete) procedures addressing non-material items and areas where material misstatements are not likely to arise.

When using checklists it is important to document not only that an inquiry was made, but to also provide appropriate details about the actual response received, who was asked and when the inquiry was completed.

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** | • nature of the engagement to be performed and the time frames, etc.<br>• assessment of independence and engagement risk<br>• signed engagement letter |
| **Understanding the Entity and Its Environment** | • AFRF that will be used<br>• information on the four specified areas of understanding required in CSRE 2400 |
| **Planning** | • determination of what would be material<br>• identification of material financial statement areas<br>• identification of areas in the financial statements where material misstatements are likely to arise<br>• listings of planned inquiries and analytical procedures<br>• planning memos or other similar documentation |

| Information Prepared by the Practitioner | |
|---|---|
| **Work Performed** | • results obtained from the procedures and the practitioner's conclusions on the basis of those results, including:<br>(a) who performed the work and the date on which the work was completed<br>(b) names of the entity personnel interviewed and the interview date<br>(c) details of what was discussed, significant matters arising, and the nature of those matters<br>(d) results from applying analytical procedures, including:<br>— information used,<br>— explanations provided for variances and unusual items, and<br>— evaluation of the findings in light of other information, such as the understanding of the entity<br>(e) listing of the additional procedures performed as considered necessary in the circumstances<br>• listing of identified misstatements and whether or not the misstatements have been corrected<br>• any unusual matters considered during the performance of the review, including the disposition of such matters |
| **Conclusions and Reporting** | • nature, timing, and extent of the procedures performed to comply with CSRE 2400 and applicable legal and regulatory requirements<br>• significant matters discussed with management and TCWG<br>• 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<br>• who reviewed the work performed for the purpose of quality control for the engagement and the date and extent of the review<br>• conclusions reached on the results of the procedures performed and the wording of the review engagement report<br>• signed letter of representation from management. |

## 5.3-2 File Assembly

Paragraphs 45 and A54 of CSQC 1 require firms to establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis. The application guidance suggests in the case of an audit, for example, such a time limit would ordinarily not be more than 60 days after the date of the auditor's report, but it does not specify an example for review engagements. Paragraph 104 and A168 of CSRE 2400 also refer to CSQC 1 and the assembly of the final engagement being completed on a timely basis.

**CONSIDER POINTS**

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.

# CHAPTER 6
# Forming an Appropriate Conclusion

| CHAPTER 6: CONTENT |
| --- |
| • How to form an appropriate conclusion on the financial statements as a whole |
| **6.1: Forming an Appropriate Conclusion** |
| 6.1-1 Evaluate Assurance Obtained on Financial Statements<br>6.1-2 Accumulate Misstatements and Evaluate the Effect of Uncorrected Misstatements<br>6.1-3 Communicate Findings<br>6.1-4 Inconsistencies |
| **Outcome** |
| The outcome of this process is an appropriate conclusion on the financial statements as a whole. |

## 6.1 Forming an Appropriate Conclusion

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

## 6.1-1 Evaluate Assurance Obtained on Financial Statements

| Paragraph | Requirement |
|---|---|
| | **Forming the Practitioner's Conclusion on the Financial Statements** |
| 76 | *Consideration of the Applicable Financial Reporting Framework in Relation to the Financial Statements*<br><br>The practitioner shall form a conclusion on whether anything 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.*<br><br>*Paragraphs 86 and 91 deal with the phrases used to express this conclusion in the case of a fair presentation framework and a compliance framework respectively. |
| 77 | To form the conclusion required by paragraph 76, the practitioner shall determine whether limited assurance has been obtained that the financial statements as a whole are free from material misstatement. In making this determination, the practitioner shall evaluate:<br>(a) The evidence obtained from the procedures performed;<br>(b) The effect of uncorrected misstatements identified during the review, and the effect of uncorrected misstatements in the prior period, on the financial statements as a whole; (Ref: Para. A123)<br>(c) The qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments; (Ref: Para. A124-A125)<br>(d) Whether, in the context of the requirements of the applicable financial reporting framework and the results of procedures performed:<br>(i) The terminology used in the financial statements, including the title of each financial statement, is appropriate;<br>(ii) The financial statements adequately disclose the significant accounting policies selected and applied;<br>(iii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;<br>(iv) Accounting estimates made by management appear reasonable;<br>(v) The information presented in the financial statements appears relevant, reliable, comparable, and understandable; and<br>(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; and (Ref: Para. A126-A128)<br>(e) Whether the financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: Para. A129-A130) |

| Paragraph | Requirement |
|---|---|
| 78 | If the financial statements are prepared using a fair presentation framework, the practitioner's consideration shall also include:<br>(a) The overall presentation, structure and content of the financial statements in accordance with the applicable framework; and<br>(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. |

As indicated by the above requirements, the practitioner has to make a number of evaluations in order to form a conclusion on whether anything has come to the practitioner's attention that the financial statements are not prepared, in all material respects, in accordance with the AFRF. The evaluation of the financial statements takes into account the:

- requirements of the AFRF
- results of procedures performed and evidence (i.e., has limited assurance been obtained)

Generally, the AFRF includes recognition, measurement, presentation and disclosure requirements. On occasion, other considerations are relevant when an AFRF is adopted for the first time or a review engagement is performed for the first time. These matters influence the planning of the engagement and are included in the following exhibit as a reminder when forming the conclusion.

**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. |

| Other Considerations | Implications |
|---|---|
| **From a Compilation to a Review Engagement** | If the engagement is changed from a compilation, consider what inquiry and analysis will be necessary for the opening balances. For example, inquiries could be made as to whether opening balances reflect the application of appropriate accounting policies; analytical procedures could be used to look for any variances in opening balances and changes in the operating results. |

Many practitioners use a financial statement presentation and disclosure checklist to ensure all the requirements of the AFRF have been met when general purpose financial statements are prepared. Where necessary, these checklists should be customized for the industry and client.

