

A research study prepared by the Auditing Practices Board

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CONTENTS

	Page
Foreword Acknowledgements Executive Overview Emergent Themes	iv v vii xiii
1 – Introduction	1
2 – Background	3
3 – The independent professional review	7
4 – Conduct of the field trials	11
5 – Findings – The cost implications of an IPR	15
6 – Findings – The effectiveness of the IPR	19
7 – Findings – Operational implementation of the illustrative Statement of Standards	23
8 – Findings – Reactions of those performing the IPR	27
9 – Findings – The response from the client	33
10 – Discussions with bankers	39
11 – Possible limitations of the research	41
Appendices	
1. Classification of clients by turnover	43
2. Hours spent on the IPR and accounting compared to the audit and accounting	44
3 Further analysis of hours data	45
4 Cost of the IPR and accounting compared to cost of the audit and accounting	46
5 Further analysis of cost data	47
6 Misstatements disclosed at various stages of the engagement	48
7 Summarisation of practitioners' views on effectiveness of the IPR with respect to error, going concern and fraud	49
8 Extent to which Appendix II of the proposed Statement was utilised by firms	51
9 Research instruments that practitioners were asked to complete	53
10 Illustrative Statement of Standards used in the field trials	63

FOREWORD

The Auditing Practices Board (APB) has supervised the performance of field trials of the Independent Professional Review (IPR) in order to contribute to the debate, initiated by the Company Law Review, as to whether the IPR should be mandated in place of the statutory audit for companies with a turnover between £1 million and £4.8 million. I hope that the findings set out in this paper, especially those that give an indication of the likely costs and effectiveness of an IPR, will assist the Government, in making policy decisions in this regard.

The findings from our research will also be of interest to a wider audience. The research demonstrates the importance that some stakeholders place on statutory accounts and the important role that external accountants have in assisting many small companies produce them. The research also reveals the effort that many external accountants take to ensure that the accounts they help to produce are 'accurate' irrespective of any requirement to undertake either an audit or an IPR. Little, if any, of this effort is explained in normal 'compilation' reports issued by accountants and this highlights the need for the accountancy profession to reassess what ought to be communicated in such reports.

Although the number of field trials was small, they did disclose that the introduction of the IPR could, in some circumstances, give rise to significant cost savings compared to the audit. However, this finding needs to be considered in the context of the limitations inherent in the trials and a number of other important findings that are set out in this paper.

WID Plaistowe November 2001

Chairman, Auditing Practices Board

ACKNOWLEDGEMENTS

The conduct of the research project was led by Professor David Hatherly who is Director of the University of Edinburgh Management School, and has served as a member of the APB since 1991. The organisation of the field trials and the initial briefings of the accounting firms were coordinated by Steven Leonard, the APB's Project Director. The debriefing interviews with the practitioners and the company directors were conducted by David Hatherly and Stephen Sheen, an independent consultant.

Conducting the research has depended entirely on the willing participation of 20 accounting firms and their clients. The APB undertook to keep confidential the names of the accounting firms and the clients taking part in the study. The research could not have happened without the generous and open contribution from the representatives of these firms and their clients: the APB is indebted to them for providing considerable time and information to the project.

John Thirlwell of the British Bankers Association kindly made arrangements for the researchers to meet with representatives of four banks.

The APB is also indebted to the members of its Small Company Working Party for developing the Discussion Paper, *The proposed 'Independent Professional Review' of the financial statements of small companies* (APB May 2000). This paper included the initial illustrative Statement of Standards for performing an Independent Professional Review. The members of the Working Party were:

Michael Foulds (Chairman) Foulds & Grant

Richard Bint PKF

Sean Murray & Conlan Crotty Murray & Co

Robert Overend Ernst & Young
David Rutherford Cowan & Partners
Danielle Stewart Warrener Stewart

Danielle Stewart also provided much valuable input to the development of the research methodology and the detailed research instruments.

This research was undertaken with cooperation from the Association of Chartered Certified Accountants (ACCA); the Audit and Assurance Faculty of the Institute of Chartered Accountants in England & Wales (ICAEW); and the Institute of Chartered Accountants of Scotland (ICAS). The APB gratefully acknowledges the support of these bodies and in particular the assistance given by David York of the ACCA, Roger Housechild of the ICAEW and James Barbour of the ICAS. Andrew Güntert of the Mercia Group Ltd also made considerable efforts to identify firms to take part in the research.

This report contains the APB's summary of the results of the research undertaken. The contents are not intended to represent the position of any of the individuals, firms or accounting bodies that participated in the research and should not be read as such.

EXECUTIVE OVERVIEW

Research objectives

Our research objectives were to:

- better understand the cost implications of an IPR compared to an audit;
- explore the effectiveness of an IPR in identifying material misstatements in contrast to an audit;
- assess the reactions of practitioners to an IPR;
- assess the reactions of directors to an IPR; and
- test the illustrative Statement of Standards for Performing an Independent Professional Review.

Scope of trials

- The field trials were conducted by twenty accounting firms each using one of their existing audit clients.
- Accounting assistance is provided by the firms to fifteen of the twenty clients; generally to the smaller clients in the sample. While the nature and extent of the accounting assistance varies quite widely, the provision of accountancy services by the same people who perform the IPR has an impact on the cost and perceived value of the IPR.
- In three cases the accounting assistance was provided by a different team of people to those performing the IPR. The number of 'pure IPRs' (ie those performed independently of accounting services) in the study was, therefore, eight (five + three).

Limitations of trials

- The number of firms and clients at which field trials were performed is small.
- The statistics used in the study are based on information provided by the practitioners and we cannot exclude the possibility that they may have been reported on an inconsistent basis.
- Nineteen of the twenty clients were in the £1 million to £3 million turnover range. Only one client had a turnover that exceeded £3 million.
- It was difficult to simulate reality because of the 'spotlight effect' of conducting research.
- Care must be taken in projecting the actual cost savings that might be realised on the basis of savings identified in the field trials. Actual costs incurred by firms may differ when they are performing IPRs as real engagements on a regular basis.

Cost savings

Potential cost savings are greatest where the company has in-house accounting expertise. In-house accounting expertise is more likely to exist within the larger companies in the £1 million to £4.8 million range.

The field trials indicate that:

- Cost savings averaged around £1,100 where the accounting firm provided accounting assistance to the client using the same team of staff. For the twelve engagements this represents a 27% saving of the combined audit and accounting fees for the preceding year. There is, however, a wide range of percentage savings; the lowest saving in the range being 4% and the highest 70%. The wide range of savings indicates that caution should be exercised in extrapolating the findings from the field trials to the whole population of companies having a turnover between £1 million and £4.8 million.
- Cost savings averaged around £2,400 where the accounting firm provided no accounting assistance, or the accounting assistance was provided by a different team of staff. For the eight 'pure IPR' engagements this represents an average 61% saving on the audit fees for the preceding year. The lowest saving in the range was 48% and the highest was 81%.
- Some practitioners were concerned that the trials may overstate the extent of cost savings. They contended that savings realised by not using junior staff may not be sustainable in the long run and time savings may reduce as the reviewer becomes more distant from the knowledge of the business provided by the last audit. In other instances, however, it was contended that savings might increase as practitioners became more familiar with the process of performing an IPR.

75% of the companies involved in the research used their outside accountants to a greater or lesser extent to assist them discharge the directors' responsibilities to prepare 'true and fair' statutory accounts. The removal of the statutory audit would not change the directors' responsibilities to prepare 'true and fair' statutory accounts. When preparing the financial statements many of the practitioners maintained that they sought to perform this work to a high standard and that, as a consequence, the accounts preparation might involve them in obtaining some corroborative evidence. For example, they might attend stock counts, reconcile creditors' statements or confirm debtors. In these cases the amount of evidence obtained by the practitioners in preparing the financial statements was more extensive than that required by the illustrative Statement of Standards for performing an IPR. If this is so, the incremental cost of an audit and, therefore, the savings from an IPR are relatively smaller; this may help to explain the findings.

Effectiveness of the IPR

The effectiveness of the IPR was explored both in discussion with those involved in the research and by recording misstatements in the financial statements identified by the IPR and the audit respectively. The research results suggest that although the IPR is capable of detecting misstatements in the financial statements the audit is more effective at detecting misstatements. This finding is consistent with the views of the practitioners expressed in discussion with the researchers.

- In eight of the twenty engagements the IPR detected financial statement misstatements. For six of the eight engagements no further misstatements were detected by the audit.
- In six of the twenty engagements the audit procedures detected misstatements that had not been detected by the IPR (in two of the six engagements the IPR had also detected some misstatements).

The misstatements that were detected by the audit (and not by the IPR) were detected largely from the results of straightforward corroborative procedures such as supplier statement reconciliations, checking the additions of stock sheets and procedures relating to cut off. In a number of instances the misstatements were material to the results of the client company.

In addition to the misstatements arising from client error, a fraud was discovered at one client. The fraud was not discovered by the IPR but at the audit stage as a result of performing corroborative procedures on the client's payroll.

Views of practitioners

The evidence obtained in performing an IPR largely comprises the interaction between analytical procedures and obtaining information and explanations from the directors. In developing the illustrative Standards, the APB sought to distinguish an IPR as much as possible from an audit. One of the ways of doing this was to prohibit practitioners from obtaining corroborative evidence when performing the IPR.

- Practitioners encountered difficulties in performing the specified analytical review procedures on the smaller clients where detailed accounting information is not maintained, industry data is not available, and budgetary information is sparse. Where analytical procedures were performed practitioners often found it difficult to obtain satisfactory explanations for trends or variations from the directors and staff of the companies. In some cases practitioners found that they had to lead their client's responses to enquiries and this limited the value of the exercise.
- Practitioners were uncomfortable with the extent of reliance on directors' explanations especially as the illustrative Statement of Standards prohibits practitioners from obtaining corroborative evidence.
- Almost all practitioners were uncomfortable with the negativity of the review report (negative assurance) and in particular its lack of communication of the work, including accounting work, performed.
- The IPR was considered, by a sizeable majority of the practitioners, to be as effective as an audit in identifying going concern problems.
- The IPR is seen as having potential as an assurance service, by some practitioners, if it is performed well. However, the ability to perform the IPR well is dependent on those undertaking the work having the skills and experience necessary to provide a deep understanding of the client's business, and the self confidence to challenge directors' explanations.

Views of company directors

- If their company were to become exempted from audit many directors considered that the amount they would spend on services from their auditors would remain unchanged. However, an audit exemption would enable them to spend the money on services that they perceive to be more beneficial than either the audit or the IPR.
- Some of the directors of the larger companies considered that there should be no requirement
 for either the audit or the IPR. Against this, some believed that the protection against
 unscrupulous directors provided by the audit is better than no protection. These directors did
 not believe that such protection could be provided by an IPR that prohibits corroborative
 evidence being obtained.

 One company director found that the questions generated by the IPR were generally more challenging than those asked in the audit and this had helped him focus on a wider vision of his business.

Views of bankers

Although discussions with bankers were not carried out as part of the field trials per se, detailed discussions of the IPR were held with small company and risk management experts from a number of banks.

- Some bankers were concerned that practitioners might be able, too readily, to report an uncertainty and that this would lead to an excessive number of modified review conclusions.
- Some bankers seem reluctant to lose the audit as they regard it as a significant component of the corporate governance of small companies.
- Bankers expressed concern that audit exemption may have unforeseen consequences for growing companies that may need an audit track record to support future financing needs.
- Although bankers understand that practitioners who perform compilations may seek to ensure that the accounts are 'right': there are no performance standards for such compilations and consequently they are reluctant to rely on unaudited financial statements.

Operational implementation of the illustrative Statement of Standards

In developing the illustrative Statement of Standards the APB diverged from ISA 910 'Engagements to Review Financial Statements' by adding a requirement to ensure that there is a sound accounting base and by removing the opportunity for practitioners to obtain corroborative evidence in order to express an unmodified review conclusion.

- The proposed requirement for ensuring there is a sound accounting base was endorsed by practitioners but the prohibition on obtaining corroborative evidence was not.
- The analytical review procedures were criticised as being insufficiently specific.
- More guidance seems to be needed on the interrelationship of analytical procedures and the enquiries made of directors.
- Practitioners had difficulties operationalising the concept of 'plausibility'. More guidance is needed on how to respond if a directors' explanation seems implausible.
- The review report was considered to be excessively negative and to fail to communicate the nature and extent of the work performed.
- With the exception of the important reservations expressed above, Appendix II of the illustrative Statement of Standards was considered to provide a reasonable basis for performing an IPR.

Summary

- IPRs can reduce costs quite significantly, particularly where the practitioner does not prepare the financial statements.
- It is difficult to gauge the effectiveness of IPRs in detecting misstatements: clearly they do detect some misstatements but not as many as an audit.

- If Standards are developed for the IPR, the APB and the profession need to consider:
 - to what level of detail procedures can be specified within Standards rather than being left to the judgment of the practitioner;
 - the extent of corroborative audit work, if any, that should be permitted by any proposed Statement of Standards;
 - how to ensure that the difference between an audit and an IPR is communicated to the reader of an IPR report and also how to make the review report more descriptive of what has been done by the practitioner whilst retaining a negative assurance conclusion;
 - practical ways of providing practitioners with training on the performance of analytical procedures when undertaking reviews of small companies.

Some of these conclusions are expanded upon in the following Section, in the broader context of a number of 'emergent themes' identified by the researchers. Clearly those who have to decide on changes to Company Law will weigh up the benefits of the IPR identified in this report with the disadvantages. Should they decide to require an IPR we endorse the comments of the Company Law Review Steering Group that its effectiveness in practice should be reassessed some years after its introduction.

EMERGENT THEMES

A number of themes emerged during the course of the field trials which deserve further consideration and examination. Some of these themes relate to technical issues associated with the IPR and the illustrative Standards prepared by the APB, others relate to the economics of the IPR and the demand for an IPR.

Technical Issues

During the conduct of the field trials it became apparent that if the IPR is to be functional from the practitioner's point of view then further work has to be undertaken in three areas - corroboration, analytical procedures and the review report.

Corroboration

In order to help distinguish an IPR from an audit, the illustrative Standards developed by the APB required that evidence for the IPR would be obtained exclusively from analytical procedures and enquiries of directors; the Standards precluded the reviewer from obtaining 'corroborative evidence'. In other words no direct confirmation was required of the assets, liabilities and transactions recorded in the financial statements or of management's explanations or representations!

Many practitioners involved in the field trials disagreed with the position taken on corroboration. They considered that there were situations where corroboration might resolve uncertainties at little additional cost.

If the IPR is to permit corroboration then the circumstances in which it may be used must be capable of clear definition. If the circumstances for its use are not clearly defined then:

- practitioners may undertake extensive corroboration (and the IPR will lose its cost advantage over the audit); and
- users may assume, incorrectly, that the financial statements have been corroborated (and an expectation gap will develop).

Review standards in the United States of America address this issue in the following manner:

"...if the accountant becomes aware that information coming to his attention is incorrect, incomplete or otherwise unsatisfactory, he should perform the additional procedures he deems necessary to achieve limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles".

A subsequent AICPA interpretation indicates that (US) standards for performing reviews of financial statements do not preclude the accountant from performing procedures that he deems necessary or that his client requests. It goes on to recommend that if the accountant plans to perform procedures that are customarily applied during an audit, he may wish to place additional importance on whether his understanding with the client should be in writing³.

³ AR Section 9100 Compilation and Review of Financial Statements; Accounting and Review Services Interpretations of Section 100. Interpretation 13, AICPA New York, 1981.

¹ The APB guidance suggested that if the reviewers concluded that they needed additional evidence in order to express an unqualified review conclusion they were to make additional enquiries of the directors and not obtain corroborative evidence themselves (See paragraph 45 in Appendix 10).

² AR Section 100 Compilation and review of financial statements. Para 31, AICPA New York, 1978 (renumbered 2000).

While it is possible that the US approach could be incorporated into the Standards for an IPR the cost implications of so doing have not been explored. The APB field trials, and the cost savings summarised in Section 5, were undertaken on the basis that no corroboration should take place of the assets, liabilities and transactions recorded in the financial statements or of management's explanations.

Analytical procedures

Analytical procedures involve comparisons of recorded amounts and ratios to expectations developed by the reviewer and a thorough investigation of the differences between expected and actual results. Reviewers develop expectations from informal 'models' of the relationships that they expect to exist between financial and non-financial data elements. These models are based on the reviewers' understanding of the client and the industry in which the client operates.

For analytical procedures to be effective data (eg analyses, management accounts, and budgets) need to be available, and there needs to be a dialogue with management so that the reviewer can understand the reasons for differences between expected and actual results. In many smaller businesses data are not available, to support an analytical approach, and the necessary dialogue with management can be time consuming and ineffective, especially if management do not share the same approach to business analysis.

The challenge is that if analytical procedures are to provide the assurance envisaged by the IPR, then some data need to be available and both practitioners and management need to develop an understanding of business analysis so that their dialogue concerning relationships in that data can be effective. Such an approach would require a commitment on the part of management both to collect the data and to use it to help them run their businesses; it would also require a training effort on the part of practitioners.

The review report

A theme of the research was that both practitioners and company directors thought that the illustrative review report was unduly 'negative' and failed to communicate clearly the work performed during an IPR and the level of assurance provided by it.

While it should be possible to describe more clearly the work undertaken during an IPR, a greater challenge exists in communicating to users the limited or 'moderate assurance' provided by an IPR. Succinctly balancing 'positive' messages about what has been done with 'negative' messages about was has not been done and combining it into a 'conclusion' will be difficult. Research currently being undertaken by the International Auditing Practices Committee (IAPC) may provide a way forward and the IPR field trials have generated some useful insights for us to share with the IAPC.

Economics of the IPR

While the field trials suggest that cost savings would arise from replacing a statutory audit with an IPR, the magnitude of the cost savings vary depending, in part, on the degree to which practitioners are also involved in the preparation of the financial statements. There are also questions regarding whether the cost savings indicated by the trials would change over time.

Cost savings

A major theme to emerge from the research is the different pattern of cost savings between those companies that perform their own in-house preparation of the financial statements and those that use accountancy firms to assist them.

The results of the field trials suggest that a change from an audit to an IPR would yield different cost savings depending on whether the audit/IPR is predominantly independent of, or embedded in, the preparation of the financial statements. The implication is that potentially we have a segmented market for the change from audit to IPR.

The greatest cost savings are likely to arise from a change from an 'independent audit' to an 'independent IPR'. In these cases there is also likely to be the in-house accounting expertise to support a relatively sophisticated dialogue around the analytical procedures, making the IPR more effective. The assurance comes from the in-house expertise, the independence of the reviewer from the preparation and from the effectiveness of the analytics.

When the practitioner is involved in the preparation of the financial statements the audit/IPR serves to 'top up' the knowledge and evidence already gained through the preparation process. The audit/IPR sits not so much outside the preparation process but, to a significant extent, is embedded in it. For instance, many practitioners reported to us that they performed corroborative work (eg supplier's statement reconciliations) as part of their accounts preparation work.

In the case of the 'embedded audit/IPR' there may be a case for a statutory compilation by a suitably qualified professional in place of either the audit or the IPR. However, definitions of 'compilation' and 'suitably qualified' would be difficult to agree and it may be impractical to legislate on this basis.

Sustainability of cost savings over time

There is some uncertainty as to whether the cost savings associated with the IPR will dissipate over time as the reviewer becomes more distant from the knowledge base obtained through the prior audit. This is more of an issue where the auditor/reviewer has not been involved in the preparation of the financial statements.

On the other hand several practitioners volunteered that currently analytical review was not a strength of their practice and the efficiency and effectiveness of analytical procedures may increase over time as practitioners become more familiar with them.

Demand for an IPR *Views of directors*

If a statutory IPR is not to be seen as a burden by the directors of a company then the benefits, both to those directors and to other stakeholders, must be clear over and above the alternative of a complete exemption from both audit and IPR. Inevitably views on the value of an IPR were conditioned by views on the value of the statutory audit.