### *Special-Purpose Financial Statements*

If the special-purpose financial statements are being prepared using a special-purpose financial reporting framework (as opposed to a general-purpose framework) the details of the framework may only be available to the engaging party and the practitioner. Please refer to Exhibit 3.3-1C of this guide for an explanation of the inter-relationships between general- and special-purpose financial statements and general- and special-purpose financial reporting frameworks.

In these situations, it is important to describe the special-purpose financial reporting framework in the financial statements since the financial statements may not be appropriate for any use other than the intended use identified for the special-purpose financial statements. The special-purpose financial reporting framework must be described in the notes to the financial statements as part of the significant accounting policies.

When reporting on financial statements prepared in accordance with a special-purpose framework, an Emphasis of Matter paragraph must be included in the review engagement report that includes both:

- a description of the purpose for which the financial statements are prepared and, if necessary, the intended users, or references to a note in the special-purpose financial statements that contains that information

- a statement 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.

Refer to **Chapter 7** of this Guide for some additional guidance on the wording of the report if the financial statements are special purpose financial statements (see paragraphs 94(e) and 98 of CSRE 2400).

## 6.1-2 Accumulate Misstatements and Evaluate the Effect of Uncorrected Misstatements

| Paragraph | Requirement |
|---|---|
| | *Accumulation of Identified Misstatements* |
| 58 | The practitioner shall accumulate misstatements identified during the review, other than those that are clearly trivial. (Ref: Para. A113) |

The practitioner must:

- accumulate identified misstatements (see paragraph 58 of CSRE 2400 above)
- communicate all accumulated misstatements to the appropriate level of management on a timely basis and request that they be corrected (see paragraph 59 of CSRE 2400, discussed later in this chapter)
- evaluate the effect of uncorrected misstatements identified during the review, and the effect of uncorrected misstatements in the prior period, in forming a conclusion on whether anything 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 AFRF (see paragraph 77(b)) of CSRE 2400)

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** | • unintentional inaccuracy in gathering or processing data from which the financial statements are prepared<br>• unintentional omission of an amount or disclosure<br>• 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<br>• misrepresentation in, or intentional omission from, the financial statements of events, transactions, or other significant information<br>• intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure<br><br>Examples include:<br>• recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives<br>• inappropriately adjusting assumptions and changing judgments used to estimate account balances<br>• using undisclosed related-party transactions, including transactions not on normal commercial terms<br>• omitting, advancing, or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period<br>• concealing or not disclosing facts that could affect the amounts recorded in the financial statements<br>• engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity<br>• altering records and terms related to significant and unusual transactions |

As indicated, the practitioner must 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. The practitioner must also communicate with the appropriate level of management on a timely basis, all misstatements accumulated during the review and request management to correct those misstatements. When forming a conclusion on the financial statements, the practitioner evaluates the effect of uncorrected misstatements on the financial statements (both for the current period and those brought forward from the previous period).

**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 overprovision in allowance for doubtful receivables | $8,500 |
| Possible overprovision in allowance for inventory obsolescence | $5,300 |
| Capital asset 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 capital asset expensed was a second-hand 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 capital 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 that were not required at all. Management agreed but indicated that the provisions would be required this year.

**Example (continued)**

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.

It is important to include carry-forward amounts from prior-period uncorrected misstatements to document any implication for the current year as not all misstatements correct themselves in one year. Some have questioned whether the accumulated misstatements should be tax affected, but it depends on the users of the financial statements and whether they are sensitive to after-tax net income. Whether to tax effect the misstatements depends on the specific facts and circumstances of the engagement.

## 6.1-3 Communicate Findings

| Paragraph | Requirement |
|---|---|
| | **Communication with Management and Those Charged with Governance** |
| 40 | 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. A65-A71) |
| | *Communication and Correction of Misstatements* |
| 59 | The practitioner shall communicate with the appropriate level of management on a timely basis, all misstatements accumulated during the review. The practitioner shall request management to correct those misstatements. (Ref: Para. A114) |

CSRE 2400 requires the practitioner to request the correction of misstatements. As indicated in paragraph 40 of CSRE 2400 and discussed in Chapter 4 of this Guide, effective and continuous effective two-way communication between the practitioner, engagement team, management, and TCWG is an important element in every engagement.

Timely communication is important because it enables management to:

- evaluate whether the items are misstatements
- inform the practitioner if it disagrees
- take action, as necessary.

The communication, including the request by the practitioner, will help management maintain accurate accounting books and records and reduce the future material misstatements, by the correction of all misstatements. The responsibility to correct misstatements belongs to management; the practitioner must evaluate any reasons management gives for not correcting any identified misstatements.