A small number of the directors interviewed made it clear that they did not need the assurance provided by either an audit or an IPR and favoured a complete exemption.

Most of the directors, however, attached value to the audit for one or more of the following reasons:

- (a) The smaller clients needed the auditors to produce accounts that would help them satisfy the directors' statutory duties. To these clients the audit was embedded in the preparation process with both the preparation and audit focused on ensuring 'true and fair' financial statements.
- (b) At larger clients some directors needed re-assurance that the numbers they had produced were 'right'.
- (c) Other directors, although confident for themselves, wished to provide assurance for other stakeholders such as bankers, venture capitalists or customers.
- (d) Many see the audit (of other companies) as a protection for themselves from unscrupulous directors of companies who might be suppliers or customers.

Because the APB illustrative Standards for the IPR focus on enquiries of directors and prohibit the reviewer from obtaining corroborating evidence, it is perceived by many of the directors interviewed as not meeting their needs. This is clearly so in respect of (d) above. Moreover, many of the directors were sceptical as to whether it would be acceptable to outside stakeholders as required by (c) above. Also they feel they would have significantly greater re-assurance per (b) above if there had been corroboration work. Finally, as the IPR report does not conclude in terms of 'true and fair' there is also doubt as to whether it is fully aligned with the role required by (a) above.

It emerges from the interviews, therefore, that the benefits of the currently proposed form of IPR are far from firmly established in the minds of the directors. Some of the bankers that we met were also dubious about the benefits of the IPR and seemed to favour retention of the existing audit requirement.

Buisiness Efficiency

Directors may be taking rather a narrow view of the benefits of an IPR as opposed to the audit. The 'think small first' theme of the Company Law Review is geared towards the smaller business sector being an important engine of economic growth and prosperity. For this to happen the smaller companies need to be ambitious, and to have reliable financial and non-financial information that is aligned with a clearly focused strategy and business model. The IPR, with its emphasis on the analytical examination and understanding of the business around a dialogue with, and possibly education and development of, the directors may assist economic growth. At least one director saw this possibility.

1 - INTRODUCTION

The Company Law Review Steering Group (CLR) has undertaken an extensive review of Company Law in the United Kingdom. One of its more controversial proposals, on which a final decision is yet to be made by Government, is whether for smaller companies the statutory audit should be replaced by an alternative less costly form of assurance known as the Independent Professional Review (IPR).

The CLR's proposal is important and far reaching because it would both reduce the level of assurance provided on the annual accounts of businesses having a turnover between £1 million and £4.8 million and change the nature of the practices of those practitioners who presently audit the accounts of such businesses.

Responses to both the CLR's consultation paper and a contemporaneous discussion paper issued by the Auditing Practices Board (APB) indicated a lack of consensus with respect to the perceived advantages and disadvantages of the IPR. In particular, the responses showed that considerable uncertainty existed regarding the potential costs and benefits of the IPR. The CLR concluded 'The results of both consultations is that, whilst there is a good measure of support, there are significant concerns and opposition over practical cost savings and users' recognition of the level of assurance they would be receiving'⁴.

The APB decided to put these issues to the test by carrying out field trials of the IPR. Although the trials would not be completed in time for the results to be reflected in its final report, the CLR has, nevertheless, recommended that 'Provided the APB's trials show IPR to be successful in terms of cost savings and users' reactions, IPR should be required for small companies in the £1 million to £4.8 million turnover range'.

This report provides a summary overview of the scope of the field trials, the methodology used in conducting the field trials and of the factual findings arising from the trials.

Research objectives

The field trials were performed using the illustrative Statement of Standards for Performing an Independent Professional Review that is set out as Appendix 10 to this paper. This Statement was developed from that published in the APB's May 2000 Discussion Paper taking account of comments received; it differs in some respects from International Standard on Auditing (ISA) 910 Engagements to review financial statements⁵

The objectives of the research were to:

- better understand the cost implications of an IPR compared to the audit;
- explore the effectiveness of an IPR in identifying material misstatements in contrast to an audit;
- assess the reactions of practitioners to performing an IPR;
- assess the reactions of directors of small companies to an IPR; and
- test the illustrative Statement of Standards developed by the APB for performing an IPR.

⁴Modern Company Law for a Competitive Economy. Completing the Structure. The Company Law Review Steering Group November 2000. Paragraph 2.57.

⁵ International Standards on Auditing are promulgated by the International Auditing Practices Committee of the International Federation of Accountants (IFAC), ISAs are published in the IFAC Handbook.

An IPR was performed by each of twenty accounting firms at a client of their choosing. The firms carrying out the trials represented a reasonable cross section of the public accountancy profession; geographically, by size of firm and by professional accounting body. Appendix 1 analyses the twenty clients by their turnover.

Report structure

Subsequent Sections report the conduct and results of the research. Section two provides more detailed background to the circumstances that gave rise to the field trials. Section three provides a brief overview of what an IPR comprises and contrasts an IPR with both audit and compilation engagements. Section four describes the conduct of the research. The research findings themselves are set out in Sections five to nine. Section ten summarises the results of some discussions with bankers concerning their observations on the IPR. Some of the limitations of the research methodology are set out in Section eleven.

2 - BACKGROUND

In April 2000, the then UK Trade Secretary announced a two-stage approach to raising the threshold below which small companies may dispense with having their annual accounts audited⁶. At that time all companies with a turnover in excess of £350,000 were required by law to have an audit of their accounts. For financial periods ending after 31 July 2000, the turnover threshold was raised to £1 million.

The Trade Secretary also announced that it was his intention to raise the threshold to £4.8 million. In his announcement he noted 'The independent Company Law Review is considering whether, for companies with a turnover of between £1 million and £4.8 million, the audit should be replaced by a lighter less costly form of assurance I shall take their final recommendations into account before proposing what, if any, statutory arrangements should replace the full audit for companies in that size range'.

The CLR envisaged that the objective of an IPR 'Would be to enable the reviewer to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, nothing has come to the reviewer's attention that causes the reviewer to believe that the financial statements were not prepared, in all material respects, in accordance with the relevant reporting framework'.

Although the performance of such review engagements is not required by legislation in other countries, review engagements are performed in a number of countries, including Canada and the United States of America. In these countries, Standards have been developed for the performance of reviews of financial statements. These Standards have either been used as the basis for developing International Standard on Auditing 910 Engagements to review financial statements, or derived from that ISA.

The CLR suggested that ISA 910 might form a suitable basis for a Statement of Standards for IPRs⁸.

In May 2000 the APB published a discussion paper which, among other things, provided an illustrative model of a Statement of Standards for performing an IPR and a discussion of a number of issues that the APB had considered in preparing the illustration. The stated objectives of the discussion paper were:

- to provide an illustrative model of Standards for a possible IPR and a discussion of some of the issues that the APB considered in preparing the Standards and guidance. The starting point used for preparing the illustrative Standards and guidance was ISA 910 although a number of changes to its approach were proposed. The APB hoped that the paper would assist those wishing to respond to the Company Law Review Steering Group to formulate their response.
- to provide an opportunity for practitioners, users and preparers to provide their views to the APB concerning the illustrative Standards.

The APB received a number of helpful responses to the discussion paper which indicated that:

• there is considerable uncertainty as to the extent of likely cost savings associated with replacing a statutory audit with an IPR;

⁶Press release from DTI Red tape reform saves small companies millions (4 April 2000)

⁷ Modern Company Law For a Competitive Economy. Developing the Framework. The Company Law Review Steering Group March 2000 pp 288

⁸ Ibid pp 460

⁹ Discussion Paper: The proposed Independent Professional Review of the financial statements of small companies. APB May 2000

- views varied as to whether the IPR, as described, was sufficiently distinguished from an audit so as to avoid unrealistic expectations as to the extent of assurance provided;
- going concern should be included in the scope of an IPR; and
- APB needed to undertake further work to refine the wording of the review conclusion and to define the procedures to be performed.

Following discussions between the APB, the CLR and the Department of Trade and Industry, the APB decided to field test its model of illustrative Standards in order to obtain objective information with which to inform the debate. The Statement of Standards used in the field trials is set out as Appendix 10 to this paper. This Statement is a development of the one that had been included in the APB's May 2000 Discussion Paper in order to take account of feedback from commentators.

The main differences between the illustration in the discussion paper and that which was actually tested are as follows:

IPR 11 (paragraph 35 in Appendix 10) was reordered to illustrate that analytical procedures form the basis for the subsequent enquiries made of directors.

Paragraph 37 of Appendix 10 was amended to provide guidance that a confirmation letter may be used to confirm the directors' views expressed to the reviewer as to whether or not the entity is a going concern.

Paragraph 54 of Appendix 10 provides guidance with respect to going concern.

The scope paragraphs in each of the example review reports (Appendices III to VII) were amended to remove the statement that consideration of the ability of the entity to continue as a going concern was not within the scope of an IPR.

Appendix II was re-engineered to be in the form of a checklist and to require the recording of the results of enquiries made and signed off for completion of each step.

Appendix II indicates that manager should complete the knowledge of the business enquiries in advance of the commencement of field work.

With respect to Appendix II the number of detailed enquiries was increased and the wording improved; generally these changes were made in response to comments received.

Appendix VII to Appendix 10 was added to provide an example review report including an explanatory paragraph where there is a fundamental uncertainty regarding the entity's ability to continue as a going concern.

In November 2000 the CLR issued a further consultation document in which it stated 10:

2.56 'For larger small companies (i.e. broadly those with a turnover of between £1 million and £4.8 million), Developing the Framework proposed the IPR. No clear consensus on this emerged from the responses. A little under half were in favour of IPR; others did not rule it out but expressed reservations; and a significant minority were against it. Those expressing reservations or opposing were, in the main, concerned that sufficient cost savings may not be realised to make the exercise worthwhile. The other main point raised by those against IPR was the so-called 'expectation gab': i.e. a concern that the degree of assurance provided by IPR will be misunderstood by users who may wrongly infer that it offers something more akin to audit assurance. Some who opposed the IPR wanted to see the retention of the normal audit requirement; others favoured exempting small companies totally from any form of assurance.

¹⁰ Modern Company Law For a Competitive Economy. Completing the Structure. The Company Law Review Steering Group November 2000. pp 24 et seq

- 2.57 In May 2000, the Auditing Practices Board (APB) issued a discussion draft, The Proposed Independent Professional Review of the Financial Statements of Small Companies, containing a draft standard for carrying out of IPRs. We understand that the responses received were similar in mix and issues raised, to those received by the Review. In effect the results of both consultations is that, whilst there is a good measure of support, there are significant concerns and opposition over practical cost savings and users' recognition of the level of assurance they would be receiving. We are pleased that the APB will put these issues to the test by carrying out field trials of the IPR. However, whilst such trials may give a reliable answer to the question of cost they will not necessarily give so good a guide as to how users will react in practice, experience with 'live' use of the IPR may be required to gauge that. The full programme of the APB trials will not be completed in time to be reflected in our final report in the spring of 2001. The results will, however, be available later in 2001, in time to be taken into account in the drafting of legislation.
- 2.58 Accordingly we recommend that, provided the APB's trials show IPR to be successful in terms of cost savings and users' reactions, IPR should be required for small companies in the £1 million to £4.8 million turnover range. We also recommend that, if the IPR is adopted, its effectiveness should be reviewed after five years of operation. Should IPR be unsuccessful in trials or in operation, we recommend that the total exemption limit be extended to all small companies.'

It was against this background that the APB embarked on the field trials described in Section 4 of this report.

Subsequently the CLR has issued its final report in which it stated¹¹:

- 4.47 'In the time available we have been unable to reach a firm conclusion on the IPR. Responses to Developing the Framework were mixed: some were in favour of IPR; others did not rule it out but expressed reservations; and a significant minority were against it. But there was a clear delineation of the issues. First, there is a concern that the reductions in cost or regulatory burden, compared with audit, may be only marginal. We agree that to be an attractive option, not only do the benefits of the IPR need to outweigh the costs, but also that the reductions in cost and burdens as compared with a full audit need to be significant: otherwise companies which are required to undertake some form of review will opt for audit; and a statutory IPR requirement would have achieved little beyond legislative complexity. Second there is the question of the 'expectation gap' whether users of the accounts will misunderstand the degree of assurance given by IPR, wrongly inferring that it gives something akin to audit assurance. The APB is currently conducting field trials of the IPR aimed at providing information on costs and some users' reactions to the degree of assurance. Like all pilot studies, of course, this will not provide certainty as to actual practice; were IPR to be required, some subsequent form of review of its effectiveness in practice would be appropriate.
- 4.48 Whilst we should prefer an acceptable balance of cost and benefit that provided some degree of assurance less than audit, if such a balance cannot be found in the IPR we are satisfied that an acceptable balance would be to extend the audit exemption to all small companies.
- 4.49 Given that the APB's research data are not available at the time of writing this Report, it would be premature for the Steering Group to make a recommendation as to whether or not to require IPR. Rather, we recommend:
 - that the audit requirement be removed in the £1 million to £4.8 million bracket in any event, once a decision on IPR can be reached;

¹¹ Modern Company Law For a Competitive Economy. Final Report. The Company Law Review Steering Group July 2001. pp 81 et seq

- on the basis of the APB's data, once available, together with other relevant considerations, the DTI should draw a policy conclusion as to whether to require IPR in that range (if IPR were to be required, companies could of course satisfy the requirement by having a full audit instead, if they preferred); and
- if IPR is so required, that its effectiveness in practice should be reviewed after five years.

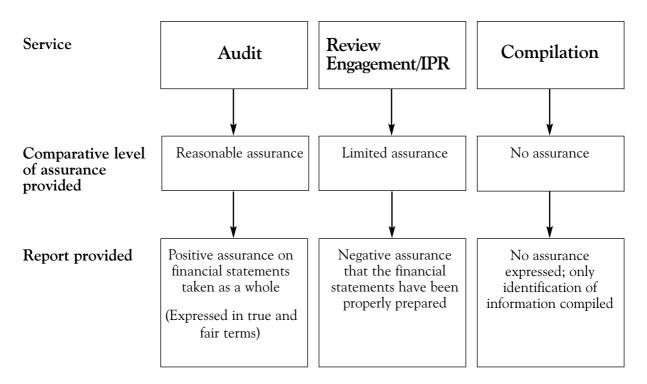
Regulation of any IPR

- 4.50 Were IPR to be required, we believe that those carrying it out should be professionally qualified and that there should be some form of monitoring. In Completing the Structure we consulted upon alternatives for a regulatory framework to achieve this:
 - one model would bring IPR within the same regulatory framework as audit regulation not audit regulation per se but something that uses the same 'machinery', ie the existing qualifying and supervisory bodies together with their monitoring activities and reporting to the Secretary of State, but in a less intrusive way for practitioners. We termed this a lighter version of audit regulation. We did not envisage that practitioners would be required to register as auditors but rather that they could register solely as IPR practitioners. And given the more limited and less judgmental nature of IPR, we felt that this regulatory model would be quite capable of providing ongoing statutory oversight that is not disproportionate; and
 - the second model would involve setting up an entirely new statutory regulatory structure restricting the ability to carry out IPR to practising members of appropriate professional bodies. Such bodies would be required to step up their internal professional regulation to include active monitoring of IPR practitioners, but such monitoring would be entirely an internal matter for the professional bodies the Secretary of State would not be overseeing it. In other words, the statutory oversight would be 'once –off' rather than continual, although, clearly, a body's statutory recognition could be withdrawn.
- 4.51 There was no consensus among consultees, although a small majority favoured the first model. The arguments marshalled in its favour were the simplicity of using existing structures, including the cost-effectiveness of doing so, the need for a certain degree of ongoing oversight and accountability and the need for audit-like skills notwithstanding that the exercise would not be an audit. Those in favour of a new system of recognition of professional bodies cited reduced cost as the main reason but also noted that differentiation from audit was needed and that a version of audit regulation could be too 'heavy'. In this the consultation has not identified any new, overwhelming argument either way.
- 4.52 Our own view is that the preferable course of action is to use the existing audit regulation structure for the sake of efficiency with the attendant possibility of cost-effectiveness and simplicity. This we recommend.
- 4.53 Our proposals on the duties and liabilities of auditors in Chapter 8 will also apply to those conducting IPRs'.

3 - THE INDEPENDENT PROFESSIONAL REVIEW

Introduction

Conceptually an IPR sits between an audit and a compilation engagement. International Standards on Auditing have established the following conceptual framework for these three services which illustrates this point:



The purpose of this Section is to compare and contrast the IPR with an audit and a compilation engagement.

Audit Engagements

The objective of an audit of financial statements is to enable auditors to give an opinion on those financial statements taken as a whole and thereby to provide reasonable assurance (sometimes referred to as a high level of assurance) that the financial statements give a true and fair view and have been prepared in accordance with relevant accounting requirements.

The opinion paragraph in the report provided by auditors is as follows:

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at ... and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

In undertaking an audit of financial statements, the auditors carry out procedures designed to obtain sufficient appropriate audit evidence, in accordance with Auditing Standards, to determine with reasonable confidence whether the financial statements are free of material misstatement. They evaluate the overall presentation of the financial statements, in order to ascertain whether they have been prepared in accordance with relevant legislation and accounting standards. The auditors issue a report clearly expressing a positive opinion as to whether the financial statements present a true and fair view of the state of affairs of the entity at the period end and of the profit or loss for that period.

The auditors determine the scope of the work required to conduct an audit in accordance with the Standards contained in Statements of Auditing Standards (SASs). Factors that influence the auditors' judgment in this regard include the requirements of, and the guidance contained in SASs, the requirements of relevant professional bodies, legislation and regulations and the terms of the audit engagement.

Although SASs prescribe certain basic principles and essential procedures that the auditors must undertake, the majority of the work undertaken by auditors to form an opinion is permeated by the exercise of judgment, in particular regarding:

- a) assessing the components of audit risk and designing procedures to ensure it is reduced to an acceptably low level;
- b) the gathering of evidence for example in deciding the nature, timing and extent of audit procedures; and
- c) the drawing of conclusions based on the evidence gathered, for example, assessing the reasonableness of the estimates made by the directors in preparing the financial statements.

Independent Professional Review Engagements

By contrast, the objective of an IPR is to enable reviewers to provide a limited level of assurance to the effect that they are not aware of any material modifications that need to be made to the financial statements in order for them to be in conformity with the applicable accounting framework. The reviewers' conclusion is expressed as follows:

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the provisions of the Companies Act 1985 applicable to small companies and the requirements of United Kingdom Accounting Standards.

This type of conclusion is known as a negative assurance opinion.

The performance of an IPR consists primarily of:

- a) undertaking limited procedures in order to assess whether the accounting records of the entity seem to provide a sound accounting base for the financial statements;
- b) making enquiries concerning the business and the financial statements and applying analytical procedures designed to identify relationships and individual items that appear unusual;
- c) obtaining plausible explanations from the directors of the entity for any unusual relationships and items identified by the reviewers; and

d) reporting a conclusion on the results of the IPR.

The word plausible is used in the sense of appearing to be 'worthy of belief' based on the information obtained by the reviewers.

As an IPR principally comprises enquiry and analytical procedures, it does not involve:

- evaluating internal controls;
- b) obtaining corroborative evidence regarding the assertions embodied in the financial statements through, for example, inspection, observation, confirmation and computation;
- considering whether the financial statements are misstated as a result of fraud or illegal c)

which are procedures ordinarily performed as part of an audit.

Consequently, there is a greater risk that misstatements in the financial statements will not be detected by an IPR compared to an audit. Accordingly, the level of assurance provided by a review conclusion is limited (sometimes described as moderate assurance) and is substantially less than the reasonable assurance provided by an audit report (sometimes referred to as a high level of assurance). The limited nature of the assurance provided by an IPR is indicated by the assurance being expressed in terms of the reviewers not being aware of the need for material modifications to the financial statements.

With respect to (b) above the APB's illustrative Standards and Guidance may lead to a greater risk that misstatements will not be detected than ISA 910. The APB's illustrative Statement states 'The reviewers may initially conclude that they need additional evidence in order to express an unqualified review conclusion. In such circumstances the reviewers make additional enquiries and do not, themselves, obtain corroborative evidence, as this would change the nature of the engagement from an Independent Professional Review to an audit. Where practical, the reviewers request the directors to perform additional procedures to provide the necessary evidence to enable the reviewers to express an unqualified conclusion'¹². In drafting its Statement of Standards the APB was particularly concerned to ensure that an IPR should be distinguishable from an audit by precluding the reviewers from obtaining corroborative evidence. In this way there is less risk that an IPR will become an audit by virtue of the reviewers undertaking corroborative work in preference to assessing the plausibility of the explanations provided by the directors.

This approach differs from ISA 910 and Standards in use, for example, in the United States of America which require the reviewer to carry out additional or more extensive procedures as are necessary to be able to express negative assurance or to confirm that a modified report is needed¹³. Review standards in the USA address this issue in the following manner:

'If the accountant becomes aware that information coming to his attention is incorrect, incomplete or otherwise unsatisfactory, he should perform the additional procedures he deems necessary to achieve limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles".

¹² See paragraph 45 of appendix 10.

¹³ See ISA 910 paragraph 27 and Codification of Statements on Standards for Accounting and Review Services AR Section 100 paragraph 31 AICPA, New York 1978 (renumbered 2000)

¹⁴ AR Section 100 op cit Paragraph 31.

Compilation Engagements

ISA 930, issued by the IAPC, describes the objectives of a compilation engagement as follows

'The objective of a compilation engagement is for the accountant to use accounting expertise, as opposed to auditing expertise, to collect, classify and summarise financial information. This ordinarily entails reducing detailed data to a manageable and understandable form without a requirement to test the assertions underlying that information. The procedures employed are not designed to and do not enable the accountant to express any assurance on the financial information. However, users of the compiled financial information derive some benefit as a result of the accountant's involvement because the service has been performed with professional competence and due care.'

The report set out below is an example, included in guidance issued by the Institute of Chartered Accountants of Scotland, of an accounts preparation report for a company¹⁵:

CHARTERED ACCOUNTANTS' REPORT TO THE DIRECTORS ON THE UNAUDITED ACCOUNTS OF XYZ LIMITED

As described on pages...to ...you are responsible for the preparation of the accounts and you consider that the company is exempt from an audit. In accordance with your instructions and in order to assist you to fulfil your responsibilities, we have prepared the accounts on pages ... to ... from the accounting records and from information and explanations supplied to us.

This report can be contrasted with that required by ISA 930:

COMPILATION REPORT TO...

On the basis of information provided by management we have compiled, in accordance with the International Standard on Auditing applicable to compilation engagements, the balance sheet of ABC Company as of December 31 20XX and statements of income and cash flows for the year then ended. Management is responsible for these financial statements. We have not audited or reviewed these financial statements and accordingly express no assurance thereon.

Guidance for performing compilations in the UK is issued by the various accounting bodies. As will be seen from the research findings in this paper a number of the accountants employed to compile financial statements often test some of the assertions underlying the financial information as part of their accounts preparation work. Some of these firms interpret their engagement as being to prepare accounts to the standard the directors require to meet their true and fair reporting obligations. Consequently, accountants performing accounts preparation engagements may be in a position to provide some assurance on the financial statements. However, as UK compilation standards do not require the nature of the practitioners' involvement to be described in the compilation report, users of such financial statements may not be informed of the full extent of the practitioners' involvement.

The fact that many of the accounts preparation engagements encountered in the field trials were intended to provide assurance to the directors has had a significant bearing on the findings of this research. This is explored further in Sections five and six of this paper.

¹⁵ Framework for the preparation of accounts. Best Practice Guidance for Member Firms. The Institute of Chartered Accountants of Scotland 1999.

4 – CONDUCT OF THE FIELD TRIALS

Sample of accounting firms selected

The ACCA, ICAEW and ICAS¹⁶ were each asked to nominate accounting firms to take part in the trials. In total, twenty firms agreed to perform one IPR each, on a client that would become exempted from the requirements for a statutory audit under the CLR's proposals.

The distribution of firms, as between the three Institutes is as follows:

ACCA	5
ICAEW	9
ICAS	6
Total	20

Selection of clients

Each of the firms selected a client which was expected to have a turnover between £1 million and £4.8 million¹⁷, where the directors would be agreeable to the IPR field trial and also agree to being interviewed by a researcher. As the firms were being expected to perform the IPR as if it were an actual engagement, they were asked to select clients where the IPR could be performed as a discrete exercise in advance of the audit. To enable researchers to collect information and views from the IPR phase the IPR and audit phases were to be separated by a period of approximately two weeks.

In practice a number of the firms encountered resistance from clients when they suggested that the audit and the IPR phases be split. These clients did not wish to have the disruption of two, rather than one, visits from the auditors. In all such cases, however, the researchers consider that they have been able to obtain the information necessary for the research.

In the event six clients either declined the opportunity to meet with the APB researchers or, for a variety of reasons, were not asked by the accounting firms to meet with the researchers. Feedback from directors is, therefore, limited to fourteen companies.

The firms involved in the trials were widely dispersed throughout England and Scotland. Appendix 1 analyses the sample of clients by turnover. As can be seen from the Appendix all of the clients, except one, had a turnover of less than £3 million. Despite this, the average turnover of all the clients involved in the field trials was approximately £2 million which is well within the £1 million to £4.8 million range.

In fifteen of the twenty clients involved in the field trials the accounting firms were involved in the preparation of the accounts. The average turnover of these fifteen firms was £1,659,000 which suggests that smaller companies require more accounting assistance than the larger ones.

Throughout the study the sample of twenty clients has been split between those clients where only a 'pure' IPR was performed and those where accounting assistance and an IPR was performed by the same team. Eight of the engagements are regarded as being 'pure' IPRs. These consist of the five clients where

¹⁶ The Association of Chartered Certified Accountants, Institute of Chartered Accountants in England and Wales, Institute of Chartered Accountants of Scotland.

¹⁷ One of the clients had a turnover marginally in excess of £4.8 million

the accounting firm is not engaged to prepare the accounts and three of the clients where the accounting firm is engaged to prepare the accounts, but where the IPR was performed by a wholly different team of people or performed at a different time to the audit and IPR.

Pilot testing

In November/December 2000 pilot tests were undertaken by four of the accounting firms in order to assess the likely effectiveness of the research methodology. The pilot testing proved to be beneficial and resulted in a number of improvements both to the methodology eventually used in the other sixteen field trials and also to the illustrative Standards and guidance that were used in those trials.

The illustrative Statement of Standards used by participants in the trials is appended, for reference, to this paper as Appendix 10. It should be noted that the Statement used differs in some important respects from that which was included in the APB's May 2000 discussion paper. It also differs in some significant respects from ISA 910.

Although the research methodology was refined somewhat as a result of the pilot studies there were no major changes and it is, therefore, considered appropriate to include the results from the pilot studies as an integral part of the overall field trials.

Methodology Briefings

Once a firm had agreed to take part in the trials and had identified a suitable client, an APB staff member met with representatives of the firm to brief them on the objectives of the field trials and the methodology that they should use.

These briefings were sometimes conducted with one firm and on other occasions with a number of firms. The factor determining how many firms were briefed at a particular session was the ability to get firms together at a convenient time and place. Twelve briefing sessions were held in total. Eleven of these sessions related to the firms involved in the pilot studies and the field trials. Two firms that were briefed subsequently decided not to take part in the field trials.

There was no particular advantage perceived for individual as against joint briefings. Individual briefings at the offices of one firm had the advantage of enabling the partner, manager and senior from the engagement being readily available to attend the session. Joint briefings, (because of travel time and costs) although not always attended by the entire review team from a firm, enabled a number of firms to share their concerns and to have the benefit of seeing the IPR through the eyes of others.

Help desk

Participants in the field trials were advised to use the APB staff member who performed the briefings as a resource (help desk) as they carried out the trial. Only one of the participants found it necessary to call for advice on what was required.

Research instruments

Those engaged in the field trials were asked to follow the Standards and guidance in the illustrative Statement of Standards for performing an Independent Professional Review set out as Appendix 10 to this paper. In addition they were asked to complete six forms the content of which would provide the basis for the subsequent debriefing. These forms are set out as Appendix 9 to this paper and comprise:

Form 1 Time analysis –hours. The purpose of this form is to provide details of the hours spent on the IPR by various staff grades. The time is allocated between

- non-recurring, to do with the briefings;
- calculating and processing accounting entries;
- drafting, finalising and printing accounts;
- establishing a sound accounting platform;
- additional work on the IPR; and
- corroborative work in performing the audit.

Comparative figures were obtained for the prior year on the basis that the prior year would, all other things being equal, provide a better measure of the audit hours as that audit had been performed without an IPR trial affecting its performance. As can be seen from Section 3 audits and IPRs are qualitatively as well as quantitatively different. An IPR is not a truncated audit. Accordingly, adding the cost of performing an IPR to the additional costs to perform an audit may not equate with the cost of performing a stand-alone audit.

Form 2 Cost analysis - £ provides a similar analysis to Form 1 but of costs rather than hours.

Form 3 Unadjusted Differences was intended to provide one of the measures of the effectiveness of the IPR. Its purpose is to allocate the adjustments found on the engagement as between those attributable to accounting; the IPR; and the corroborative audit work.

Forms 4, 5 and 6 Asked various questions of the senior, manager and partner respectively.

Appendix II of the illustrative Statement of Standards¹⁸

In the draft Statement of Standards included in the APB's discussion paper the Appendix of illustrative procedures was not portrayed as being prescriptive. Arising from the pilot tests it was decided that for the purposes of the field trials, and for the avoidance of doubt as to the scope of the procedures, all of the procedures in Appendix II should, unless clearly inapplicable, be mandatory. It was also thought helpful, for purposes of the research, to mandate that the results of enquiries should be recorded as well as the identity of the company director or employee to whom the enquiry was directed. In these ways each IPR would be performed on broadly the same basis as the others.

Consequently, the format of Appendix II was changed to make it more like a checklist; providing spaces for the results of enquiries, recording the name of the employees spoken to, a working paper cross reference and a sign off for completion of each step. In addition managers and partners were required to sign off that they had reviewed the completed Appendix. A note was added to the Appendix indicating that the planning steps would typically be performed by the manager in advance of the field work.

Blank boxes were included in the Appendix for the manager or senior to include additional steps considered necessary as a result of the planning and analytical review procedures.

Relationship of enquiries and analytical procedures

The areas where participants expected to experience the most difficulty were;

a perceived lack of specificity of the enquiries set out in Appendix II

 $^{^{18}}$ See pages 78 to 86 of this paper

- the intended interrelationship between the enquiries and the analytical procedures; and
- the scope of the analytical procedures.

As can be seen from the Sections dealing with the research findings these difficulties carried through into the findings of the research.

Debriefing the firms

Between completion of the IPR and the commencement of the audit, an APB researcher, who had not taken part in the briefing session, visited the firm and also met a representative from the client, usually the managing director¹⁹. The advantage of this approach was that the debriefing was led by someone who had not been involved in the development of the illustrative Statement of Standards and, therefore, may be more sympathetic to comments and criticisms that might be made of it.

The debriefing visits typically lasted for a day and included the following:

- Separate meetings with the senior, manager, and partner to obtain their feedback on the
 performance of the IPR and to discuss their completion of research instruments 4 to 6
 respectively.
- A review of the IPR working paper file completed for the engagement.
- Discussion of the content of the working paper file with the representatives of the firms.

The meetings with the engagement teams were, necessarily, rather structured so as to achieve results that would be broadly comparable as between firms. However, ample opportunity was given to the firms' representatives to raise and discuss their own concerns regarding the IPR with the researcher.

Debriefings with clients

The discussions with the clients were rather less structured than those with the representatives of the firms. From the pilot studies it was found that the extent of the knowledge and interest of the client directors varied quite widely. The discussion that took place was loosely based on the following three topics:

- Views on the relative cost effectiveness of an IPR compared to an audit. This involved a fair amount of explanation of the differences between audits and IPRs and in particular the differences between the audit and review reports.
- Their experience of the IPR compared to their previous experience of being audited.
- What they thought the reaction of other stakeholders would be to the IPR.

The content of the remainder of the interview was largely dictated by the interviewer's assessment of the interest and knowledge of each client and was allowed to develop as a conversation rather than asking each of the clients the same questions. The researchers considered that this was a more appropriate way to establish client views than highly structured interviews.

 $^{^{\}rm 19}$ For the pilot studies the briefings and debriefings were undertaken by the same person.

5 – FINDINGS – THE COST IMPLICATIONS OF AN IPR

Appendices 2 and 4 provide a summary of the hours and costs respectively of the IPR and accounting assistance compared to the previous year's audit and accounting assistance. Before analysing the data derived from the field trials it may be helpful to explain the influence on the data of the extent of the accounting and compilation work performed on the various engagements.

Impact on data of accounts preparation work

In twelve of the twenty engagements those performing the IPR were formally involved to some extent with preparing or compiling the accounts that were subsequently subject to IPR and audit. In three engagements the accounting firm was involved in providing compilation assistance but used a separate staff team. In five engagements the accounting firm was not engaged to prepare the accounts at all. As the issues that arise at clients that have in-house accounting expertise differ from those arising at clients with no such expertise, there is scope for further research into how many of the companies in the £1 million to £4.8 million band have in-house accounting expertise.

When briefed, the firms were instructed to perform the IPR on accounts that had been prepared and compiled using the same procedures and with the same degree of care usually employed by that firm on that engagement. In this way the IPR would be being performed under realistic conditions and under conditions comparable to the prior year's audit engagement which was to be used as a comparator. These instructions seemed to be followed by all of the firms except one. This firm prepared the financial statements very quickly, without carrying out their normal procedures to check the accuracy of the figures. As a result, the subsequent audit corroboration time was higher than the firm's 'standard' and the audit identified errors that would normally have been identified at the accounts preparation stage. (In the various appendices this is firm 4).

In recording the hours and costs of performing the IPR the firms included, as can be seen from Forms 1 and 2 of the research pack²⁰, the time and costs of:

- a) calculating and processing accounting entries; and
- b) drafting, finalising and printing accounts.

The only time and costs that have been excluded from the analyses is that considered to be non-recurring; arising from IPR briefings etc.

In view of the fact that few of the clients, taking part in the field trials, had the resources or the ability to prepare reliable accounts, the impact of the accounts preparation time on the findings is quite considerable. There are two factors that have had a particular impact on the data:

- a) the extent of compilation and accounts preparation work performed varies widely from engagement to engagement. In some instances the accounts were compiled into statutory format from a reasonably complete trial balance whereas in other instances the accounting firm was preparing accounts from the records of prime entry. There were also differences in the extent to which expenses such as depreciation and interest accruals were included in management accounts prepared by companies;
- b) the allocation of time for similar tasks as between accounts preparation, IPR and audit varies from firm to firm.

²⁰ See Appendix 9

With respect to the latter point, and as discussed in Section 3, the researchers were informed by many of the firms that they undertake some corroborative procedures when preparing the accounts and that their objective in preparing them is to 'get them right'.

One partner interviewed noted, 'Our approach is to do the accounts preparation work to a standard that meets the directors' responsibilities for truth and fairness and we would do more substantive work in this role than the IPR expects'. Another partner stated that 'if the firm has prepared the accounts it will have exceeded the level of assurance that is to be generated by the IPR'.

Consequently the firms frequently included within the accounts preparation caption, time spent on enquiry and corroborative work which might otherwise be regarded as IPR or audit time respectively.

Hours spent on the IPR and accounting compared to the audit and accounting

Appendix 2 sets out for each of the field trials a comparison of the hours spent by the practitioners on the IPR and the accounting, with the hours spent on the previous year's audit and accounting.

It can be seen that the hours savings, from performing an IPR compared to an audit, vary widely. Although the mean saving is 47%, the lowest saving is 9% and the highest is 84%. Generally the lower percentage savings occur on those engagements where the accounting work represents a high proportion of the total time spent. In these instances the firms typically consider that the purpose of the compilation work is to get the accounts 'right' and therefore what might otherwise be regarded as audit corroboration is classified as accounting assistance.

This point is illustrated by the split of the results between the eight 'pure' IPRs and the others, as shown in Appendix 3. In summary this shows the following:

	8 clients that are pure IPRs	12 clients where there is accounting assistance
Mean hours for accounts preparation and IPR	23	63
Mean hours for accounts preparation and audit	75	98
Time saving in hours	52	35
Saving as a % of audit and accounts preparation	69%	35%

Where there is no accounts preparation or compilation work the average time spent on an IPR is 23 hours compared to 75 hours for the audit. In terms of time, therefore, there is an average 52 hour saving; representing 69% of the audit and accounts preparation time for the previous year.

The time saving is dramatically less for those firms that were also engaged to prepare the accounts. Here the aggregate audit and accounts preparation hours average 98 per engagement compared to 63 for the IPR and accounts preparation. This is an average saving of 35 hours; which is 35% of the audit and accounts preparation time for the previous year.

When predicting possible time savings, therefore, it is important to be clear whether the engagement includes accounts preparation and whether the statistics include or exclude the accounts preparation and compilation work.

Cost of the IPR compared to the audit

As can be seen from Appendix 4, the relative cost of the IPR to the audit shows a similar trend to the relative hours. The average cost saving of the IPR and compilation is about 40% of the average cost of the audit and compilation.

As for time, it is perhaps more useful to compare the mean of the savings on those engagements with no accounting assistance and the mean for those with accounting assistance which are set out in Appendix 5. In summary this shows the following:

	8 clients that are pure IPRs	12 clients where there is accounting assistance
Mean cost for accounts prep and IPR	£1,546	£2,930
Mean cost for accounts prep and audit	£3,919	£4,037
Cost saving	£2,373	£1,108
Cost saving as a % of audit and accounts preparation	61%	27%
Time saving as a % of audit and accounts preparation	69%	35%

For clients involving accounts preparation work the average cost of the IPR and compilation was £2,930 compared to an average cost of the audit and compilation of £4,037. The average saving per IPR was therefore £1,108 representing 27% of the combined audit and accounting fee. The lowest saving in the range was 4% and the highest was 70%. The average cost saving is not quite as great as the average hours saving of 35% because staff mix is different: the audit involves more junior staff.

The wide range of savings indicates that caution should be exercised in extrapolating the findings from the field trial to the whole population of companies having a turnover between £1 million and £4.8 million.

For clients involving no accounts preparation work the average cost of the IPR was £1,546 compared to the average cost of the audit of £3,919. The average saving per IPR was therefore £2,373 representing 61% of the audit fee. The lowest saving in the range was 48% and the highest was 81%. The average cost saving is not quite as great as the average hours saving of 69% because the audit involves more junior staff.

Other observations made by firms concerning costs

When interviewing representatives of the firms they raised a number of other important considerations with respect to time and costs. These are as follows:

Training juniors

When audits are undertaken a junior staff member typically becomes the senior the following year and brings to the following year's engagement a considerable amount of knowledge and experience from having been the junior.

Many of the time savings in undertaking an IPR were realised by not using junior staff on the engagement. Some of the firms pointed out that this saving may not be sustainable in the long run. This is because the lack of on the job training for juniors would need to be replaced by other training methods or by much more detailed briefings before the commencement of an engagement.

Credit taken for prior years' audits

A number of the practitioners expressed the view that the time taken on the IPR was less than it might be in subsequent years because many of those engaged in the IPR had been involved with the audit for a number of years and, therefore, had an accumulation of knowledge of the business on which to draw. Over time this knowledge level would decay and therefore the costs of the IPR would increase as this knowledge would need to be obtained afresh.