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

**Exhibit 6.1-3A**

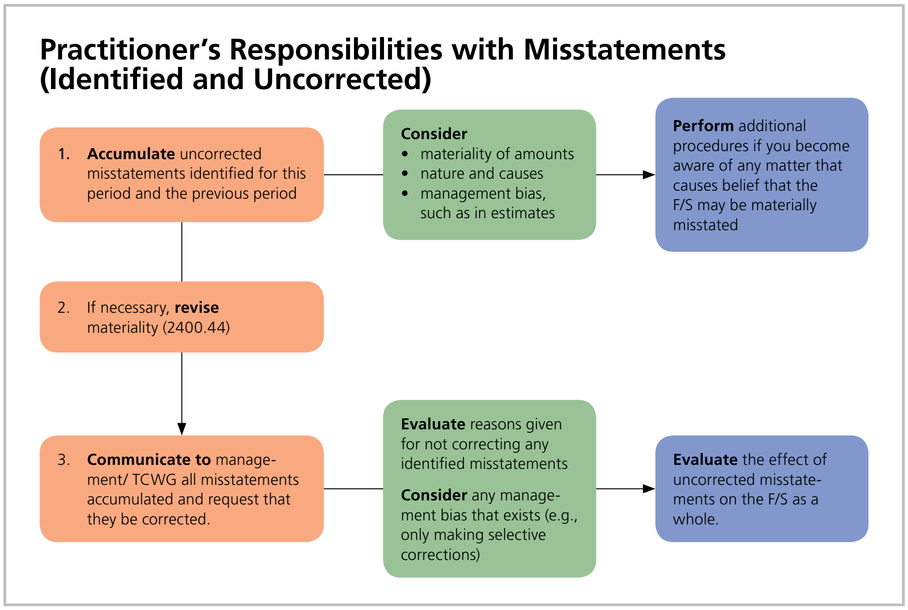
| Other Considerations | Implications |
|---|---|
| Matters to Discuss and Document | use and application of significant accounting policies |
| | calculation and reasonableness of management estimates |
| | material uncertainties that may cast significant doubt on the entity's ability to continue as a going concern |
| | significant difficulties encountered on the engagement (e.g., missing evidence or unavailable documents or personnel) |
| | any disagreements with management and how they were resolved |
| | whether or not identified misstatements were corrected |
| | wording of the practitioner's conclusion on the financial statements |
| | other relevant matters |

As introduced in Chapter 5, **Section 5.3** of this Guide, when discussing documentation, whenever discussions take place (with management, TCWG, or others) of significant matters arising during the engagement, they shall be documented (see paragraph 106 of CSRE 2400). As with all discussions, the documentation would include:

- nature of the matters discussed
- main points of discussion
- conclusions reached
- any significant professional judgments made in reaching those conclusions.

The following exhibit provides a summary of the practitioner's involvement with both identified and uncorrected misstatements.

### Exhibit 6.1-3B




## 6.1-4 Inconsistencies

When exercising professional skepticism in performing 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 of this Guide, specifically **Section 5.1-8**).

As indicated in Chapter 5, **Section 5.3** of this Guide, when discussing documentation, there is a requirement to document how any inconsistency was addressed (see paragraph 107 of CSRE 2400).

# CHAPTER 7
# Reporting

| CHAPTER 7: CONTENT | |
|---|---|
| • Understanding the elements of the review engagement report<br>• How to modify the standard wording when necessary | |
| **7.1: Wording of the Report** | **7.2: Modified Conclusions** |
| 7.1-1 Report Elements<br>7.1-2 Emphasis of Matter<br>7.1-3 Other Matter<br>7.1-4 Other Reporting Responsibilities<br>7.1-5 Report Dating<br>7.1-6 Unmodified Conclusion | 7.2-1 Circumstances Requiring a Modified Conclusion<br>7.2-2 The Three Modified Conclusions<br>7.2-3 Representations from Management Are Not Reliable or Not Provided<br>7.2-4 Withdrawal from Engagement<br>7.2-5 Reference to Modification in Prior-Period Report<br>7.2-6 Content of "Basis for Conclusion" When Report Is Modified |
| **Outcome** | |
| The outcome is a well-prepared review engagement report that is appropriately worded based on the evidence obtained. | |

## 7.1 Wording of the Report

| Paragraph | Requirement |
|---|---|
| | *Form of the Conclusion* |
| 79 | 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. |

| Paragraph | Requirement |
|---|---|
| | **The Practitioner's Report** |
| 94 | The practitioner's report for the review engagement shall be in writing, and shall contain the following elements: (Ref: Para. A136-A139, A165, A167)<br>(a) A title, which shall clearly indicate that it is the report of an independent practitioner for a review engagement;<br>(b) The addressee(s), as required by the circumstances of the engagement;<br>(c) An introductory paragraph that:<br>(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;<br>(ii) Refers to the summary of significant accounting policies and other explanatory information; and<br>(iii) States that the financial statements have been reviewed;<br>(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. A140-A143)<br>(i) Their preparation in accordance with the applicable financial reporting framework including, where relevant, their fair presentation; and<br>(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;<br>(e) If the financial statements are special purpose financial statements:<br>(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<br>(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;<br>(f) A description of the practitioner's responsibility to express a conclusion on the financial statements including reference to Canadian generally accepted standards for review engagements and, where relevant, applicable law or regulation; (Ref: Para. A144-A145, A166)<br>(g) A description of a review of financial statements and its limitations, and the following statements: (Ref: Para. A146)<br>(i) A review engagement in accordance with Canadian generally accepted standards for review engagements is a limited assurance engagement; |

| Paragraph | Requirement |
|---|---|
| | (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<br>(iii) The procedures performed in a review are substantially less in extent than, and vary in nature from, those performed in an audit conducted in accordance with Canadian generally accepted auditing standards and, accordingly, the practitioner does not express an audit opinion on the financial statements;<br>(h) A paragraph under the heading "Conclusion" that contains:<br>(i) The practitioner's conclusion on the financial statements as a whole in accordance with paragraphs 79-93, as appropriate; and<br>(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 the 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. A147-A148)<br>(i) When the practitioner's conclusion on the financial statements is modified:<br>(i) A paragraph under the appropriate heading that contains the practitioner's modified conclusion in accordance with paragraphs 79 and 82-93, as appropriate;<br>(ii) A paragraph, under an appropriate heading, that provides a description of the matter(s) giving rise to the modification; and (Ref: Para. A149)<br>(iii) If applicable, a reference to a modified conclusion in the prior period's practitioner's report when the matter that gave rise to the modification in the prior period is unresolved in the current period; (Ref: Para. A150-A152)<br>(j) A reference to the practitioner's obligation under Canadian generally accepted standards for review engagements to comply with relevant ethical requirements;<br>(k) The practitioner's signature; and (Ref: Para. A153)<br>(l) The date of the practitioner's report; (Ref: Para. A161-A164)<br>(m) The location in the jurisdiction where the practitioner practices. |