Adequacy of IPR to support tax returns

Some of the practitioners involved in the field trials were concerned that the cost savings should not be considered solely in the context of the provision of assurance on the financial statements. Typically the firms also prepare the corporation tax returns for their clients. Some of the tax partners of the firms indicated that the enquiry procedures required by the IPR may not provide sufficient support for their involvement in the preparation of the tax return.

Other considerations

The three considerations set out above would each tend to reduce the savings from the IPR. In other instances, however, it is possible that savings might increase as practitioners became more familiar with the process of performing an IPR.

6 - FINDINGS - THE EFFECTIVENESS OF THE IPR

Introduction

As can be seen from the comparison of an audit with an IPR set out in Section 3 of this paper, there is a greater risk that misstatements in the financial statements will not be detected by an IPR compared to an audit. This is the principal reason why IPRs are said to provide a limited level of assurance. One measure of the relative effectiveness of the IPR and the audit is to compare the misstatements that came to light in the field trials as a result of the IPR and the audit respectively. However, in making such comparisons there should not be a presumption that the IPR would detect all the misstatements that were detected by the audit.

Differences arising from the IPR

As part of the engagement the accounting firm were requested to record the misstatements detected by the accounting work, the IPR and the corroborative audit work. The form that they were asked to complete to record this information is Form 3 in Appendix 9.

A summarisation of the results from Form 3 is set out in Appendix 6. The consistency with which firms recorded misstatements arising from the accounting work varied widely and therefore Appendix 6 summarises only the differences disclosed at the IPR and audit stages of the engagement.

Appendix 6 shows both the net amount of the differences disclosed at the two stages of the engagement and the number of differences identified.

The incidence of adjustments as between engagements can be summarised as follows:

	Pure IPR/audit	Engagements with accounting assistance	Total
No errors found at either stage	3	5	8
Errors at IPR stage only	3	3	6
Errors at both IPR and audit		2	2
Errors found only by audit	2	2	4

For eight of the twenty IPRs, misstatements were detected. On two of them additional misstatements were detected by the audit. There were four engagements where only the audit detected misstatements. These results suggest that although the IPR is capable of detecting misstatements in the financial statements, the audit is more effective at detecting misstatements.

The misstatements that were detected by the audit (and not by the IPR) were detected largely from the results of straightforward corroborative procedures such as supplier statement reconciliations, checking the additions of stock sheets and procedures relating to cut off. As can be seen from Appendix 6, in a number of instances the misstatements were material to the results of the client company.

Where firms, that also provided accounting assistance, had kept records of the adjustments arising from the accounting work, it was striking that almost all of the adjustments they made arose from the accounting work rather than the audit or IPR. On discussion with the firm's staff they were of the view that an IPR would not have detected all of the differences identified by the accounting work. As was noted in Section 5 one of the firms prepared the financial statements very quickly without carrying out their normal accounting procedures to check the accuracy of the figures. At this firm, when the IPR was performed no misstatements were identified. However, at the audit stage a number of misstatements were identified that the firm asserted would have been identified by their normal accounting procedures that they usually performed before commencing an audit.

The failure of the IPR to detect some of the differences subsequently identified by the audit may have been a result of the limited vision of the capabilities of the analytical work held by a number of practitioners. However, if the analytical work had been increased this would have had an effect on the hours and costs of the IPR.

Discovery of fraud

The IPR report specifically states that 'It is not within the scope of an IPR to consider whether fraud or illegal acts have occurred'.

On one of the engagements a fraud relating to a fictitious employee on the payroll was discovered through the performance of corroborative audit steps. The firm that undertook this audit did not identify the fraud as part of the IPR and through discussion expressed the view that an IPR, no matter how well performed, would not have identified the particular fraud.

This finding would seem to support the inclusion of the fraud disclaimer within the report on the IPR.

Opinions of practitioners on the effectiveness of various aspects of the IPR

Appendix 7 summarises the views of all the practitioners (partners, managers and seniors) concerning the effectiveness of the IPR with respect to detecting:

- material errors;
- going concern difficulties; and
- fraud and irregularity.

85% of the practitioners consider that an IPR would be less effective than an audit at detecting material errors and their views seem to be supported by the data on unadjusted differences that comes out of the study. From the practitioners' point of view, this would seem to support the use of negative rather than positive assurance in the reviewers' communication. It is not entirely clear how the concept of limited assurance should be communicated to stakeholders through the review report.

Opinions on the effectiveness of the IPR in detecting going concern difficulties is more mixed. 67% of the practitioners take the view that an IPR is as effective as an audit. This finding seems to indicate that there is no significant difference between the procedures adopted by the firms in the IPR with respect to going concern and those adopted in the audit.

Not surprisingly, perhaps, 91% of practitioners thought that the IPR would be less effective than an audit at detecting fraud and irregularity. This seems to support the specific statements in the IPR report to the effect that it is not within the scope of an IPR to consider whether fraud or illegal acts have occurred.

Those who thought that an IPR was as effective as an audit in detecting fraud and illegal acts did so on the basis that fraud by directors might be difficult to cover up if practitioners' enquiries were rigorous; giving rise to inconsistent answers or nervous body language on the part of the directors. However, those who thought an IPR had potential to detect fraud generally considered it to be ineffective with respect to the detection of innocent error. These views are explored further in Section 8.

7 – FINDINGS – OPERATIONAL IMPLEMENTATION OF THE ILLUSTRATIVE STATEMENT OF STANDARDS

Analytical Procedures

When briefing the firms the most difficult aspect of the IPR to communicate was the importance of the interrelationship between the analytical review and the enquiries made of directors. Following the pilot studies, the content of the briefing and the structure of Appendix II to the Statement were both changed in order to emphasise that the responses to the enquiries should be assessed for plausibility; and that one way to do this would be to relate the responses to the findings of the analytical procedures. In addition the performance of the analytical review may trigger a number of enquiries the responses to which need to be assessed for plausibility.

From the debriefings it became clear that:

- many (although not all) of the firms did not consider the performance of analytical procedures to be a strength of their practice, and that more guidance may be needed on the interrelationship of the analytical review and the enquiries made of directors;
- practitioners encountered difficulties in performing the specified analytical review procedures on the smaller clients where detailed accounting information is not maintained, industry data is not available, and budgetary information is sparse;
- many of the firms thought that the analytical procedures in Appendix II of the proposed Standard needed improvement and did not give a firm enough lead that the analytical review should inform and assist the enquiries. Some practitioners criticised the procedures for setting objectives at a high level but not in fact prescribing sufficiently detailed procedures;
- a number of practitioners seemed to be deterred from performing detailed analytics because they considered this to be corroborative work that is debarred by the draft Statement;
- practitioners had difficulties operationalising the concept of 'plausibility'. The opinion of many firms about the overall effectiveness of the IPR was very much coloured by their low opinion of the capability of analytical review to lead to an initial conclusion that an explanation given to the reviewer was implausible.

Representatives of one firm made the interesting observation that as they had taken a 'bottom up' approach to the overall assignment with the accounts preparation being done first that detailed analytical procedures did not have the prospect of contributing much to the job. As an example, they noted that analytical review might raise suspicions about capitalisation policies but the reviewer will already have pulled these figures apart and substantiated them in processing the asset register.

The research has clearly shown that the role of analytical procedures within the IPR process needs to be better explained both within the illustrative Standard and within the Appendix of specified procedures. Indeed there must be some question as to whether the analytical procedures can be specified with sufficient clarity to warrant including them as an element of Appendix II which is intended to be specified procedures.

Arising from the pilot studies that were carried out to prove the validity of the methodology to be used in the field trials it was concluded that more resource material on the use of analytical procedures might be of use to firms. However, the difficulty with developing suitable resource material is that the only

material published by the APB on analytical review is SAS 410 'Analytical Procedures', which is not really appropriate for the purpose. At subsequent briefings it was emphasised to the partners that they would need to plan the analytical procedures for the more junior staff and in particular to set expectations for the predicted outcomes of the procedures. From the debriefings it seems that this planning was frequently not done.

If Standards for IPR engagements are developed by the APB further consideration will need to be given to the way in which the requirements concerning analytical procedures are articulated.

Effectiveness of Appendix II

Based on the evidence from the debriefings and in particular reviewing the IPR files maintained by the firms it seems as though the Appendix of specified procedures was, with the important exception of the analytical procedures discussed above, generally speaking effective.

As can be seen from Appendix 8, (which sets out the responses of the seniors to the questions in the research instrument dealing with Appendix II), Appendix II was used without significant alteration on all but one of the engagements. Although a number of firms have suggested detailed improvements to the scope and wording of the procedures, only one firm felt it necessary to develop a different programme of procedures.

One of the partners expressed a concern that Appendix II has no requirement for the reviewers to reach intermediate conclusions and considered this a major weakness. 'There is nothing in Appendix II that indicates a need to sum up, just a requirement to sign up to the completion of Appendix II'.

Appendix II differs in content and structure from that in ISA 910 in so far as:

- a) there are many more procedures in Appendix II aimed at determining whether the accounting records are likely to provide a sound accounting basis for the financial statements; and
- b) the procedures in Appendix II are set out as a sequence of 'drop down' procedures to support the bold letter standards. Consequently procedures relating to, for example, debtors are dispersed rather than grouped together. The ISA 910 procedures, by contrast are sequenced by balance sheet and income statement caption.

There was support amongst the practitioners to the APB's approach to enhance the ISA 910 procedures to include specific procedures aimed at ensuring that the accounting records provide a sound accounting basis.

At the debriefings the researchers showed the practitioners the ISA 910 structuring of the list of procedures and obtained views on it. No particularly strong preference emerged for either structure. Some practitioners expressed the view that the ISA approach might be more helpful in engagements where there was a significant element of accounting assistance or where junior staff were used. They thought it would not be helpful when undertaking a pure IPR. On the other hand some seniors considered that the approach in Appendix II resulted in them having to ask questions on similar subjects (such as stock) in a haphazard rather than an integrated way.

Based on the research there would seem to be no compelling reasons to change the structure adopted by the APB.

Reliance on enquiry

Almost without exception the partners, managers and seniors involved in the field trials were uncomfortable with the fact that they had to rely on the integrity of the directors and were not

permitted (by the Statement of Standards) to test their reliance through obtaining corroborative evidence. One of the staff who had performed an IPR made the following observation: 'I was conscious of having to do a lot of leading in making enquiries in order to get responses that could be relied upon. It was the reviewer who was forming opinions about movements in the accounts and feeding them to the client. The reviewer would then receive confirmation of their own prejudices rather than assurance about the accuracy of the financial statements'.

There are a number of inferences that can be drawn from this comment:

- For IPR engagements to be performed effectively there may be a need for training staff in the making of enquiries.
- Appendix II should be reviewed to ensure that the questions are sufficiently specific as to what
 assurance is to be gained from each procedure.
- A question arises as to whether it is acceptable to provide assurance based on making enquiries
 of directors who have a low level of accounting expertise and who are unwilling to take
 ownership of the accounts. In such circumstances it may be necessary to consider providing the
 choice of either a compilation report or an audit opinion based on substantive work. A review
 report that is dependent on evidence obtained from the directors would seem to be inherently
 unreliable.

Prohibition on reviewers performing corroborative work

Paragraph 45 of the APB's illustrative Statement of Standards for Performing an Independent Professional Review provides guidance to reviewers for those circumstances where they initially conclude that they need additional evidence in order to express an unqualified review conclusion. In such circumstances the reviewers make additional enquiries and do not, themselves obtain corroborative evidence. The reason for this is that it would change the nature of the engagement from an IPR to an audit. ISA 910, by contrast, requires corroborative work to be performed to assist in removing uncertainty.

At the debriefings a number of the firms expressed some degree of concern about the Statement's prohibition on corroboration. The most basic concern is that without the capacity for corroboration a client can 'Tell you what they like'. One of the engagement partners was very concerned about the prohibition on corroboration. In his view if the objective is to cut costs then procedures such as physical verification of fixed assets and attendance at stocktakes do not take much time relative to the substantial assurance that they provide. He considered that the IPR should not be so pure as to exclude all corroborative procedures.

8 – FINDINGS – REACTIONS OF THOSE PERFORMING THE IPR

As part of the field trials the researchers met with the partners, managers and seniors who performed the IPRs. At some of the firms other partners and managers who have responsibility for technical matters within the firm were also interviewed. These interviews occurred at the briefing and debriefing sessions described in Section 4.

Forms 4, 5 and 6 of the research pack (see Appendix 9) served both to provide empirical data for input into the project and also as a mechanism to structure informal discussions with the individuals involved.

At the debriefing sessions a researcher typically spoke with seniors, partner and managers separately. The length of interviews was usually about one hour. Without exception everyone that took part in the trials seemed to have considered quite thoroughly their reaction to the IPR. The comments that the researchers have recorded, therefore, provide a rich source of input to the research and the objective of this Section is to provide a summary of the recurring themes that arose in these discussions.

Ability of companies to produce their own accounts

A substantial number of partners and managers commented that there appears to be an, unfounded, assumption underlying the IPR that companies generally have a finance director and, therefore, the competence to prepare their accounts up to the standard required by the Companies Acts. One partner commented 'There are probably very few companies even up to the proposed £4.8 million limit who will be able to do anything more than process their day to day accounts entries in Sage and produce a trial balance. This will leave them a long way from satisfying the requirements of the Companies Act'.

One of the larger firms informed us, for example, that they have 190 audit clients of which 160 clients expect that firm to produce accounts that are 'right'.

Many of the firms considered that their compilation procedures provided a higher level of assurance than the IPR. There were many reasons cited for this but in the main this is because the compilation service provided is much more than preparing a set of accounts produced by a commercial accounting package such as 'Sage'. A compilation typically seems to involve the performance of some procedures to confirm the accuracy of the financial statements. Often these procedures include the gathering of corroborative evidence such as debtor confirmations, supplier statement and bank reconciliations and attendance at stock takes.

One firm explained that their approach is to perform accounts preparation work to a standard that meets the directors' responsibilities for truth and fairness and they would do more substantive work than the IPR expects.

This view is supported by the cost information obtained from the field trials which is set out in Section 5. This data shows that where accountants are heavily involved in accounting and compilation work that the incremental cost of an audit is low in comparison to the cost of preparing the accounts. This is because much of the work that would be carried out as part of an audit of accounts wholly prepared by the directors has already been carried out by the auditors in preparing the accounts. Consequently when an IPR is substituted for an audit although there is a saving this is not as much as might have been expected because the compilation work includes many steps that would be regarded as part of an audit.

In many instances, the researchers were informed that accounts are being prepared by practitioners such that they can provide a high level of assurance. If the IPR were legislated for engagements where accounts have been compiled to such a high standard then the assurance provided by the practitioners' report might be lower than the actual level of assurance attained by the practitioner.

Where no accounting work has been performed by the firms then the savings are much greater, there is no risk that a lower level of assurance than that actually attained will be provided and, therefore, the potential benefit of he IPR can be more clearly seen.

Concerns over reliance on enquiries and subjective evaluations of plausibility

Many of the practitioners considered that the Achilles heel of the IPR is its reliance on enquiry of company directors and employees and its prohibition on the reviewer obtaining corroborative evidence.

One of the managers interviewed considered that an IPR should be regarded as a significantly different task as compared to an audit because its performance requires very different skills. 'The success of the enquiry process is largely dependent on the ability of the reviewer to assess the plausibility of subjective explanations rather than the ability to obtain objective evidence'.

The concern about relying on enquiry links in to the reliance that is often placed on the reviewer to compile the accounts on behalf of the directors. One manager expressed his concern in terms of there being little financial understanding within the company and being conscious of having to do a lot of leading in order to obtain meaningful responses. He considered 'That there was a possibility that the reviewer would form ideas about the movements in the accounts and inadvertently feed these to the client who would accept the ideas because they did not have the expertise to discern that the reviewers' ideas were not in fact true'. The reviewer, therefore, would receive confirmation only of their own prejudices rather than assurance about the accuracy of the financial statements. On the same subject, a partner from a different firm remarked that 'Without some corroboration of the financial awareness of the directors, judgments of plausibility would have an element of guess work that could not be controlled by professional standards'.

One partner from another firm commented 'Directors see the accounts as a necessary evil and have no incentive to actually understand the accounts process. Their need to know is therefore low and their willingness to buy in support is high. The IPR would therefore be valueless to them if all it was intended to do was confirm the plausibility of their explanations about the accounts because they pay others precisely so that they do not have to waste their own time becoming competent to provide plausible answers'.

A senior on one of the engagements commented 'I am concerned that the level of assurance provided by an IPR is impaired by the fact that the IPR essentially lacks teeth. There is certainly the risk that directors will provide the answers they think the reviewer wants to hear rather than the truth. Provided the answer is plausible the reviewer will accept the answer with no additional work being undertaken. The finance directors of large plcs would probably appreciate the consequences of lying to the reviewer. The less experienced director of an owner-manager business is more likely to regard the IPR as unnecessary red tape and essentially provide the answers which will see the reviewer off the premises in the shortest possible time'.

Others expressed a concern about the IPR's reliance on the integrity of directors. This reliance is accentuated by the Statement's prohibition on reviewers obtaining their own corroborative evidence. The partner and manager at one firm agreed that they would prefer to go further than is permitted by paragraph 45 of the proposed Standard because 'Unless the reviewer goes deeper then the client can tell you anything they like'.

One senior expressed the view that 'The IPR could be an effective replacement for the audit where a company has a good bookkeeper and no reason to dress up the books. However, as a reviewer can never know the company better than the directors there will always be a potential for the wool to be pulled over the reviewer's eyes'. In this

senior's view the IPR would definitely fail with a manipulative intelligent client who could present misstatements plausibly. On the other hand companies with competent bookkeepers and responsible directors are more likely to want the reassurance provided by the audit.

Another partner considered that the IPR could be quite dangerous in those circumstances where the directors have massaged the figures to make them look more plausible and to disguise a decline in business that may give rise to going concern problems.

A number of the practitioners expressed concern that the IPR would not pick up innocent errors where the accounts were still plausible to both the directors and the reviewers. One partner expressed his view on this matter in an interesting way as follows:

'There is not much confidence that an IPR would pick up innocent but silly mistakes — the financial awareness of company directors is generally low and if a mistake is made it will often be the case that the erroneous outcome needs to be a long way out before it is not incapable of acceptance by the directors. Even material misstatements can be rationalised and explained as 'ok' to other parties. This contrasts with the situation where there is deliberate manipulation: in order to hide deception, directors may not have the skills to lie consistently and expose themselves to being uncovered by expert reviewers. The IPR might, therefore, introduce two levels of likelihood of identifying material misstatements higher where the error is deliberate, but considerably lower where it is accidental'.

This point was brought home quite dramatically at another client where the partner explained, 'The IPR requires a well managed client – if there are no management accounts (apart from simple monitoring of turnover and cash) and no management appreciation of how the year-end figures arise from the company's activity, then leading questions from reviewers will give directors scope to construct plausible answers from the confusion. On this assignment, the bookkeeper was able to provide a very plausible explanation as to why wages had fallen during the year – unfortunately she had misheard the senior's question as to why wages had risen'.

New clients

A number of the practitioners expressed the view that their ability to perform an IPR was greatly facilitated by the fact that they had previous audit experience with the clients. Although they could not quantify it, many thought that the previous experience:

- a) gave rise to a cost saving that would diminish the more remote the IPR became from the last audit; and
- b) provided the core knowledge base on which the IPR was founded.

A number of partners expressed concerns about how the IPR would work on a new client. One partner cited the following example 'How would the review of stock be approached if the reviewer had no accumulated corroborative evidence that the company understood the requirements of an effective stock take and had been competent to carry them out'.

Another partner considered that it would be difficult to see how an IPR could be started without an upfront investment in audit procedures.

At another firm the view was expressed that the detection of material errors depends on the reviewer's ability to make an assessment of the integrity of the client and placing a reliance on this to judge responses. This, it was asserted, would be impossible with a new client.

The effectiveness of the IPR methodology therefore seems to be called into question in circumstances where the reviewer does not have the experience gained from prior audits or reviews.

Quality of staff and staff training

A number of partners expressed concern about their ability to train staff to perform IPRs effectively.

One partner observed that the IPR requires a high quality of staff with an ability to ask penetrating questions. A partner from another firm considered that 'The IPR requires different skills from those possessed by auditors – a reviewer would be able to do an audit but an auditor would not necessarily be competent to do an IPR. This is because the reviewer not only has to ask the right questions and analyse the responses given to spot implausibilities but to have the strength to stand up to implausibilities and press for further explanation. An ability to read body language would be advantageous'.

As can be seen from Section 5 on cost savings these savings largely arise through not using a junior member of staff on the engagement. Many partners expressed the view that they would not be able to develop seniors if there is no junior work to be done.

Absence of risk assessment

One partner considered that the IPR approach is flawed without an element of risk assessment and an ability to focus on particular aspects of companies. On a similar theme another partner noted that the reviewer needs to be aware of the key issues for the particular client but Appendix II only prompts questions about a range of generally applicable issues. Without the experience to see behind the questions reviewers could skate over some of the more important matters for a particular company.

The researchers also spoke to a number of bankers responsible for risk management in lending at some of the larger bank headquarters. Their lending techniques are focused very much on individual risk assessments rather than establishing blanket rules for companies meeting certain size criteria. This might indicate that the procedural approach of the IPR is incompatible with the approach that bankers take to assessing the creditworthiness of customers.

Benefits of IPR

Although the IPR as an engagement was considered to be fundamentally flawed by many of the practitioners, the list of enquiries in Appendix II to the Statement was regarded as quite a valuable tool. A number of firms indicated that they might incorporate it into the planning section of their existing audit procedures. As one partner put it 'The IPR had one clear benefit in that it helped him to find out more about the business than had previously been the case with the accounts preparation and audit process in previous years. The enquiries required by Appendix II considerably refreshed his understanding of the client's strategies and its ways of working'.

The review report

Almost without exception the partners, managers and seniors taking part in the study reacted unfavourably to the proposed review report (see page 87). Concerns were expressed about its negativity and the fact that it describes an IPR in terms of what it is not.

During the pilot studies a manager at one of the firms concluded that APB's proposed review report is very vague in terms of both describing what has been done and expressing the reviewers' conclusions. The manager was concerned that the review report would not be understood because 'It does not adequately describe the areas covered by the review and uses jargon such as 'analytical procedures' without explaining what these terms mean'. The manager considered that a more effective review report would set out more details of the different aspects of the IPR and express a conclusion on each of these aspects. The manager developed an alternative review report that was used by the researchers in discussion with those who performed the IPR.

The alternative report was more descriptive regarding both the review work performed and the respective responsibilities of the directors and the practitioners. Although opinion was divided as to whether or not the alternative review report was an improvement, discussing it served as a useful catalyst in ascertaining the views of practitioners as to what the IPR report should comprise. The following matters were raised by those interviewed.

- A number of the firms took the view that the review conclusion in APB's draft Statement is too negative especially in the way it describes an IPR in terms of what it is not. A number of the firms thought that although the alternative report was more descriptive about the review procedures that it still did not say much more that would be of value to stakeholders.
- One partner considered that a positive rather than a negative conclusion should be expressed. This view, however, seems to be at variance with a number of others who thought that the review conclusion is still too much like an audit report and should be distinguishable by its style from an audit report rather than by a statement that it isn't one.
- Some of the firms took the view that the review conclusion needs to explain the extent of the involvement of the firm with the preparation of the accounts. As one manager put it 'The new review conclusion is clearer as to what the client gets for their money, but it still doesn't say whether the accounts are right'. One senior commented 'The new review conclusion is still too concerned with making sure that no one thinks an audit has been carried out it would be acceptable if it was taken just a little further and became an accounts preparation certificate'. Others, however, took the view that the IPR conclusion should not deal with the accounts preparation work at all
- Another partner expressed the view that the review conclusion has no positive aspects than can be sold to the client. 'The conclusion needs to have positive aspects if it is to be the product that audit firms are going to have to sell'.

One partner expressed concern over negative assurance as follows 'It has the danger of playing down the skills of the accountants. There is no clear sense in which the conclusion makes clear how much expertise has been brought to bear in the work needed to arrive at the signature. Perhaps something more in line with the long-form report of the 1970's would be more professional'.

The APB has noted the concerns of the practitioners regarding the wording of the review report and the need they perceive to include a more positive description of what an IPR comprises. However, no matter how clearly the scope of the IPR is explained, and how different the review report is from an audit report, there will always be a risk that users of the financial statements might assume that an audit has been performed. This risk can only be dealt with by ensuring that the review report explicitly states that an audit has not been performed.

Concluding comments

Overall, practitioners considered that the perceived drawbacks of the IPR far outweighed the perceived advantages. Indeed many of those interviewed perceived only drawbacks. Few, if any, of those undertaking the field trials would be supportive of the introduction of the IPR as a requirement of Company Law. A number of the partners expressed the view that if the audit exemption limit is to be raised that the IPR should not be legislated for. Many partners considered that companies should be left to form their own relationships with financial advisers in preference to having to carry out an IPR which they considered, often for different reasons, to be fundamentally flawed.

The views of the practitioners seemed to be particularly coloured by the negativity of the proposed review report and the prohibition on them performing corroborative work to resolve uncertainties. Although they understood APB's reasoning for seeking to clearly distinguish an IPR from an audit they seemed to consider the result inherently unprofessional.

However, not all views were negative and in some instances the researchers sensed that initial negative views ameliorated somewhat between the briefing and debriefing sessions. A compliance partner at one of the larger firms monitored the performance of the IPR closely and concluded as follows:

'It seems to me that the IPR essentially 'strips out' of the audit the thinking elements i.e. an emphasis on analytical review and discussions with the client, although there is no necessity to substantiate the explanations. If done well I believe that this is perhaps the most useful part of an audit as it is a test of whether the accounting work carried out makes sense in terms of our knowledge of the business. The problem is that this is often the most difficult part of an assignment to get staff to perform well as it requires both experience and confidence. If performed badly then I believe that this would add little value over an accounts preparation only job....There is also the view that much of the substantive type audit work is of little value. However, reviewing a file where none of this has been carried out does serve to emphasise what is missing...In conclusion I believe that whilst the IPR does not give as much assurance as an audit it is a useful report provided that it is performed well'.

9 – FINDINGS – THE RESPONSE FROM THE CLIENT

The purpose of the interviews with client company directors was to understand the directors' perceptions of:

- (1) the drivers of stakeholder²¹ demand for assurance; and of
- (2) how well that demand could be met through an IPR.

Understanding the sources and nature of the stakeholders' demand for assurance provides the key to consideration of the second question above. Moreover, it was also necessary that the interviewees understood the purpose of the IPR and how it is carried out. Sources of understanding of the IPR were the directors' discussions with the auditors both prior to the exercise and during the conduct of the IPR. Additional explanation of the IPR was given by the researchers during the conduct of the interviews and, where helpful, the interviewee was taken through a comparison of the audit and IPR reports. It was recognised that in future much of the understanding of the IPR for both directors and outside stakeholders would come from the IPR report and accordingly these interviewees were invited to comment on the draft report given in Appendix III to Appendix 10 of this paper (see page 87).

The drivers of demand

The circumstances of the client companies varied widely in terms of:

- (a) the pattern of stakeholder interests (ie the number of stakeholders, the nature and size of their stake);
- (b) the level of internal accounting expertise; and
- (c) the risk profile presented by the client's business activity.

Each of these three factors, prima facie, might be expected to drive the stakeholders' demand for assurance and hence the client's attitude to both the audit and the IPR, in terms of their ability to promote better (and lower cost) relations with key stakeholders. At one extreme the client might be expected to regard assurance activities by an outside auditor/reviewer as giving low added value. This would be when the company is owner managed, has no outside borrowings, a high level of internal accounting expertise and a low risk business. However, even then there may be a demand for assurance from customers, suppliers and the Inland Revenue. At the other extreme a client with high borrowings, little internal accounting expertise and a 'high risk' business is likely to find that an audit adds considerable value in terms of assurance for, and hence better relations with, outside stakeholders. Furthermore, the client's directors are likely to want reassurance for themselves as to the company's financial performance and integrity. However, few of the companies involved in the field trials were located at either of the extremes discussed above. Instead many of them presented different patterns of stakeholder interests, levels of internal expertise and business risk. Given this 'milieu' it is not surprising that the responses of the client representatives interviewed should reflect a significant diversity of attitude to both the audit and the IPR's ability to meet stakeholder needs.

Patterns of stakeholder interests

The interviews confirmed outside stakeholder interests as a key driver of the client's response to the

²¹ Stakeholders include not only directors and shareholders, but bankers, other financiers, the Inland Revenue, suppliers and customers. Our conversations were with the directors, who also on occasion spoke as users of the audited accounts of their suppliers and customers. We also conducted conversations with bank representatives responsible for their banks' credit policy in the relevant small business market (see Section 10).

experience of undergoing the IPR. For example the directors of several companies commented that the IPR would be fine 'Provided it was accepted by the bank', and where applicable the venture capitalists or finance company, and the Inland Revenue. One of the larger clients maintained that there was no evidence that the audited accounts, though submitted, were ever used by the bank. However this company also submitted regular management accounts and so the annual accounts could play a role as ex post confirmation of the management accounting numbers without the client necessarily being aware. Another client whose owner-managed business did not rely on any outside finance did not see the need for an audit or an IPR. This company was rarely asked for audited accounts by either customers or suppliers. This company stated that 'We would opt for an IPR over an audit but would prefer neither and instead would spend the money on specific consultancy projects'.

It was interesting that whilst some interviewed client companies did not give weight to suppliers as being stakeholders, other clients did. For example, one company had been turned down by a prospective supplier of goods due to a perception of excessive risk based on the accounts. Several companies recognised the potential importance of their own audit because they used the audited accounts of their customers and suppliers. One company reported that 'The company secretary does request audited accounts from potential new customers and suppliers, in order to confirm that the company has some reliable history and to allow analysis of particular aspects of the P&L account and balance sheet'. As suppliers, therefore, many interviewees felt that access to audited accounts was important. Thus it might be expected from a creditor's perspective, that if the statutory audit requirement were removed in relation to the customer's accounts then the statutory IPR would be better than nothing.

However, this thought was challenged vigorously by one interviewee as follows: 'The overall view in our industry is that it would not be a good idea to place more trust in directors. A significant amount of income is lost from fly by night companies that shutdown just before their creditors become substantial enough to justify legal action and open up again in a new guise. Unless these directors can be made accountable, then the IPR is too weak to improve the situation'. Hence the lack of corroborative testing of directors' assertions was seen as a fundamental weakness. A similar view was expressed by the company secretary for one of the larger clients, who felt that an IPR would not be welcome to shareholders and other stakeholders. He argued that 'If it were explained to them that an IPR does not involve any testing of transactions, there would be such a huge decline in the assumed level of assurance that it is almost inevitable that the company would voluntarily have an audit'. However the same company secretary felt that much of the stakeholder enthusiasm for the audit could be based on a misunderstanding that the audit checked every transaction.

The chances of any company requesting an audit or an IPR for the sake of outside stakeholders is greater when those stakeholders have real clout. There remains the issue of whether weaker stakeholders such as a passive minority shareholder (a feature of many of the client companies) or a supplier that is also a small company should be protected by a statutory requirement for an audit or an IPR. If there is no statutory requirement for an audit, then suppliers might still be able to gain assurance through a credit agency that could use its clout to obtain a 'voluntary' audit or IPR, and pass on its assessment of credit worthiness. This arrangement would also have the advantage of giving weaker or fragmented stakeholders access to the technical expertise of the agency.

The pattern of stakeholder interests and the power relations between stakeholders is something that is difficult for legislation to capture. Hence rather than focusing on the real drivers of the demand for assurance, legislation discriminates between companies for purposes of the statutory audit (and potentially the IPR), through surrogates such as size. A further research project might study the relations between size and the drivers of stakeholder demand in order to validate or challenge the choice of surrogate. The study might also look at what has happened in the £350,000 to £1 million turnover category to see to what extent audits have continued voluntarily or have been required by powerful stakeholders in spite of the statutory exemption.

Informal discussions with bank representatives responsible for credit policy towards smaller companies, revealed a sceptical view of blanket size criteria such as turnover as suitable for determining whether or not they would wish an IPR or an audit to be performed. Bankers preferred to use risk analysis on a 'client by client' basis to determine the level of assurance they would require.

Levels of internal expertise

Each of the client representatives interviewed saw the client company as a stakeholder in the audit/IPR. However, as might be expected the audit/IPR tended to be seen as more important by those clients who did not have internal expertise in accounting. What came across as particularly valuable to the smaller clients was the overall relationship with the outside professional accountant and comfort was not easily attributed to particular parts of the overall service. These clients did not believe that the relationship with their outside accountants would change fundamentally if an IPR replaced an audit or indeed if there was no statutory requirement for either. For example one smaller client with an efficient bookkeeper but no other internal expertise said 'I am willing to pay the price of an audit for peace of mind and I appreciate a finance professional going through the business and directing me away from irregularities. I want the reassurance an audit provides and I am not particularly interested in the assurance an IPR provides for others'. Although this client director sees the audit in terms of his own need, it is likely that if the client needs an audit for reassurance then the client's stakeholders will perceive a similar need in respect of their peace of mind.

Larger firms, however, with internal expertise were in general less enthusiastic about an audit as a source of assurance for the directors. For example the MD and company secretary of one company both had accounting and auditing expertise and reported that 'If the company wanted effective assurance about the robustness of say its cash receipting systems, the work would require a much greater effort for the huge number of transactions that take place than the effort that the external auditor applies for purposes of the statutory audit'.

There was a recognition however from the MD that the audit had some deterrent effect in inhibiting employees from misbehaviour and that it might be possible to continue this effect through the IPR, provided employees were not aware of the removal of testing. Nevertheless the MD remained convinced that the audit did not give sufficient added value for either internal or external stakeholders.

Understanding the review

In a number of cases interviewees were taken through the standard SAS 600 audit report and the proposed review reports (set out as Appendix III to Appendix 10 of this paper) by the researcher. From a comparison of these reports the interviewees saw that an IPR did not include:

- Examination on a test basis of evidence relevant to the amounts and disclosures.
- Assessment of the significant estimates and judgements made by the directors.
- Consideration of the appropriateness of the accounting policies to the company's circumstances, consistently applied and adequately disclosed.
- Evaluation of the overall adequacy of the presentation of the information.

From the point of view of the company as stakeholder the interviewees were generally relaxed that there should be no test examinations. However, the overall consensus was that the three other activities should be carried out in the IPR. In the case of clients without internal accounting expertise, there was an expectation that these three activities would generally be done by the outside accountant as part of the compilation. The directors were relying on the professionals to get the accounting policies and the overall adequacy of the presentation right. In many cases this reliance extended to assistance with key estimates and judgements.

Those companies with internal accounting expertise were relaxed that the IPR did not include work on financial systems since systems were generally within the internal competence of the company. On the other hand, larger companies in particular expressed some dismay that the reviewers would have no responsibility for fraud or corruption since the internal expertise of the company did not generally extend to the capacity to search for fraud. However, if these matters were of concern internally then they could be covered as a separate assignment for the external reviewer.

There was some concern expressed as to the overall (external) effect of removing the requirement to search for fraud and irregularity. For instance one director expressed the following view 'I do not have any concerns for my own company if the assurance was reduced or removed but I am worried that making it clear the reviewers do not have responsibility for fraud and corruption provides significant opportunities for companies that are less scrupulous'. Comments on the reviewers' absence of responsibility for fraud resonate with those expressed on the absence of corroborative evidence for directors' explanations and representations. As preparers of accounts, directors are relaxed about not having their representations corroborated. If they wish to have corroboration then it can be an agreed-upon-procedure. However they recognise other users will find the IPR to be 'Only as good as the trust you have in the directors'.

A key activity in the IPR is the assessment of whether the accounting numbers are plausible in the light of the reviewer's (and client's) understanding of the business and whether the reviewer's (and client's) understanding of the business is plausible in the light of the reported accounting numbers. Thus, the IPR requires a practitioner-client dialogue round the interaction between the accounting numbers and the client's business. The IPR places much reliance on this dialogue during which it is possible that both the reviewer's and client's understanding of the business advances. Given this emphasis it is debatable whether an expertly conducted IPR develops understanding of the business more than an audit, and whether an understanding based on audit experience is an adequate platform for the IPR.

For the most part, client directors interviewed had not noticed any great practical difference between the audit and the IPR in terms of the questions asked of them during the two activities. It was felt in most cases that the reviewer had a good understanding of the business sufficient to conduct the necessary enquiries. However, many interviewees felt that understanding of the business gained from past audits would in fact degrade over time if the IPR replaced the audit. For example, one interviewee felt that 'Without the cumulative experience of the audit, reviewers will not be able to develop an understanding of the company's business in the time they spend on the IPR, sufficient to be able to judge the plausibility of management explanations'. Similar concerns were expressed in respect of new clients where the experience gained on prior audits would not be present. The implication of these comments is that audit testing and verification is regarded as an important source of knowledge of the business.

However, at least one interviewee felt that the IPR had generated more challenging and insightful questions than the audit and had helped his understanding of his business. 'The questions were different from what I am used to – they did inspire me to think deeper about the company's financial affairs. I had to do some thinking to answer some of the queries, but found it valuable to be challenged as to how the business had got where it had and where it was going'. There is thus some modest evidence of the ability of the IPR to promote business thinking.

The review report

In relation to the IPR an important potential source of understanding for the directors (and outside stakeholders) is the review report. A number of directors commented upon the review report as given in Appendix III to Appendix 10 of this paper. The main comment was that the report gave the objective of an audit but not of the IPR. It is not altogether clear, for example, that the purpose of enquiries of directors and performance of analytical procedures is to assess the plausibility of the financial statements. It is clear to directors from the review report that an IPR is 'less than' an audit. However many of the omissions such as the absence of testing only become clear when there is a comparison with an audit report. It is clear from the review report that fraud and illegal acts are not addressed and that conformity with the Companies Acts is considered. The position of going concern is less clear. Some readers felt that the review report gave less confidence that the company was a going concern than did the audit report. The IPR was considered to be more judgmental than an audit. Thus the reference to the UK standards for Independent Professional Reviews in the review report does not get across the essentially procedural, non-judgmental basis of those standards. One interviewee commented that 'My understanding of the assurance provided by the review conclusion is zero, because of its crucial reliance on an understanding of what would constitute 'UK standards for IPRs'- without knowing what these standards require it is impossible to scope

the work done'. It is particularly true of negative assurance reports, of which the review report is an example, that communicating the assurance requires a communication of the work performed.

The risk profile of the business

Other things being equal, the greater the risk associated with a business activity the greater the demand from stakeholders for assurance as to the actual outturn. At the same time when there is greater risk, the range of plausible outcomes and explanations increases, rendering the IPR less convincing as a deliverer of assurance. This is particularly true for outside stakeholders but directors too might welcome corroboration of what they think is the explanation.

Similarly, inside a given business some activities or issues may be highly predictable while others are volatile or risky. Once again the IPR is less effective with respect to the riskier activities. For example, one of the interviewees describes his company as a 'stock' company since by far the most important issue in the company's reporting of performance is the valuation of stock. The IPR would provide no independent assurance in this area and hence it was expected that the bank and venture capitalist stakeholders would continue to require an audit. For other clients there were similar 'high risk' areas though the clients' directors did not assert that stakeholders would, therefore, necessarily require an audit. Conversations with bank representatives supported the view that they might in many high risk cases expect to continue with an audit. However, this would be subject to competitive pressures and might not happen in a market where there was a shortage of borrowers.

This issue goes to the heart of the debate about the 'risk based' audit versus the procedurally based IPR. The IPR gives relative certainty as to procedures but these procedures deliver a wide range of possible assurance depending on the risk level and profile of the client's business activity.