## 7.1-1 Report Elements

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

**Exhibit 7.1-1A**

| Report Elements and Paragraph Reference in CSRE 2400 | |
|---|---|
| **Review Engagement Report** | title and appropriate addressee: paragraph 94(a) and (b) |
| | introductory paragraph: paragraph 94(c) |
| | description of management's responsibility: paragraph 94(d) |
| | description of practitioner's responsibility: paragraph 94(f) |
| | description of a review and its limitations: paragraph 94(g) |
| | engagement conclusion: paragraph 94(h) and (i) |
| | obligation to comply with relevant ethical requirements: paragraph 94(j) |
| | date, signature, and location of practitioner: paragraph 946(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
- reference to management's responsibility for determining that the AFRF was acceptable in the circumstances (i.e., applicable if management had a choice of financial reporting frameworks).

Appendix 3 of CSRE 2400 includes the following examples of review engagement reports on special-purpose financial statements:

- Illustration 6: A practitioner's report on financial statements prepared in accordance with the financial reporting provisions of a contract (for purposes of this illustration, a compliance framework).

- Illustration 7: A practitioner's report on a single financial statement prepared in accordance with the cash receipts and disbursements basis of accounting (for purposes of this illustration, a fair presentation framework).

## 7.1-2 Emphasis of Matter

| Paragraph | Requirement |
|---|---|
| | *Emphasis of Matter and Other Matter Paragraphs in the Practitioner's Report* |
| 95 | *Emphasis of Matter Paragraphs in the Practitioner's Report*<br>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. |
| 96 | When the practitioner includes an Emphasis of Matter paragraph in the practitioner's report, the practitioner shall include it immediately after the paragraph that contains the practitioner's conclusion on the financial statements under the heading "Emphasis of Matter," or other appropriate heading. |
| 98 | *Alerting Readers that the Financial Statements Are Prepared in Accordance with a Special Purpose Framework*<br>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. A154-A155) |
| 99 | *Alerting Readers that a Material Uncertainty Exists Relating to Going Concern*<br>If adequate disclosure is made in the financial statements about the entity's ability to continue as a going concern, the practitioner shall express an unmodified conclusion and include an Emphasis of Matter paragraph in the practitioner's report to: (Ref: Para. A156)<br>(a) Highlight the existence of a material uncertainty relating to the event or condition that may cast significant doubt on the entity's ability to continue as a going concern; and<br>(b) Draw attention to the note in the financial statements that discloses the matter. |

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

**Exhibit 7.1-2A**

| | |
|---|---|
| **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 |
| | major catastrophe |
| | other significant uncertainties and inconsistencies |
| | early application (where permitted) of a new accounting standard |
| | special-purpose financial statements |

As indicated above, 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
- 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.

## 7.1-3 Other Matter

| Paragraph | Requirement |
|---|---|
| | *Other Matter Paragraphs in the Practitioner's Report* |
| 97 | 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. |
| 100 | *Alerting Readers that the Prior Period Financial Statements Were Reviewed or Audited by a Predecessor Practitioner*<br>If the financial statements of the prior period were subject to a review engagement or an audit engagement by a predecessor practitioner, the practitioner shall state in an Other Matter paragraph in the practitioner's report: (Ref: Para. A157)<br>(a) That the financial statements of the prior period were subject to a review engagement or an audit engagement by the predecessor practitioner;<br>(b) The type of conclusion expressed by the predecessor practitioner and, if the conclusion was modified, the reasons therefore; and<br>(c) The date of the predecessor practitioner's report. |
| 101 | *Alerting Readers that the Prior Period Financial Statements Were Not Reviewed or Audited*<br>If the financial statements of the prior period were not subject to a review engagement or an audit engagement, the practitioner shall so state in an Other Matter paragraph in the practitioner's report. |

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 is placed under the heading "Other Matter."

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

**Exhibit 7.1-3A**

| | |
|---|---|
| **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 with wording similar to the following:<br>"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]*." |
| | Financial statements are reviewed by another practitioner in the prior year.<br>(Illustration 2 of Appendix 3 of CSRE 2400 contains an example of the practitioner's report when the prior-period financial statements were reviewed by a predecessor practitioner and an Other Matter paragraph is included.) |
| | Financial statements of the prior year were not reviewed. |

## 7.1-4 Other Reporting Responsibilities

| Paragraph | Requirement |
|---|---|
| | *Other Reporting Responsibilities* |
| 102 | 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 CSRE 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. A158-A160) |

The practitioner may have additional responsibilities to report on other matters that are supplementary to the responsibilities outlined in CSRE 2400. Examples of these responsibilities are outlined in the following exhibit.

**Exhibit 7.1-4A**

| | |
|---|---|
| **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 |
| | expressing a conclusion on specific matters, such as the adequacy of accounting books and records |

Canadian Standard on Related Services (CSRS) 4460, *Reports on Supplementary Matters Arising From an Audit or a Review Engagement*, deals with circumstances when a practitioner has received a request from a third party, or is required by law, regulation or agreement, to provide a written report on a supplementary matter arising from the review engagement. The report issued is separate from the report on the related review engagement.

In some cases, law, regulation or agreement may require that the report on these other responsibilities be included within the independent practitioner's review engagement report. In such cases, the results of such work are included 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."

The requirement to address these other reporting responsibilities in a separate report or a separate section of the practitioner's report clearly distinguishes them from the practitioner's specific responsibility under CSRE 2400 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.

## 7.1-5 Report Dating

| Paragraph | Requirement |
|---|---|
| | *Date of the Practitioner's Report* |
| 103 | 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. A161-A164)<br>(a) All the statements that comprise the financial statements under the applicable financial reporting framework, including the related notes where applicable, have been prepared; and<br>(b) Those with the recognized authority have asserted that they have taken responsibility for those financial statements. |

The review engagement report will be dated in compliance with paragraph 103 of CRSE 2400 to signify to the reader the date of the practitioner's conclusion which therefore lets the reader presume 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.

(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 this acceptance of responsibility for the financial statement.

### Exhibit 7.1-5A

| | |
|---|---|
| **Identify Who Has the Authority to Accept Responsibility** | The recognized individuals or body with the authority to assert that they have taken responsibility for the financial statements, including the related notes, could be:<br>• owner or owner-manager<br>• TCWG, such as a board of directors<br>• other individuals or bodies specified in local regulations |
| **Obtain Evidence of Responsibility Accepted** | Evidence could include:<br>• written confirmation from the owner or owner-manager<br>• minutes from the meeting (i.e., a directors' meeting) where the financial statements were approved<br>• other equivalent documentation |

## 7.1-6 Unmodified Conclusion

| Paragraph | Requirement |
|---|---|
| | Unmodified Conclusion |
| 80 | 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 |
| 81 | 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. A131-A132)<br>(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<br>(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 2.2-3**, can be issued on financial statements when the practitioner:

- has obtained the limited assurance that the financial statements as a whole are free from material misstatement as required by CSRE 2400
- is not, on the basis of the evidence obtained, aware of any matters that would cause the practitioner to believe the financial statements are not prepared, in all material respects, in accordance with the AFRF.

Appendix 3 of CSRE 2400 includes the following examples of an unmodified review engagement report on general-purpose financial statements:

- Illustration 1: A practitioner's report on financial statements prepared in accordance with a fair presentation framework designed to meet the common financial information needs of a wide range of users (e.g., ASPE).

## 7.2 Modified Conclusions

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

| Paragraph | Requirement |
|---|---|
| | Modified Conclusion |
| 82 | The practitioner shall express a modified conclusion in the practitioner's report on the financial statements as a whole when:<br>(a) The practitioner determines, based on the procedures performed and the evidence obtained, that the financial statements are materially misstated; or<br>(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. |
| 83 | If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the practitioner shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the conclusion in the practitioner's report. (Ref: Para. A127) |

| Paragraph | Requirement |
|---|---|
| 84 | When the practitioner modifies the conclusion expressed on the financial statements, the practitioner shall:<br>(a) Use the heading "Qualified Conclusion," "Adverse Conclusion" or "Disclaimer of Conclusion," as appropriate, for the conclusion paragraph in the practitioner's report; and<br>(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). |
| 85 | *Financial statements are materially misstated*<br>If the practitioner determines that the financial statements are materially misstated, the practitioner shall express:<br>(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<br>(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. |
| 86 | 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:<br>(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<br>(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). |

| Paragraph | Requirement |
|---|---|
| 87 | 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:<br>(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<br>(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). |
| 88 | 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:<br>(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;<br>(b) Explain how disclosures are misstated if the material misstatement relates to narrative disclosures; or<br>(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. |
| 89 | *Inability to obtain sufficient appropriate evidence*<br>If the practitioner is unable to form a conclusion on the financial statements due to an inability to obtain sufficient appropriate evidence, the practitioner shall:<br>(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<br>(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 |
|---|---|
| 91 | When the practitioner expresses a qualified conclusion on the financial statements due to an inability to obtain sufficient appropriate evidence, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:<br>(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<br>(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). |
| 92 | When disclaiming a conclusion on the financial statements the practitioner shall state in the conclusion paragraph that:<br>(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<br>(b) Accordingly, the practitioner does not express a conclusion on the financial statements. |
| 93 | In the basis for conclusion paragraph, in relation to either the qualified conclusion due to an 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. |

## 7.2-1 Circumstances Requiring a Modified Conclusion

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

- when financial statements are materially misstated
- when there is an inability to obtain sufficient appropriate evidence

These two circumstances are outlined in the following exhibit.

**Exhibit 7.2-1A**

| Action | Circumstance |
|---|---|
| **Modified Conclusion Is Necessary When:** | **Financial Statements Include a Material Misstatement**<br>This includes:<br>• uncorrected material misstatements<br>• inappropriate accounting principles or inconsistent application<br>• failure to disclose information that results in a material misstatement. |
| | **Inability to Obtain Sufficient Appropriate Evidence**<br>This could include:<br>• circumstances beyond the control of the entity (e.g., a fire that damaged accounting records)<br>• circumstances relating to the nature or timing of the practitioner's work (e.g., unavailability of expected information)<br>• limitations imposed by management (e.g., management not allowing access to a key person within the entity). |

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

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

This is illustrated in the following exhibit.