Suppose the resultant assurance is low (i.e. at the bottom end of the range) because there is an important uncertainty that the IPR cannot resolve due to lack of corroborative testing. The review report then includes an explanatory paragraph in respect of the 'fundamental' uncertainty as per appendices VI and VII of Appendix 10 to this paper.

There is a possibility that such a review report might be quite common though none of the field test reviewers indicated that they felt it necessary to issue one. However one of the field test reviewers had in the past issued an audit report with a fundamental uncertainty paragraph in respect of the directors' valuation of stock, the valuation having been accepted since detailed testing was judged impractical. It was remarked that this audit report had been issued to the client's stakeholders without any comments being received. It is possible, therefore, that review reports with fundamental uncertainty paragraphs might be acceptable to stakeholders. Use of such paragraphs is the first move in trying to discriminate between the quite different levels of assurance that can be associated with procedurally based IPRs.

Concluding comments

The key question which the discussion and analysis of the interview evidence from client company directors has addressed is

What is the nature of stakeholder demand for assurance and how well is this demand met by the IPR?

In order to address this question it was necessary for the discussions to explore the drivers of stakeholder demand for assurance with each client and for the directors to understand the purpose and nature of the IPR. Thus the broad framework for each interview was first stakeholder expectations, secondly the directors' experience and understanding of the IPR and finally their verdict on the cost effectiveness of the IPR.

Overall there was little conviction that the IPR could meet the needs of either external or internal stakeholders. Notably the lack of corroboration of directors' explanations, the absence of testing and of a responsibility for fraud lead to comments that the IPR is only as good as the trust you have in the directors, that the company would have to have a voluntary audit, and that there would be significant opportunities for unscrupulous companies. Of course these comments would still apply if there were no IPR or audit. The accounts would only be as good as the trust you have in the directors, the company might still need an audit to meet the needs of powerful stakeholders and there would be scope for unscrupulous companies. The difference is that the cost of the IPR would not be imposed by statute.

An interesting difference emerges between those, mainly smaller, companies that have little internal accounting expertise and the companies that do have such expertise. The smaller companies are less critical of the audit, seeing it as an integral part of the wider relationship with their professional accounting advisers.

The companies with a good level of internal expertise are less inclined to regard the audit as adding value. One interpretation of this could be that there is a need for all companies to have access to professional accountants either internally or externally in order to provide the assurance needed by internal and external stakeholders. This could be achieved, for example, by a statutory requirement for a qualified accountant to be responsible for compiling the accounts. However, definitions of 'compiling the accounts' and 'qualified accountant' may be difficult to establish.

There is recognition by directors that powerful outside stakeholders such as banks and finance companies might continue to insist on an audit. There is also recognition that suppliers to and customers of a small company do place reliance on audited accounts and smaller suppliers in particular might not be in a position to force an audit in the event of the statutory requirement being removed. It remains an open question whether credit agencies might step in to provide suppliers with the assurance they require and perhaps use their clout to force audits or other forms of assurance.

Only one client reported that the IPR had asked more interesting and challenging questions than the audit. This was the only indication that in practice the IPR could lead to an improved and in-depth practitioner-client dialogue around the interaction between the accounting numbers and the client's business. Such a dialogue could add value to the client's strategic development of the business and might help to justify the IPR as a driver of economic development in terms of 'think small first'. However, this potential benefit was not much in evidence in the sample and would depend upon the client and reviewer's willingness and ability to engage in the necessary dialogue. Nevertheless, it might support the view that the IPR be available on a voluntary basis where the conditions suggested that it could add value to the business.

10 – DISCUSSIONS WITH BANKERS

Although not part of the field trials per se, the researchers had a number of discussions concerning the IPR with small company and risk management experts from a number of banks.

Not surprisingly these meetings did not produce conclusive outcomes in the sense of providing a completely clear picture of what the likely attitude of banks might be towards the IPR. This reflects the fact that the IPR is a new and rather abstract concept to bankers as well as to practitioners and company directors. As a consequence, the concerns of the bankers tended to be focused as much on the implications to them of the loss of the audit as on the possibilities of the IPR.

Loss of the audit

In terms of the loss of the audit, the bankers we spoke to did not consider the statutory audit in terms of 'bureaucratic red tape'; rather they seemed to regard the audit as an important element of the corporate governance of small and medium sized businesses. A number of them questioned whether those who advocate the audit exemption have considered the consequences for companies that are growing and who may need an audit track record at some point in their growth. Many lending decisions made by banks are, apparently, significantly influenced by the client's audit track record. The lack of a track record may increase the cost of capital for such companies.

Some of the bankers considered that a compelling case could be made for very small companies, that cannot afford their own in-house accounting support, to have an audit. Although bankers understand that practitioners who provide accounting assistance frequently seek to ensure that the accounts are 'right' they are reluctant to rely on unaudited financial statements on that basis in the absence of professional standards which require that level of performance from practitioners. A connected observation, that was of particular interest, was the view expressed by some that the perceived quality of the assurance provider may be as important a consideration to bankers as the level of assurance purported to be provided.

Concerns with the IPR

When focusing on the IPR bankers identified two significant drawbacks. First, they were very concerned that the practitioners' conclusion was not expressed in terms of the true and fair view. Although the bankers understood:

- that the directors' responsibility to prepare financial statements that provide a true and fair view remains unchanged; and appreciated
- that the limited procedures undertaken by the practitioner are insufficient to enable them to opine in true and fair terms

they were nevertheless concerned that an IPR may not be as actionable as an audit and consequently of less worth from their perspective.

The bankers second concern was that practitioners seemed able to readily lay off risk to bankers by either reporting uncertainties in an indiscriminate way or reporting uncertainties that could have been resolved by the practitioner obtaining corroborative evidence. This concern echoes some of the concerns about the prohibition on corroboration discussed in Sections eight and nine.

Potential of the IPR

Not all of the views expressed by bankers towards the IPR were negative. They seemed to agree that an IPR would be better than no assurance at all. As evidenced by some of their views reported above, they largely discounted the idea that they would not understand the meaning of the different levels of assurance between an audit, an IPR, and accounts preparation.

In some circumstances the bankers thought that an IPR may fit some customers needs better than an audit, especially as it is cheaper. Such customers may be those that do not borrow heavily and have a good track record or customers in sound low risk businesses.

11 – POSSIBLE LIMITATIONS OF THE RESEARCH

- 1. The field trials were performed by firms willing to participate and secondly each firm selected a client willing to participate. The number of trials performed is small and not random. Nineteen of the twenty clients were in the £1 million to £3 million turnover range. Only one client had a turnover that exceeded £3 million.
- 2. ISA 910, the International Review Standard, was not field tested. ISA 910 does allow an element of corroboration in certain limited circumstances and this might have avoided some of the adverse comment attracted by the APB's version of a review standard on the issue of corroboration. However, if corroboration is allowed there is the potential for greater cost and for greater confusion with the audit.
- 3. The IPR was a new experience for all of those participating in the sample. It is not necessarily the case that adverse attitudes at the point of introduction would sustain over time once there was greater familiarity with and preparation for the IPR, especially in the area of analytical procedures and their inter-relationship with the understanding of the business.
- 4. The statistics in Appendices 2 to 6 are as reported to the researchers by the practitioners and there may be inconsistencies in the way in which practitioners have completed the forms and in particular the way in which time has been analysed between headings.
- 5. The researchers have tried as hard as practicable to simulate reality in the conduct of the IPRs. However, especially due to the briefing and debriefing there is a possible spotlight effect whereby reviewers (and directors) perform differently when they know they are being observed by researchers. Moreover, in the field trials there was no potential legal liability exposure for the practitioners. If the IPR was real and achievable then it is possible that senior personnel (partners) would be drafted in to assume more of the work, especially the analytics. It is also possible there would be greater use of uncertainty paragraphs in the review report, to give an element of protection. One of the concerns raised by bank representatives was that the IPR should be actionable, if it was to replace the audit.
- 6. Care must be taken in projecting the actual cost savings that might be realised on the basis of savings identified in the field trials. Actual costs incurred by firms may differ when they are performing IPRs as real engagements on a regular basis.

Classification of clients by turnover

Decile	Turnover	No accounting assistance	Accounting assistance	Total
1	£1,000,000 to £1,399,000	-	7	7
2	£1,400,000 to £1,799,000	•	3	3
3	£1,800,000 to £2,199,000	•	2	2
4	£2,200,000 to £2,599,000	2	1	3
5	£2,600,000 to £2,999,000	2	2	4
6	£3,000,000 to £3,399,000	•	-	_
7	£3,400,000 to £3,799,000	•	-	-
8	£3,800,000 to £4,199,000	•	-	_
9	£4,200,000 to £4,599,000	•	-	_
10	£4,600,000 to £5,000,000+	1		1
	Sub total	5	15	20
	Accounting assistance performed by different		(2)	
	staff	3	(3)	
	Total	8	12	20

The average turnover of all the clients is

£2,028,000

We have split the clients between those engagements that involved accounting assistance and those that did not. Eight of the engagements were considered to be 'pure' IPRs. Of these, however, three involved accounting assistance that was either performed by staff of the accounting firm that were entirely different from the staff performing the IPR or performed at a different time to the audit and the IPR. The remaining five of the eight clients were engagements where the firm provided no significant accounting assistance.

The average turnover of the 15 clients where there was accounting or compilation work is	£1,659,000
The average turnover of the 5 clients where there was no accounting or compilation work is	£3,135,000
no accounting of compliation work is	$\underline{\omega}_{\mathcal{I}}, \underline{1}_{\mathcal{I}}, \underline{0}_{\mathcal{I}}, \underline{0}_{\mathcal{I}}$

Hours spent on the IPR and accounting compared to the audit and accounting

No.	Accounts preparation and IPR hours	Accounts preparation and audit hours	Saving of hours	Saving as a %
	(A)	(B)	(C)	(C as a % of B)
	Hours	Hours	Hours	%
1	143	175	32	18
2	20	60	40	67
3	11	46	35	76
4	26	86	60	70
5	94	126	32	25
6	29	38	9	24
7	23	65	42	65
8	23	40	17	43
9	9	55	46	84
10	31	74	43	58
11	51	83	32	39
12	66	82	16	20
13	76	193	117	61
14	21	104	83	80
15	70	95	25	26
16	55	89	34	38
17	18	91	73	80
18	54	86	32	37
19	72	79	7	9
20	51	101	50	50
TOTAL	943	1,768	825	47
Divisor	20	20	20	
MEAN	47	88	41	47

Further analysis of hours data

	Accounts preparation and IPR hours	Accounts preparation and audit hours	Saving of hours	Saving as a %
	(A)	(B)	(C)	(C as a % of B)
Clients involving no accounts preparation or compilation (8 clients)	186	597	411	69%
Mean (8)	23	75	52	
Clients with accounts preparation (12 clients)	757	1171	414	35%
Mean (12)	63	98	35	
Total 20	943	1,768	825	47%
Mean (20)	47	88	41	47%

Cost of the IPR and accounting compared to cost of the audit and accounting

No.	Accounts preparation and IPR hours	Accounts preparation and audit hours	Saving of hours	Saving as a %	
	(A)	(B)	(C)	(C as a % of B)	
	£	£	£	%	
1	6,404	7,418	1,014	14	
2	996	2,715	1,719	63	
3	470	1,952	1,482	76	
4	1,291	4,295	3,004	70	
5	5,050	6,973	1,923	28	
6	1,588	2,190	602	27	
7	1,552	3,753	2,201	59	
8	840	1,500	660	44	
9	485	2,595	2,110	81	
10	1,335	2,560	1,225	48	
11	2,258	2,828	570	20	
12	2,416	3,024	608	20	
13	3,459	6,322	2,863	45	
14	861	3,310	2,449	74	
15	3,096	3,215	119	4	
16	1,933		965	33	
17	1,230	3,373	2,143	64	
18	3,385	4,032	647	16	
19	3,438	3,754	316	8	
20	5,439	11,096	5,657	51	
TOTAL	47,526	79,803	32,277	40	
Divisor	20	20	20		
MEAN	2,376	3,990	1,614	40	

Further analysis of cost date

	Accounts preparation and IPR hours	Accounts preparation and audit hours	Saving of hours	Saving as a %
	(A)	(B)	(C)	(C as a % of B)
Clients involving no accounts preparation or compilation (8 clients)	£12,368	£31,354	£18,986	61%
Mean (8)	£1,546	£3,919	£2,373	
Clients with accounts preparation (12 clients)	£35,158	£48,449	13,291	27%
Mean (12)	£2,930	£4,037	£1,108	
Total 20	£47,526	£79,803	£32,277	40%
Mean (20)	£2,376	£3,990	£1,614	40%

Misstatements disclosed at various stages of the engagement

No.	IPR Stage Dr/(Cr)		Audit corroboration Dr/(Cr)		Profit/(loss) before tax
	£	No	£	No	£
1			(21,994)	3	66,610
2	2,481	2***	-	0	166,759
3		-	-	-	
4	-	-	(4,777)	4	(5,600)
5	3,085	1	2,873	4	(25,700)
6			-		
7	-		(12,000)	1	21,000*
8			_		
9	(8,400)	2	-		170,711
10		-	_		
11	(127)	4	-		31,444
12	2,806	1	-		(171,037)
13	32,000	1	6,228	5	390,391
14			18,282	10	174,000
15	(13,262)	2	-		192,730
16	-		-		
17	-		-		
18	-		-		
19			-		
20	-	1**		-	48,000

Note: A debit (dr) denotes adjustments that decrease profit and a credit (cr) denotes adjustments that increase profit

* denotes profit after tax and before audit adjustment ** this was a balance sheet adjustment of £23,000

*** one of the adjustments was a balance sheet adjustment

The incidence of adjustments as between engagements:						
	Pure IPR/audit	Accounting assistance				
No errors found at either stage	3	5				
Errors found at IPR stage only	3	3				
Errors found at IPR and audit		2				
Errors found at audit only	2	2				
Total	8	<u>12</u>				

Summarisation of practitioners' views on effectiveness of the IPR

Opinions as to effectiveness of IPR in detecting material error

Partner		Manager		In- charge		Total	
No.	%	No.	%	No.	%	No.	%
15	88	11	85	13	81	39	85
2	12	2	15	3	19	7	15
0	0	0	0	0	0	0	0
	No. 15	No. % 15 88 2 12	No. % No. 15 88 11 2 2	No. % No. % 15 88 11 85 2 12 2 15	No. % No. % No. 15 88 11 85 13 2 12 2 15 3	No. % No. % No. % 15 88 11 85 13 81 2 12 2 15 3 19	No. % No. % No. % No. 15 88 11 85 13 81 39 2 12 2 15 3 19 7

Opinions as to effectiveness in detecting going concern difficulties

	Partner		Manager		In- charge		Total	
	No.	%	No.	%	No.	%	No.	%
Less effective than an audit	7	41	2	15	6	38	15	33
Same as an audit	10	59	11	85	10	62	31	67
More than an audit	0	0	0	0	0	0	0	0

Opinions as to effectiveness in detecting fraud and irregularity

	Partner		Manager		In- charge		Total	
	No.	%	No.	%	No.	%	No.	%
Less effective than an audit	16	94	11	92	14	88	41	91
Same as an audit	1	6	1	8	2	12	4	9
More than an audit	0	0	0	0	0	0	0	0

Note: One manager did not express an opinion with repect to fraud and irregularity

Extent to which Appendix II of the proposed Statement was utilised by firms

This table is based on the feedback from the staff member who led the field work and is based on their responses to questions 4,5,6 and 8 of Form 4

No	Appendix II completed	Additional procedures	Procedures not performed	Helpful
1	,	None	None	Yes as a guide to depth of work requested
2	,	Yes on non trade debtors and creditors that are not dealt with	None	Yes followed completely
3	3	None	None	Yes made me think about what reliance to place on figures
		None	None	Yes very helpful
5	3	Yes, four procedures which are performed on all clients. An example is checking all depreciation calculations	Those relating to statutory disclosure because the firm prepares the statutory accounts	Used in similar way to audit programme
6	,	None other than analytical review	None	Yes
7	3	None	Work on estimates and judgment limited as covered in accounts preparation and tax work	Helped to guide the work done but ISA Appendix much more helpful
8	3	None	Procedures with respect to work in progress	Gave an indication of the level of work expected
9	3	None	The company has no stock and there are no going concern issues	Yes
		Analytical review	None	Yes: But could have been expanded more

No	Appendix II completed	Additional procedures	Procedures not performed	Helpful
11	8	N/a	N/a	The firm had developed their own version of an IPR programme
12	3	None	Stock cut-off as not material	Yes
13	,	Specific enquires relating to client specific balances such as deferred income and intra group transactions	Analytical review using industry and budgeted information not possible as not available Steps 7 and 22 not performed because	Yes. This programme formed the basis for our approach
			we prpare the statutory accounts.	
14	٠	None	No minutes kept by client	Yes
15	•	Additional questions on disclosures	All procedures were performed.	Thorough basis for review
16	,	Reconciliation scrutinies		It was a little vague in places and very prescriptive in others which was a bit off-putting. Overall it was fairly helpful.
17	3	Preparation of statutory financial statements	None	Yes
18	5	Agreeing opening balances Credit balances on sales ledger Review of reserves	None	Yes the question revealed and targeted risk risk areas
19	3		All procedures performed	Yes
20	3	Procedures to address issues regarding accounting for contracts	Analytical review to budget and industry not feasible.	Yes although some of the procedures were not clear and the depth varied between procedures.

Research instruments that practitioners were asked to complete

Form 1 Time analysis - hours

	IPR Senior	Manager	Partner	Other staff	Total
Briefings, reading APB draft, completion of forms etc associated with the field test (i.e. non- recurring)					
Calculating and processing accounting entries					
Drafting, finalising and printing accounts					
Work performed as part of the IPR to establish that 'a sound accounting platform' exists					
Additional work in performing the IPR					
Additional corroborative work in performing the audit					
Total current year					
Total for prior year audit and accounting assistance					

Has there been a major change in the scope of the audit between the current year and the prior year such that the time spent on the prior year audit is an unsatisfactory basis for the cost of the current year audit without the distortion of pilot testing the IPR?

Form 2 Cost analysis - £

	IPR Senior	Manager	Partner	Other staff	Total
Briefings etc associated with the field test (i.e. non-recurring)					
Calculating and processing accounting entries					
Drafting, finalising and printing statutory accounts					
Work performed as part of the IPR to establish that 'a sound accounting platform' exists					
Additional work in performing the IPR					
Additional corroborative work in performing the audit					
Total current year					
Total for prior year audit and accounting assistance					

Note: The total for the prior year should be adopted to reflect the same scale rates as the current year. If the staff mix has altered significantly from year to year please recompute the prior year to reflect the same staff mix as the current year.

Form 3 Unadjusted differences

Profit (loss) before tax £.....

Nature of adjustment	Dr or Cr to profit	£	Found during accounting work (£)	Found as a result of IPR (£)	Found as a result of additional corroborative work in performing the audit (£)

Form 4

Reactions of senior undertaking the IPR

How would you describe your level of knowledge of the client's business and its accounting?	
2. Have you been involved with this client in previous years.	
3. What involvement did you have with planning what work to perform.	
 4. To what extent was the work plan based on Appendix II designed to reflect your knowledge of the client's business and its accounting? 	
5. What procedures in addition to Appendix II did you perform?	
6. What procedures in Appendix II did you not perform? Please provide reasons.	

7. What work was done on going concern? 8. Did you find Appendix II helpful?	
9. How effective do you think an IPR is likely to be in detecting material errors?	a) Much less effective than an auditb) About the same as an auditc) More than an audit
10. How effective do you think an IPR is likely to be in detecting going concern difficulties	a) Much less effective than an auditb) About the same as an auditc) More than an audit
11. How effective do you think an IPR is likely to be in detecting fraud and irregularity?	a) Much less effective than an auditb) About the same as an auditc) More than an audit
Do you believe that the review report is the most effective way to communicate the assurance provided by the IPR? If you have any suggestions for improving the report please note them below.	
13 Do you have any other observations?	