**Exhibit 7.2-1B**

| Nature of Matter | Pervasiveness of Effects on Financial Statements | |
|---|---|---|
| | **Material but NOT Pervasive** | **Material AND Pervasive** |
| **Financial Statements Materially Misstated** | qualified conclusion | adverse conclusion |
| **Inability to Obtain Necessary Evidence** | qualified conclusion | disclaimer of conclusion |

## 7.2-2 The Three Modified Conclusions

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

### Exhibit 7.2-2A

| Type | Applicability |
|---|---|
| **Qualified Conclusion** | Matter (i.e., misstatement or scope limitation) is material, but not pervasive enough to require an adverse conclusion or a disclaimer of conclusion.<br><br>Include a Basis for Qualified Conclusion paragraph that describes the matter. In the Qualified Conclusion paragraph, use the wording in paragraph 2400.86 or .91. |
| **Adverse Conclusion** | Effects of misstatements are both material and pervasive throughout the financial statements.<br><br>Include a basis for an Adverse Conclusion paragraph (before the Adverse Conclusion paragraph) that describes the matter. In the Adverse Conclusion paragraph, use the wording in paragraph 2400.87. |
| **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 2400.92. |

## 7.2-3 Representations from Management Are Not Reliable or Not Provided

The ability for the practitioner to obtain reliable representation from management is emphasized in CSRE 2400.

| Paragraph | Requirement |
|---|---|
| 71 | If management does not provide one or more of the requested written representations, the practitioner shall: (Ref: Para. A116)<br>(a) Discuss the matter with management and, where appropriate, those charged with governance;<br>(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<br>(c) Take appropriate actions, including determining the possible effect on the conclusion in the practitioner's report in accordance with this CSRE. |

| Paragraph | Requirement |
|---|---|
| 72 | 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:<br>(a) The practitioner concludes that there is sufficient doubt about the integrity of management such that the written representations are not reliable; or<br>(b) Management does not provide the representations required by paragraph 68. |

As indicated from paragraphs 71-72 of CSRE 2400 above, the failure of management to provide representation can lead to a disclaimer of a conclusion or possible withdrawal, if possible, from the engagement.

## 7.2-4 Withdrawal from Engagement

| Paragraph | Requirement |
|---|---|
| 13 | In all cases when limited assurance cannot be obtained and a qualified conclusion in the practitioner's report is insufficient in the circumstances, this CSRE 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. A7-A9, A133-A134) |
| 90 | The practitioner shall withdraw from the engagement if the following conditions are present: (Ref: Para. A133-A134)<br>(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;<br>(b) The practitioner has determined that the possible effects on the financial statements of undetected misstatements are material and pervasive; and<br>(c) Withdrawal is possible under applicable law or regulation. |

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.

| **Consideration of Withdrawal from Engagement (if withdrawal is possible under applicable law or regulation)** | If management imposes a scope limitation after accepting the engagement, and 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, withdrawing from the engagement should be considered. The practicality of withdrawing from the engagement may depend on the stage of completion and whether it is possible under any legal requirements. However, if all conditions in paragraph 90 of CSRE 2400 are met, the practitioner must withdraw from the engagement. |
|---|---|

The discussion in this chapter assumes the practitioner did not know of the management scope limitation before acceptance. As discussed in Chapter 3 of this Guide, the engagement should not be accepted if it is known that management or TCWG will impose a scope limitation such that it would result in disclaiming a conclusion (see paragraph 27(e) of CRSE 2400).

## 7.2-5 Reference to Modification in Prior-Period Report

When the practitioner's conclusion on the financial statements is modified in the current period as a result of an unresolved modified conclusion from the prior period, a reference to the modified conclusion from the prior period is required to be included (see paragraphs 94(i)(iii) and A150-A152 of CSRE 2400).

The reference in the practitioner's report may be completed in two ways:

1. by reference to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material
2. by including an explanation that the practitioner's conclusion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and corresponding figures, if applicable.

It should be noted that when the practitioner's report on the prior period included a modified conclusion and the matter that gave rise to the modified conclusion is resolved and properly accounted for or disclosed in the financial statements for the current period in accordance with the AFRF, the practitioner's conclusion on the current period does not need to refer to the previous modification.

Illustration 8 in Appendix 3 of CSRE 2400 includes an example of a review-engagement report with an unresolved qualification in a prior year arising from a scope limitation. In Illustration 8, the practitioner for the current year was also the practitioner for the prior year.

**Example**

An extract from Illustration 8 is included below:

> *Basis for Qualified Conclusion*
> In common with many not-for-profit organizations, ABC Organization derives revenue from fundraising activities, the completeness of which is not susceptible to us obtaining evidence we considered necessary for the purpose of the review. Accordingly, the evidence obtained of these revenues was limited to the amounts recorded in the records of ABC Organization. Therefore, we were unable to determine whether any adjustments might have been found necessary with respect to fundraising revenue, excess of revenue over expenses, and cash flows from operations for the years ended December 31, 20X1 and 20X0, current assets as at December 31, 20X1 and 20X0, and net assets as at January 1 and December 31 for both the 20X1 and 20X0 year ends. Our conclusion on the financial statements as at and for the year ended as at December 31, 20X0 was modified accordingly because of the possible effects of this limitation in scope.

## 7.2-6 Content of "Basis for Conclusion" When Report Is Modified

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"
- "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 7.2-6A**

| 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:<br>• Explain how financial statement disclosures are misstated.<br>• Make reference to a more extensive discussion of the matter in a note to the financial statements (as necessary). |
| | If information is omitted:<br>• Describe the nature of omitted information if the material misstatement relates to the non-disclosure of information required to be disclosed.<br>• Include the omitted disclosures (where practicable) unless prohibited by law or regulation. |
| **Inability to Obtain Sufficient Appropriate Evidence** | Describe the circumstances and reasons that led to the inability to obtain sufficient appropriate evidence.<br>Make reference to a more extensive discussion of the matter in a note to the financial statements (as necessary). |

Appendix 3 of CSRE 2400 includes the following examples of review engagement reports with modified conclusions:

- Illustration 2: A practitioner's report containing a qualified conclusion due to an apparent material misstatement of the financial statements. Financial statements prepared in accordance with a compliance framework designed to meet the common information needs of a wide range of users. (Financial statements prepared using a compliance framework)
- Illustration 3: A practitioner's report containing a qualified conclusion due to the practitioner's inability to obtain sufficient appropriate evidence. (Financial statements prepared using a fair presentation framework—Canadian accounting standards for private enterprises)

- Illustration 4: A practitioner's report containing an adverse conclusion due to material misstatement of the financial statements. (Financial statements prepared using a fair presentation framework — Canadian accounting standards for private enterprises)

- Illustration 5: A practitioner's report containing a disclaimer of conclusion due to the practitioner's inability to obtain sufficient appropriate evidence about multiple elements of the financial statements — resulting in inability to complete the review. (Financial statements prepared using a fair presentation framework — IFRSs)

## APPENDIX A

# Description of Terms Used in the Guide

The following terms and descriptions are included in paragraph 15 of CSRE 2400:

| 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. |
| **Applicable financial reporting framework** | The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation. |
| **Date the financial statements are issued** | The date that the practitioner's report and reviewed financial statements are made available to third parties. |
| **Emphasis of Matter paragraph** | A paragraph included in the practitioner's review engagement report that refers to a matter appropriately 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. |
| **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. |

<table>
<tr><th>Term</th><th>Description</th></tr>
<tr><td>General purpose framework</td><td>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.<br><br>The term “fair presentation framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:<br>1. 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; or<br>2. 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.<br><br>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 in (i) or (ii) above.</td></tr>
<tr><td>Initial review engagement</td><td>An engagement in which either:<br>1. The financial statements for the prior period were not audited or reviewed; or<br>2. The financial statements for the prior period were audited or reviewed by a predecessor practitioner.</td></tr>
<tr><td>Inquiry</td><td>Inquiry consists of seeking information of knowledgeable persons from within or outside the entity.</td></tr>
<tr><td>Limited assurance</td><td>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 CSRE. 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. (Ref: Para. A13)</td></tr>
<tr><td>Other Matter paragraph</td><td>A paragraph included in the practitioner’s review engagement report that refers to a matter other than those presented or disclosed in the financial statements that, in the practitioner’s judgment, is relevant to users’ understanding of the review engagement, the practitioner’s responsibilities or the practitioner’s review engagement report.</td></tr>
</table>

| Term | Description |
|---|---|
| **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 CSRE 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 to which the engagement team and engagement quality control reviewer are subject, which comprise relevant independence and other ethical requirements set out in rules of professional conduct/code of ethics applicable to the practice of public accounting issued by the various professional accounting bodies. |
| **Special purpose financial statements** | Financial statements prepared in accordance with a special purpose framework. |
| **Special purpose framework** | 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. (Ref: Para. A14-A16) |

## Other Terms

In addition to the terms set out in paragraph 15 of CSRE 2400 described above, there are a number of other terms that are used in this Guide.

The following terms and descriptions are provided in the Glossary of Terms (Glossary) in the *CPA Canada Handbook - Assurance* and some CASs, and are considered relevant to CSQC 1 and CSRE 2400:

| Term *(Source)* | Description |
|---|---|
| **Accounting estimate (Glossary, in part)** | 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. |

| Term *(Source)* | Description |
|---|---|
| **Engagement team (Glossary, in part)** | 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 (CAS 570.02)** | 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 (CAS 200.06)** | 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, in part)** | 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. |
| **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. |
| **Professional skepticism (Glossary)** | Professional skepticism—An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of evidence. |

<table>
<tr><th>Term (Source)</th><th>Description</th></tr>
<tr><td>Related party (Glossary, in part)</td><td>A related party is usually defined in the applicable financial reporting framework. Examples would include:<br>• A person or another entity that has control or significant influence (directly or indirectly) over the reporting entity;<br>• Another entity over which the reporting entity has control or significant influence; or<br>• An entity under common control with the reporting entity through having:<br>1. Common controlling ownership;<br>2. Owners who are close family members; or<br>3. Common key management.<br><br>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.</td></tr>
<tr><td>Those charged with governance (TCWG) (Glossary)</td><td>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.</td></tr>
<tr><td>Special purpose framework (Glossary)</td><td>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.</td></tr>
</table>

# APPENDIX B
# Factors to Consider for Client Acceptance or Continuance

The following table includes some of the factors to consider when considering whether to accept a new review engagement client or continue with an existing client. They are based on various sources as noted.

| Factors to Consider for Acceptance/Continuance |
|---|
| **Independence Factors/Threats** (see CSRE 2400.27(b))<br>• Review prohibitions within the relevant ethical requirements that would preclude the firm or any staff member from performing the engagement.<br>• Review for significant threats to the firm's independence. If threats are identified, document the nature of the safeguards put in place. |
| **Purpose of the Engagement** (see CSRE 2400.27(a) and .A38-.A39)<br>Determine that there is a rational purpose for the engagement, and that a review engagement is appropriate in the circumstances. |
| **Quality Control** (see Firm's Manual based on CSQC 1)<br>Consider if accepting this engagement would contravene any of the firm's quality assurance policies, as documented in the firm's quality assurance manual. |
| **Indication of Client Imposed Scope Limitation** (see CSRE 2400.27(e))<br>Consider if the limitation would result in a disclaimer of a conclusion on the financial statements. |

## Factors to Consider for Acceptance/Continuance

**Management Integrity** (see CSRE 2400.27(d))

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.

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**Predecessor Accountant** (if appropriate) (see CSRE 2400.55 and .A107)

If the financial statements for the prior period were audited or reviewed by a predecessor practitioner, consider the following:

- The reasons the prospective client provided regarding the change in accountants.
- If any other accountants recently declined to serve the prospective client.
- If the predecessor's working papers should be reviewed.

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**General Practice Management Factors**

Consider whether any of the following factors would impact engagement acceptance

- Doubts about the entity's ability to continue in existence.
- Users of financial statements.
- Negative industry trends.
- Participation in high-risk business ventures.
- Availability and reliability of information and personnel, i.e., poor accounting systems and records, accessibility.
- 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.