Form 5

Reactions of manager undertaking the IPR

How would you describe your level of knowledge of the client's business and its accounting?	
2. Have you been involved with this client in previous years?	
3. What involvement did you have with planning what work to perform?	
 4. To what extent was the work plan based on Appendix II designed to reflect your knowledge of the client's business and its accounting? 	
5. What procedures in addition to Appendix II did you perform?	
6. What procedures in Appendix II did you not perform? Please provide reasons.	

7. What work was done on going concern? 8. Did you find Appendix II helpful?	
9. How effective do you think an IPR is likely to be in detecting material errors?	a) Much less effective than an auditb) About the same as an auditc) More than an audit
10. How effective do you think an IPR is likely to be in detecting going concern difficulties	a) Much less effective than an auditb) About the same as an auditc) More than an audit
11. How effective do you think an IPR is likely to be in detecting fraud and irregularity?	a) Much less effective than an auditb) About the same as an auditc) More than an audit
Do you believe that the review report is the most effective way to communicate the assurance provided by the IPR? If you have any suggestions for improving the report please note them below.	
13 Do you have any other observations?	

Form 6

Reactions of the partner responsible for the IPR

	ld you describe your level of e of the client's business and its ag?	
2. Were you to perform	involved in planning what work n	
you requi undertake	newing the work performed did the senior or manager to the additional procedures before infortable with the scope of the formed?	
staff used If not wo	comfortable with the level of to undertake the IPR? ald you expect to use less or more ed staff for such an engagement	
	ctive do you think an IPR is likely etecting material errors?	a) Much less effective than an audit b) About the same as an audit c) More than an audit
	etecting going concern	a) Much less effective than an auditb) About the same as an auditc) More than an audit
	ctive do you think an IPR is likely etecting fraud and irregularity?	a) Much less effective than an auditb) About the same as an auditc) More than an audit

8	Do you believe that the review report is the most effective way to communicate the assurance provided by the IPR? If you have any suggestions for improving the report please note them below.	
9.	Do you have any other observations?	
^•	20 you have any other observations.	

THE AUDITING PRACTICES BOARD

ILLUSTRATIVE STATEMENT OF STANDARDS FOR PERFORMING AN INDEPENDENT PROFESSIONAL REVIEW

DRAFT DEVELOPED FOR FIELD TESTING

February 2001

ILLUSTRATIVE STATEMENT OF STANDARDS FOR PERFORMING AN INDEPENDENT PROFESSIONAL REVIEW

Important Notice: This document is an illustration of a Statement of Standards for performing an Independent Professional Review. It has been developed solely for the purpose of field testing such engagements.

This document has not been subject to the due-process procedures that the APB is required to carry out before promulgating either an Exposure Draft or a Statement of Standards. Consequently, this document should not be regarded as having the status of either a Statement of Standards or an Exposure Draft of such a Statement.

This illustrative Statement applies only to the performance of Independent Professional Reviews, it is not intended to apply to other forms of review.

Contents	Paragraphs
Introduction	1 - 2
Objective of an Independent Professional Review	3 – 6
Acceptance and continuance of engagements to conduct	
Independent Professional Reviews	7 - 11
Training and experience	12 - 14
Ethical standards	15
Accounting base	16 - 19
Review procedures	20 - 38
Materiality	39 – 40
Post balance sheet events	41 - 43
Conclusions and reporting	44 - 63

Appendices:

1 Appendi	eccs.
1	Example engagement letter
II	Detailed procedures
III	Example review report expressing an unqualified review conclusion
IV	Example review report expressing a qualified review conclusion
V	Example review report expressing an adverse review conclusion
VI	Example review report including an explanatory paragraph explaining a
	fundamental uncertainty
VII	Example review report including an explanatory paragraph where there is a fundamental uncertainty regarding the entity's ability to continue as a going concern

Introduction

- 1. The purpose of this Statement of Standards is to establish Standards and provide guidance on the responsibilities of those performing an Independent Professional Review and the form and content of the report that is issued in connection with such a review.
- 2. An Independent Professional Review of financial statements should be conducted in accordance with the Standards set out in this Statement. (IPR 1)

Objective of an Independent Professional Review

- 3. The objective of an Independent Professional Review of financial statements is to enable reviewers to state whether they are aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the applicable provisions of the Companies Act 1985 and United Kingdom Accounting Standards²².
- 4. An Independent Professional Review consists primarily of:
 - a) undertaking limited procedures in order to assess whether the accounting records of the entity seem to provide a sound accounting base for the financial statements;
 - b) making enquiries concerning the business and the financial statements and applying analytical procedures designed to identify relationships and individual items that appear unusual;
 - c) obtaining plausible²³ explanations from the directors of the entity for any unusual relationships and items identified by the reviewers; and
 - d) reporting a conclusion on the results of the review.
- 5. As an Independent Professional Review principally comprises enquiry and analytical procedures, it does not involve:
 - a) making an assessment of internal controls;
 - b) obtaining corroborative evidence regarding the assertions embodied in the financial statements through, for example, inspection, observation, confirmation and computation; or
 - c) considering whether the financial statements are misstated as a result of fraud or illegal acts; which are procedures ordinarily performed as part of an audit.
- 6. Consequently, there is a greater risk that misstatements in the financial statements will not be detected by a review than an audit. Accordingly, the level of assurance provided in a review report is limited and is substantially less than the reasonable assurance provided by an audit report. The limited nature of the assurance provided by an Independent Professional Review is indicated by the assurance being expressed in terms of the reviewers 'not being aware' of the need for material modifications to the financial statements (negative assurance).

Acceptance and continuance of engagements to conduct Independent Professional Reviews

7. Reviewers should, in considering whether to accept an engagement to perform an

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²² The Financial Reporting Standard for Smaller Entities (effective March 2000) – the FRSSE- prescribes the basis, for those entities within its scope that have chosen to adopt it, for preparing and presenting their financial statements.

²³ The word plausible is used in the sense of appearing to be worthy of belief based on the information obtained by the reviewers.

Independent Professional Review, seek to ensure that they are competent to undertake the work and should assess the integrity and accounting competence of the owners, directors and management. Reviewers should also consider, before the end of their term of office, whether they are willing to continue in office as reviewers. (IPR 2)

- 8. Reviewers enquire as to:
 - a) the identity of those who control the entity, its owners, directors and managers;
 - b) the nature of the entity's activities; and
 - c) the reasons for the proposed appointment and the reasons for the retirement or removal of any incumbent or predecessor auditors or reviewers.
- 9. Reviewers make enquiries to help them assess the integrity of the owners, directors and management of the entity (or their equivalents). Such enquiries may involve discussions with third parties and searches of relevant databases.
- 10. Enquiries that the reviewers might make to assess initially the accounting competence of the owners, directors and management might include:
 - ascertaining the accounting experience of those responsible for maintaining the accounting records and preparing the financial statements of the entity;
 - ascertaining whether the accounting records and the preparation of the financial statements is computerised and if so which computer package is being used;
 - enquiring whether periodic management accounts and budgets are prepared, and if so how frequently;
 - if available, looking at the latest available management accounts;
 - assessing whether the accountant will have sufficient time to prepare the financial statements;
 - enquiring whether significant adjustments have had to be made to the financial statements as a result of an audit or independent professional review in previous years and the reasons for such adjustments.
- 11. Before accepting the engagement the reviewers should also consider whether:
 - a) the entity satisfies all conditions for exemption from audit;
 - b) any request for an audit has been deposited at the registered office of the entity; and
 - c) the reviewers are aware of any requests from 10% or more of the shareholders for an audit²⁴. (IPR 3)

Training and experience

- 12. In engagements to perform an Independent Professional Review partners and staff with appropriate training and experience should be involved in the conduct of the work. (IPR 4)
- 13. Some of the skills needed to conduct a review are the same as those employed in auditing. For example, skills that are employed in both types of engagement include bringing to bear an objective and enquiring mind, performing analytical procedures and considering the accounting principles used and disclosures made in the financial statements of the entity.

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²⁴ These are the current conditions that need to be met for audit exemption. The Comapny Law Review may specify different conditions

- 14. To perform an Independent Professional Review effectively partners and staff will, in particular, need to have had training and experience in:
 - a) understanding the business and operational performance of the entity;
 - b) making enquiries and evaluating responses to them;
 - c) performing analytical procedures: and
 - d) the detailed requirements of United Kingdom Accounting Standards, including where appropriate the FRSSE.

Ethical standards

15. In the conduct of an Independent Professional Review reviewers should comply with the ethical standards and other relevant ethical guidance of their professional bodies that are applicable to the conduct of Independent Professional Reviews. (IPR 5)

Accounting base

- 16. The initial stage of an Independent Professional Review, following acceptance of the engagement, should be the performance of limited procedures to assess whether the accounting records are likely to provide a sound accounting base for the financial statements. (IPR 6)
- 17. The effectiveness of an Independent Professional Review will be diminished if the entity's accounting records do not reliably summarise its transactions, assets and liabilities. Review procedures, unlike an audit, do not require consideration of the entity's systems of internal control nor require corroborative evidence to be obtained concerning the assertions underlying the financial statements. (e.g. the completeness of revenue and valuation of stock). Consequently the effectiveness of a review will be considerably diminished if it is based on financial statements that have not been subject to an appropriate level of accounting expertise to collect and summarise the underlying financial information.
- 18. In addition to considering the accounting competence of the owners, directors and management of the entity as part of their acceptance procedures, reviewers also perform limited procedures to assess whether the accounting records of the entity seem to provide a sound accounting base for the financial statements on which the review engagement is to be based. Illustrative examples of such possible limited procedures are provided in Appendix II.
- 19. The directors of small companies usually engage an accounting firm to assist them to comply with their statutory responsibility to prepare annual accounts. Often the same accountant is engaged both to assist with accounts preparation and to perform the Independent Professional Review. The procedures performed in assisting with the preparation of the accounts are likely to be directly relevant in determining whether the financial statements provide a sound base for the performance of an Independent Professional Review as described in this Statement.

Review procedures

Terms of engagement

20. The reviewers and the directors should agree on the terms of the engagement. The whole of the terms of the engagement should be recorded in writing. (IPR 7)

- 21. Owing to the potential for misunderstanding the scope of the work to be carried out, and the limited nature of the assurance to be provided, the reviewers usually meet with the directors to discuss the terms and objectives of the engagement and the nature of the limitations of the services to be provided. It may not be necessary to have such meetings where the engagement is recurring or the directors are familiar with Independent Professional Reviews.
- 22. An engagement letter will assist in planning the review work. It is in the interests of both the reviewers and the directors that the reviewers send an engagement letter documenting the key terms of the appointment. An engagement letter confirms the reviewers' acceptance of the appointment and helps avoid misunderstanding regarding such matters as the objective and scope of the engagement, the extent of the reviewers' responsibilities and the form of report to be issued.
- 23. The engagement letter sets out the directors' responsibilities for the maintenance of accounting records and the preparation of the financial statements including the selection of accounting policies.
- 24. Other matters usually included in the engagement letter are:
 - The objective of an Independent Professional Review.
 - The scope of the review, including references to this Statement.
 - Emphasising that the review does not involve consideration of whether the financial statements are misstated as a result of fraud or illegal acts
 - The reviewers need to have unrestricted access to the records, documentation and other information they may require in connection with the review.
 - The wording of the report that the reviewers expect to provide.
 - A statement that an audit is not being performed and that an audit opinion will not be expressed.
- 25. An example of an engagement letter for an Independent Professional Review is set out in Appendix I to this Standard.

Planning

- 26. The reviewers should develop and document a plan for their work so as to perform the engagement in an effective manner. (IPR 8)
- 27. Planning is necessary for reviews of entities of all sizes. The objectives of planning the review work, which takes place before the detailed review work begins, include:
 - a) ensuring that appropriate attention is devoted to the different areas of the review; and
 - b) assisting in the proper assignment of work to members of the review team and their briefing.

Knowledge of the business

28. In developing the plan the reviewers should obtain or update their knowledge of the entity's business and operational performance (including consideration of the entity's organisation, accounting systems, operating characteristics, accounting principles and practices) and the nature of its assets, liabilities, revenues and expenses. (IPR 9)

- 29. For the reviewers to be in a position to assess whether the information and the results of their analytical procedures obtained during the course of the engagement are plausible, they require sufficient knowledge of the entity and the business in which it is involved to make intelligent enquiries and make a reasonable assessment of responses and other information obtained. The performance of an Independent Professional Review also requires a general understanding of the manner in which the entity operates and an appreciation of matters that could have a significant effect on the financial statements being reported on.
- 30. The requisite knowledge includes a general understanding of the accounting matters peculiar to the business and to the industry of which it forms part. The reviewers may possess much of this knowledge through previous involvement with the entity or similar entities, in which case only limited enquiries would be needed to update such knowledge.

Documentation

- 31. The reviewers should document in their working papers matters which are important in providing evidence to support the review report, and evidence that the review was carried out in accordance with this Statement. (IPR 10)
- 32. Working papers are the record of:
 - a) the planning and performance of the review;
 - b) the supervision and review of the work performed;
 - c) the evidence resulting from the review procedures carried out; and
 - d) support for the overall review conclusion.
- 33. The extent of working papers is essentially a matter of professional judgment since it is neither necessary nor practical to document every matter reviewers consider. Working papers (or an annotated review programme) will usually document the results of all of the procedures required by this Statement.

Detailed procedures

- 34. In an Independent Professional Review engagement the reviewers, not the directors of the entity, are responsible for determining the minimum scope of the review.
- 35. For the purpose of expressing negative assurance in the review report, the reviewers should obtain appropriate evidence by performing the following procedures:
 - Perform analytical procedures designed to identify relationships and individual items that appear unusual or are inconsistent with the reviewers' knowledge of the business, including:
 - Comparison of the financial statements with statements for prior periods.
 - Comparison of the financial statements with expected results of the entity from budgets.
 - Consideration of relationships between elements of financial information that are expected to conform to a predicted pattern based on the entity's experience, such as the relationship of gross profit to sales.

- Make enquiries of the directors concerning:
 - Whether the financial statements have been prepared in accordance with the requirements of the Companies Act 1985 and United Kingdom Accounting Standards.
 - The accounting policies applied in the preparation of the financial statements.
 - The rationale to support accounting estimates and other matters where the directors have had to exercise significant judgment.
 - Actions taken at meetings of shareholders, the board of directors, or comparable meetings that may affect the financial statements

In applying these procedures, the reviewer would consider the types of matters that required accounting adjustments in prior periods.

- Make enquiries of the directors concerning any relationships or unusual items that are identified by the analytical procedures.
- Read the financial statements to consider whether the financial statements appear to conform with the applicable provisions of the Companies Act 1985 and United Kingdom Accounting Standards.

These procedures should be performed with an attitude of professional scepticism recognising that circumstances may exist which cause the financial statements to be misleading (IPR 11)

- 36. Illustrative examples of possible procedures that might be performed to meet the requirements set out in IPR 11 are set out in Appendix II. In performing an Independent Professional Review, the reviewers may also find it helpful to use a Companies Act and either a FRSSE disclosure checklist or a checklist of other United Kingdom Accounting Standards.
- 37. As a review involves accepting directors' explanations and confirmations made in response to the reviewers' enquiries, so long as they appear plausible, a letter confirming the answers to the more significant enquiries may be obtained from them. In particular, such a confirmation letter may be used to confirm the directors' views, expressed to the reviewer, as to whether or not the entity is a going concern.
- 38. In addition to reducing the possibility of misunderstanding, a confirmation letter further impresses on the directors the importance of responding fully to the reviewers' enquiries and confirms oral explanations provided by the directors to the reviewers.

Materiality

- 39. When considering the possible effect of a misstatement the measurement of what is material is made by reference to the financial statements the reviewer is reporting on, not the limited level of assurance being provided. (IPR 12)
- 40. The judgment as to what is material is made by reference to the financial statements on which the reviewer is reporting and the needs of those relying on that information, not to the limited level of assurance provided. This is the case notwithstanding the greater risk that misstatements will not be detected by the performance of an Independent Professional Review rather than an audit.

Post balance sheet events

- 41. The reviewers should enquire about events subsequent to the date of the financial statements that may require adjustment of, or disclosure in, the financial statements. (IPR 13)
- 42. Examples of specific enquiries which may be made of management are:
 - the current status of items involving subjective judgment or which were accounted for on the basis of preliminary data, for example litigation in progress;
 - whether new commitments, borrowings or guarantees have been entered into;
 - whether any events have occurred which might bring into question the appropriateness of accounting policies used in the financial statements as would be the case for example, if such events might call into question the validity of the application of the going concern concept to the whole or a material part of the entity.
- 43. The reviewers do not have any responsibility to perform procedures to identify events occurring after the date of their report.

Conclusions and Reporting

- 44. The reviewers should evaluate the evidence obtained and draw a conclusion as to whether they are in a position to express negative assurance to the effect that they are not aware of any material modifications that need to be made to the financial statements in order for them to be in conformity with the applicable provisions of the Companies Act 1985 and the requirements of United Kingdom Accounting Standards. (IPR 14)
- 45. The reviewers may initially conclude that they need additional evidence in order to express an unqualified review conclusion. In such circumstances, the reviewers make additional enquiries and do not, themselves, obtain corroborative evidence, as this would change the nature of the engagement from an Independent Professional Review to an audit. Where practical, the reviewers request the directors to perform additional procedures to provide the necessary evidence to enable the reviewers to express an unqualified conclusion.

Basic elements of an unqualified review report

- 46. The reviewers' report should include the following matters:
 - a) a title identifying the person or persons to whom the report is addressed;
 - b) an introductory paragraph identifying the financial statements on which the review has been performed;
 - c) a scope paragraph, describing the nature of a review, including:
 - (i) a reference to this Statement;
 - (ii) a statement that a review is limited to enquiries and analytical procedures; and
 - (iii) a statement that an audit has not been performed, that the procedures undertaken provide less assurance than an audit and that an audit opinion is not expressed;

- d) a review conclusion expressed in terms of negative assurance;
- e) the manuscript or printed signature of the reviewers;
- f) the date of the reviewers' report. (IPR 15)
- 47. Appendix III to this Statement is an illustration of a review report expressing an unqualified review conclusion.

Modified review conclusions

- 48. If a need for material modifications to the financial statements has come to the reviewers' attention, the review conclusion should describe those matters including, unless impracticable, a quantification of the possible effect(s) on the financial statements, and either:
 - (a) express a qualification of the negative assurance provided indicating that the conclusion is expressed except for the effects of the matter giving rise to the need for the modification; or
 - (b) when the reviewers conclude the effect of the matter giving rise to the need for modification is so material that the financial statements are seriously misleading issue an adverse review conclusion. (IPR 16)
- 49. Appendix IV to this Statement is an illustration of a qualified review conclusion and Appendix V is an illustration of an adverse review conclusion.

Scope limitations

- 50. In those rare circumstances where there has been a material scope limitation, the review conclusion should describe the limitation and either:
 - (a) express a qualification of the negative assurance provided regarding the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed; or
 - (b) when the possible effect of the limitation is so significant and pervasive that the reviewer concludes that no level of assurance can be provided, not provide any assurance. (IPR 17)

Uncertainties

- 51. Inherent uncertainties about the outcome of future events, (for example the collection of an accounts receivable) frequently affect, to some degree, a wide range of components of the financial statements at the date they are approved. If it is not possible for the directors to remove the uncertainties by obtaining more information at the date they approve the financial statements, the statements reflect the working assumptions of directors as to their financial outcome and, where material, describe the circumstances giving rise to the uncertainties and their potential financial effect.
- 52. The existence of either an inherent uncertainty, such as the outcome of pending litigation, that is not fundamental to the financial statements would not cause the reviewer to modify the standard review conclusion provided the financial statements adequately disclose such matters.