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**Firm Competencies** (see CSRE 2400.22)

Assess whether the firm has the necessary resources available to complete the engagement. Consider the following:

- Engagement partner possess competence in assurance skills and techniques and competence in the financial reporting
- Availability of firm personnel with appropriate experience and industry knowledge.
- Use of external experts (where required).
- Availability of a suitably qualified EQCR person (where required by firm policies).

## Factors to Consider for Acceptance/Continuance

**Engagement Preconditions** (see CSRE 2400.28 and A41-A52)

The following steps must be completed before accepting a review engagement:

- Determine if the financial reporting framework to be used in the preparation of the financial statements is acceptable.
- Management has 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 review, and
        » Unrestricted access to persons within the entity from whom we determine it is necessary to obtain audit evidence.

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**Engagement letter** (see CSRE 2400.34)

- If the engagement is to be accepted, an engagement letter must be requested and a signed copy been obtained and put on file (prior to the commencement of the engagement).

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**APPENDIX C**

# Some Factors to Consider for Understanding the Entity and Its Environment and the Development of Inquiries

| Some Factors to Consider for Understanding the Entity and its Environment to Develop Inquires and Identify Areas in the Financial Statements Where Material Misstatements Are Likely to Arise (see CSRE 2400.43–.45 and .A85–.A101 and 2400.47) | ✓ |
|---|---|
| Relevant industry, regulatory, and other external factors, including the AFRF. (see CSRE 2400.44(a)) | ☐ |
| The nature of the entity, including:<br>(a) Its operations;<br>(b) Its ownership and governance structure;<br>(c) The types of investments that the entity is making and plans to make;<br>(d) The way the entity is structured and how it is financed; and<br>(e) The entity's objectives and strategies. (see CSRE 2400.47(b)) | ☐ |
| The entity's accounting systems and accounting records. (see CSRE 2400.47(c)) | ☐ |
| The entity's selection and application of accounting policies. (see CSRE 2400.47(d)) | ☐ |
| **Estimates**<br>Consider how significant estimates are prepared by management, and what assumptions are used in supporting evidence. (see CSRE 2400.47(a)) | ☐ |

| Some Factors to Consider for Understanding the Entity and its Environment to Develop Inquires and Identify Areas in the Financial Statements Where Material Misstatements Are Likely to Arise (see CSRE 2400.43–.45 and .A85–.A101 and 2400.47) | ✓ |
|---|---|
| **Related Parties** (see CSRE 2400.47(b))<br><br>Consider the existence of related parties, and whether there were any related party transactions during the period. If so, determine the purpose of those transactions and how they are measured, and collectability of amounts receivable.<br><br>*(Consider asking management to prepare a list of related party transactions before the start of each engagement.)* | ☐ |
| **Significant, Unusual, or Complex Events and Transactions** (see CSRE 2400.47(c))<br><br>Consider the existence of any significant, unusual, or complex transactions, events, or matters that have affected (or may affect) the entity's financial statements, including:<br>(a) Significant changes in business activities or operations;<br>(b) Significant changes to contract terms, such as finance and debt contracts or covenants;<br>(c) Significant journal entries or other adjustments to the financial statements;<br>(d) Significant transactions occurring or recognized near the end of the reporting period;<br>(e) The status of any uncorrected misstatements identified during previous engagements; and<br>(f) Effects or possible implications for the entity of transactions or relationships with related parties. | ☐ |
| **Fraud and Noncompliance** (see CSRE 2400.47(d))<br><br>Obtain an understanding of any actual, suspected, or alleged:<br>(a) Fraud or illegal acts affecting the entity<br>(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. | ☐ |
| **Subsequent Events** (see CSRE 2400.47(e))<br><br>Obtain and understanding if 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? | ☐ |
| **Going Concern** (see CSRE 2400.47(f), (g) and .A100)<br><br>Obtain an understanding of any events or conditions that may cast doubt on the ability to continue as a going concern and the basis for management's assessment of the ability to continue as a going concern. | ☐ |
| **Commitments** (see CSRE 2400.47(h))<br><br>Obtain an understanding of any material commitments, contractual obligations, or contingencies that affect the entity's financial statements, including disclosures. | ☐ |
| **Nonmonetary Transactions** (see CSRE 2400.47(i))<br><br>Obtain an understanding of any material nonmonetary transactions or transactions for no consideration in the financial reporting period under consideration. | ☐ |

**APPENDIX D**

# 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 and document your findings.

## Accounts Receivable

- Develop an expectation for the current period's trade receivable balance by using the change in revenue from the prior period.
- 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 revenue with the same ratio in the previous period.

Obtain explanations for unexpected balances and 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:

1. extending the analytical procedures to the previous three or four years to understand trends
2. 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
- 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 (e.g., 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:
  1. days' purchases in accounts payable ([trade accounts payable]/[costs of goods sold] × 365)
  2. quick ratio ([current assets-inventory]/[current liabilities])
  3. current ratio ([current assets]/[current liabilities]).

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

## Long-Term Debt

Compare the following to the previous period:

- total long-term debt balance
- composition of long-term debt
- debt-to-equity ratio ([long-term debt/[total equity])
- debt ratio ([total liabilities]/[total assets])
- 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 (e.g., 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 an analytical procedure or proof in total (e.g., 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 E
# Going-Concern Events and Conditions

This listing is drawn from paragraph A105 of CSRE 2400. The list is not exhaustive and the significance of such events or conditions can often be mitigated by other factors.

| Events or Conditions That May Cast Significant Doubt on the Going-Concern Assumption | |
|---|---|
| **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. |

| Events or Conditions That May Cast Significant Doubt on the Going-Concern Assumption | |
|---|---|
| 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. |

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