Fundamental uncertainty

- 53. If the reviewers have become aware of information which indicates to them that a fundamental uncertainty exists such that the financial statements may be misleading they should include an explanatory paragraph to their report referring to the matter. The explanatory paragraph should be separate from the review conclusion and the reviewers should use words which indicate that they express no opinion on the matter. (IPR 18)
- 54. In some circumstances, the degree of uncertainty and its potential impact on the view given by the financial statements may be very great. For example,
 - a) if the entity is making significant losses;
 - b) if there is an excess of liabilities over assets; or
 - c) there appears to be a lack of resources to pay debts as they fall due or meet bank convenants to ensure renewal of existing facilities,

there may be uncertainty as to whether it is appropriate to prepare the financial statements on the going concern basis. In such cases reviewers may, as described in paragraph 45, request the directors to perform additional procedures to demonstrate the appropriateness of preparing the financial statements on the going concern basis.

- 55. Where the reviewers regard an inherent uncertainty to be fundamental the reviewers include in their report an explanatory paragraph describing the matter giving rise to the uncertainty and its possible effects on the financial statements, including (where practicable) quantification. References may be made to notes in the financial statements but such a reference is not a substitute for sufficient description of the fundamental uncertainty so that a reader can appreciate the principal points at issue and their implications.
- 56. Communication with the reader is enhanced by the use of an appropriate sub-heading differentiating the explanatory paragraph from other matters included in the reviewers' report.
- 57. Appendices VI and VII to this Statement are illustrations of review reports which include an explanatory paragraph explaining a fundamental uncertainty.

Inconsistent application of accounting policies

58. An inconsistency in the application of accounting policies would not cause the reviewers to modify the standard review conclusion provided the financial statements adequately disclose such matters.

Dating the review report

- 59. The Independent Professional Review report should be dated with the date on which the reviewers sign their report for distribution with the financial statements. Since the reviewer's responsibility is to report on the financial statements as prepared and presented by the directors, the reviewers should not sign or date the report earlier than the date on which the financial statements are approved by the directors. (IPR 19)
- 60. The date of the Independent Professional Review report informs the reader that the reviewers have considered the effect of events or transactions, of which they are aware, that occurred up to that date.
- 61. The reviewers are not in a position to issue their opinion until the financial statements have been approved by the directors and the reviewers have completed their assessment of all the

evidence they consider necessary for the opinion to be given in their report. This assessment includes events occurring up to the date the opinion is expressed.

Other reporting matters

- 62. Each page of the financial statements should be marked 'Unaudited see review report of Independent Professional Reviewer on page ...'. (IPR 20)
- 63. Where the financial statements are included in a document, such as an annual report, that contains other information, the reviewers' report should make clear that such other information is excluded from the scope of the Independent Professional Review. (IPR 21)

Appendix I

Example of an Engagement Letter for an Independent Professional Review of Financial Statements

The Directors Small Limited

Date

Dear Sirs

This letter sets out our understanding of the terms of our engagement to review the balance sheet of the company as at its year end date and the profit and loss account for the year then ended.

It explains the scope of the work which we will undertake, and the form of our proposed review report, and draws attention to the inherent limitations of a review.

DIRECTORS' RESPONSIBILITIES

As directors of the company, you are responsible for ensuring that the company maintains proper accounting records and for preparing financial statements which give a true and fair view and which have been prepared in accordance with the Companies Act 1985 (the Act). You are also responsible for making available to us, as and when required, all the company's accounting records and all other relevant records and related information, including minutes of all management and shareholders' meetings.

You are further responsible for determining whether, in respect of the year, the company meets the conditions for exemption from an audit of the accounts set out in section 249A of the Act, and for determining whether, in respect of the year, the exemption is not available for any of the reasons set out in section 249B.

The responsibility for safeguarding the assets of the company and for the prevention and detection of fraud, error and non-compliance with laws and regulations rests with yourselves.

Once we have issued our report we have no further direct responsibility in relation to the financial statements for that accounting period. However, we expect that you will inform us of any material event occurring between the date of our report and that of the Annual General Meeting which may affect the financial statements.

REVIEWER'S RESPONSIBILITIES

We will review the balance sheet of Small Limited as at its year end date and the profit and loss account for the year then ended, in accordance with the Statement of Standards for performing an Independent Professional Review.

Our work will be substantially less in scope than an audit in accordance with United Kingdom Auditing Standards and therefore is designed to provide a lower level of assurance than an audit. It will consist principally of making enquiries of you, applying analytical procedures to financial data and assessing whether accounting policies and presentation have been consistently applied. It will not include audit procedures such as tests of controls and verification of assets and liabilities.

Our review is not designed to, and therefore cannot be relied upon to, disclose any irregularities, including fraud, which may exist.

Our review is not designed to, and therefore will not necessarily, reveal weaknesses in internal controls, errors in the accounting records, misstatements of management estimates, or other matters which might be revealed if we were to conduct an audit in accordance with United Kingdom Auditing Standards

There is no assurance that our review will reveal all matters of significance related to the financial statements. However, we shall report to you any significant findings from our work which we consider should be brought to your attention.

REPORTING

We will issue a review report to the company in accordance with the Statement of Standards for performing an Independent Professional Review, for publication in the financial statements

We expect to report on the financial statements as follows:

REVIEWERS' REPORT TO THE MEMBERS OF SMALL LIMITED ON THE UNAUDITED FINANCIAL STATEMENTS OF THE COMPANY

We have reviewed the financial statements on pages ... to ... which are the responsibility of the company's directors and which have been prepared in accordance with the [Financial Reporting Standard for Smaller Entities effective March 2000) and the] accounting policies set out on page

Review work performed

We conducted our review in accordance with the United Kingdom Standards for Independent Professional Reviews. The extent of our review was therefore limited to making enquiries of the directors and performing analytical procedures on financial data.

An Independent Professional Review is substantially less in scope than an audit performed in accordance with United Kingdom Auditing Standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly we do not express such an opinion

It is not within the scope of an Independent Professional Review to consider whether fraud or illegal acts have occurred.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the provisions of the Companies Act 1985 applicable to small companies and the requirements of United Kingdom Accounting Standards.

CONFIRMATIONS FROM THE DIRECTORS

As part of our procedures, we may request you to provide written confirmation of oral or written explanations that we have received from you during the course of our work.

LIMITATION OF LIABILITY

[The accountants can agree with the directors a limit on any liability arising out of the work. In such circumstances, legal advice may be required the form of words to be included with the engagement letter.]

FEES

[Insert appropriate wording]

APPLICABLE LAW

This [engagement letter] shall be governed by, and construed in accordance with, [English] law. The Courts of [England] shall have exclusive jurisdiction in relation to any claim, dispute or difference concerning the [engagement letter] and any matter arising from it. Each party irrevocably waives any right it may have to object to an action being brought in those Courts, to claim that the action has been brought in an inconvenient forum, or to claim that those Courts do not have jurisdiction.

AGREEMENT OF TERMS

Once it has been agreed, this letter will remain effective, from one review appointment to another, unless it is replaced. We shall be grateful if you could confirm in writing your agreement to these terms by signing and returning the enclosed copy of this letter, or let us know if they are not in accordance with your understanding of the terms of our engagement.

Yours faithfully
ABC& Co.
We agree to the terms of this letter
Signed for and on behalf of Small Limited
Date

Appendix II Illustrative detailed procedures that may be performed in an Independent Professional Review

Knowledge of the business

In developing the plan the reviewers should obtain or update their knowledge of the entity's business and operational performance (including consideration of the entity's organisation, accounting systems, operating characteristics, accounting principles and practices) and the nature of its assets, liabilities, revenues and expenses. (IPR 9)

Note: Steps 1 to 4 will typically be performed by the manager in advance of the commencement of the field work.

No.	Review Procedures	Results of enquiries made	W/ paper ref.	Name of employee to whom enquiry directed	Initials /Date
1a	Obtain or update knowledge of the entity's activities, its main products and services and the industry in which it operates.				
1b.	Obtain or update knowledge of the accounting system and the entity's processes to capture and record information relating to all activities of the entity.				
1c.	Obtain or update knowledge of the legal, regulatory and taxation issues affecting the business.				
1d.	Obtain or update knowledge of management responsibilities.				
1e	Discuss with the directors their aims and aspirations for the business.				
1f	Enquire of the directors whether they have any plans to change the nature, management or ownership of the business including any plans to dispose of major assets or parts of the business.				

No.	Review Procedures	Results of enquiries made	W/ paper ref.	Name of employee to whom enquiry directed	Initials /Date
2	Enquire whether there have been any changes in the last year in loan agreements, security arrangements or commitments.				
3	Enquire whether any legal actions are threatened, pending or in process. If so consider whether they might give rise to contingencies that may require disclosure in the financial statements.				
4	Enquire whether there are, or have been, any disputes with the Inland Revenue or HM Customs & Excise, which could have a significant effect on the taxation payable (receivable) by the entity.				

Accounting base

The initial stage of an Independent Professional Review, following acceptance of the engagement, should be the performance of limited procedures to assess whether the accounting records are likely to provide a sound accounting base for the financial statements. (IPR 6)

5	Enquire how the directors have satisfied themselves of the integrity and completeness of the accounting records during the period under review. In particular, make enquiries as to whether all control accounts (e.g. bank, cash, sales ledger, purchase ledger, PAYE, VAT and net pay) have been satisfactorily reconciled.			
6	Enquire of the directors whether there have been any accounting breakdowns (e.g. as a result of computer system failure or loss of key			

No.	Review Procedures	Results of enquiries made	W/ paper ref.	Name of employee to whom enquiry directed	Initials /Date
	personnel) or if any reviews by regulators have suggested inadequacies within the accounting system (e.g. during PAYE or VAT compliance visits).				
7	Obtain the trial balance and determine whether it agrees with the nominal ledger and the financial statements.				
8	Review balances of suspense accounts at the balance sheet date.				
9	Enquire about the entity's procedures for classifying expenditure as between capital and revenue. Review fixed asset and repairs and maintenance accounts for seemingly inappropriately classified material capital or revenue expenditure.				
10	Enquire about the procedures employed by the entity to ensure that all goods despatched and services provided are recognised as sales. With respect to cutoff enquire about the procedures employed by the entity to ensure that revenue and expenses have been recognised in the correct periods.				
11	Obtain the bank reconciliation as at the balance sheet date. Identify and obtain satisfactory explanations for any material old or unusual reconciling items.				
12	Review the trade creditors listing for debit balances.				
13	Enquire whether major sales and expenses have				

No.	Review Procedures	paper	Name of employee to whom enquiry directed	Initials /Date
17	the prior year's accounts have been resolved. Enquire of management about events after the balance sheet date that might have a material effect on the financial statements. Consider the need for adjustments or disclosure.			

Make enquiries of directors concerning

- Whether the financial statements have been prepared in accordance with the requirements of the Companies Act 1985 and United Kingdom Accounting Standards

 - The accounting policies applied in the preparation of the financial statements.

18	Consider the main categories of asset, liability, income and expense and consider whether there are suitable accounting policies for all significant items. Review these policies and consider whether they conform to acceptable accounting practice and that their application will not result in an inappropriate presentation of the information in the accounts.		
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Make enquiries about the rationale to support accounting estimates and other matters where the directors have had to exercise significant judgment

19	Consider whether stock valuation methods are consistent with the prior year including such factors as material, labour and overhead.		
20	Discuss fixed asset depreciation methods and rates. Consider whether the approach is		

No.	Review Procedures	Results of enquiries made	W/ paper ref.	Name of employee to whom enquiry directed	Initials /Date
	consistent with the prior year.				
21	Review aged debtors listing to identify unusually large accounts, credit balances and unusually old (unprovided) balances. Discuss with management the basis for calculating the bad debt provision.				
22	Consider the tax expense in relation to the entity's accounting income for the period (i.e. the effective tax rate). Consider the adequacy of provisions for deferred and current tax liabilities, including provisions in respect of prior periods.				
23	Discuss whether any fixed assets have suffered a material permanent impairment in value.				
24	Enquire about the carrying values of investments. Consider whether there are any realisation problems.				
25	Enquire whether there any fundamental uncertainties and whether there has been any change in the status of fundamental uncertainties previously disclosed.				
26	Where the entity: a) is making significant losses b) has an excess of liabilities over assets; or c) appears to have a lack of resources to pay debts as they fall due or meet bank covenants to ensure renewal of existing facilities, consider whether there is uncertainty as to				

No.	Review Procedures	•	W/ paper ref.	Name of employee to whom enquiry directed	Initials /Date
	whether it is appropriate to prepare the financial statements on the going concern basis.				

Make enquiries concerning actions taken at meetings of shareholders, the board of directors, or comparable meetings that may affect the financial statements

27	Read the minutes of meetings of shareholders and the board of directors in order to identify matters that could be important to the review. Performing this procedure may enable the reviewer to identify factors that affect the going concern assumption.		
28	Review the minutes of any meetings of directors or shareholders which have taken place since the completion of detailed review work, and consider whether there is any impact on the financial statements.		

Perform analytical procedures designed to identify relationships and individual items that appear unusual or are inconsistent with the reviewers' knowledge of the business including,

- Comparison of the financial statements with statements for prior periods
- Comparison of the financial statements with expected results of the entity from budgets
- Consideration of relationships between elements of financial information that are expected to conform to a predicted pattern based on the entity's experience, such as the relationship of gross profit to sales

29	Review the profit and loss account and balance sheet to determine whether they appear to be consistent with your knowledge of the entity's				
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No.	Review Procedures	Results of enquiries made	W/ paper ref.	Name of employee to whom enquiry directed	Initials /Date
30	business. This will include comparing the figures in the final accounts for the year with:				
	a) accounts for prior periods				
	b) budgets/forecasts/management expectations				
	c) similar industry information, if any.				
	Obtain plausible explanations for unexpected fluctuations and inconsistencies.				
31	Enquire whether any legal actions are threatened, pending or in process. If so consider whether they might give rise to contingencies that may require disclosure in the financial statements.				

Make enquiries of the directors concerning any relationships or unusual items that are identified by the analytical procedures

Read the financial statements to consider whether the financial statements appear to conform with the applicable provisions of the Companies Act 1985 and either United Kingdom Accounting Standards or the FRSSE

31	Check the adequacy of disclosures in the financial statements and their compliance with the Companies Act 1985 and either United Kingdom Accounting Standards or the FRSSE.		
32	Enquire about the existence of transactions with related parties, how such transactions have been accounted for and whether related parties have been properly disclosed.		
32	Consider the position regarding the comparative		

No.	Review Procedures	Results of enquiries made	W/ paper ref.	Name of employee to whom enquiry directed	Initials /Date
	figures, where it is the first year that a review has been performed.				
34	Confirm the balance sheet contains a statement by the directors acknowledging their responsibilities in relation to the accounts.				

No.	Review Procedures	Results of enquiries made	W/ paper ref.	Name of employee to whom enquiry directed	Initials /Date
35	Deliberately left blank for other procedures considered necessary at planning stage or as a result of analytical procedures				
36					
37					

Completion of programme reviewed by manager	Date	
Completion of programme approved by partner	Date	

Appendix III

Example review report expressing an unqualified review conclusion

REVIEWERS' REPORT TO THE MEMBERS OF SMALL LIMITED ON THE UNAUDITED FINANCIAL STATEMENTS OF THE COMPANY

We have reviewed the financial statements on pages ... to ... which are the responsibility of the company's directors and which have been prepared in accordance with the [Financial Reporting Standard for Smaller Entities (effective March 2000) and the] accounting policies set out on page....

Review work performed

We conducted our review in accordance with the United Kingdom Standards for Independent Professional Reviews. The extent of our review was therefore limited to making enquiries of the directors and performing analytical procedures on financial data.

An Independent Professional Review is substantially less in scope than an audit performed in accordance with United Kingdom Auditing Standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly we do not express such an opinion

It is not within the scope of an Independent Professional Review to consider whether fraud or illegal acts have occurred.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the provisions of the Companies Act 1985 applicable to small companies and the requirements of United Kingdom Accounting Standards.

Date Reviewers

Appendix IV

Example review report expressing a qualified review conclusion

REVIEWERS' REPORT TO THE MEMBERS OF SMALL LIMITED ON THE UNAUDITED FINANCIAL STATEMENTS OF THE COMPANY

We have reviewed the financial statements on pages ... to ...which are the responsibility of the company's directors and which have been prepared in accordance with the [Financial Reporting Standard for Smaller Entities (effective March 2000) and the] accounting policies set out on page

Review work performed

We conducted our review in accordance with the United Kingdom Standards for Independent Professional Reviews. The extent of our review was therefore limited to making enquiries of the directors and performing analytical procedures on financial data.

An Independent Professional Review is substantially less in scope than an audit performed in accordance with United Kingdom Auditing Standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly we do not express such an opinion.

It is not within the scope of an Independent Professional Review to consider whether fraud or illegal acts have occurred.

Qualified review conclusion

The directors have informed us that stock has been stated at its cost which is in excess of its estimated net realisable value. Computations made by the directors show that stock, if valued at the lower of cost and net realisable value as required by United Kingdom Accounting Standards, would have been decreased by $\mathfrak{L}X$, and profit on ordinary activities after taxation and net assets would have been decreased by $\mathfrak{L}Y$.

On the basis of our review, except for the effects of the overstatement of stock, described in the previous paragraph, we are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the provisions of the Companies Act 1985 applicable to small companies and the requirements of United Kingdom Accounting Standards.

Date Reviewers

Appendix V

Example review report expressing an adverse review conclusion

REVIEWERS' REPORT TO THE MEMBERS OF SMALL LIMITED ON THE UNAUDITED FINANCIAL STATEMENTS OF THE COMPANY

We have reviewed the financial statements on pages ... to ... which are the responsibility of the company's directors and which have been prepared in accordance with the [Financial Reporting Standard for Smaller Entities (effective March 2000) and the] accounting policies set out on page ...

Review work performed

We conducted our review in accordance with the United Kingdom Standards for Independent Professional Reviews. The extent of our review was therefore limited to making enquiries of the directors and performing analytical procedures on financial data.

An independent professional review is substantially less in scope than an audit performed in accordance with United Kingdom Auditing Standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly we do not express such an opinion.

It is not within the scope of an Independent Professional Review to consider whether fraud or illegal acts have occurred.

Adverse review conclusion

As more fully explained in note ... no provision has been made for losses expected to arise on certain long-term contracts currently in progress, as the directors consider that such losses should be off-set against amounts recoverable on other long term contracts. United Kingdom Accounting Standards require that provision should be made for foreseeable losses on individual contracts.

As more fully explained in note ... rentals under both finance and operating leases are charged to income when payments are made. Finance leases have not been recorded on the balance sheet as an asset and as an obligation to pay future rentals. United Kingdom Accounting Standards require that finance leases should be recorded on the balance sheet.

The directors have informed us that they are not willing to quantify the effect of these departures from the requirements of United Kingdom Accounting Standards.

Because of the significance of the matters described above we have concluded that the financial statements are misleading and that there are material modifications that should be made to them in order for them to be in conformity with the provisions of the Companies Act 1985 applicable to small companies and the requirements of United Kingdom Accounting Standards. As the directors are unwilling to quantify the effects of the matters described above we are unable to state what the modifications to the financial statements should be.

Date

Appendix VI

Example review report including an explanatory paragraph explaining a fundamental uncertainty

REVIEWERS' REPORT TO THE MEMBERS OF SMALL LIMITED ON THE UNAUDITED FINANCIAL STATEMENTS OF THE COMPANY

We have reviewed the financial statements on pages ... to ... which are the responsibility of the company's directors and which have been prepared in accordance with the [Financial Reporting Standard for Smaller Entities (effective March 2000) and the] accounting policies set out on page....

Review work performed

We conducted our review in accordance with the United Kingdom Standards for Independent Professional Reviews. The extent of our review was therefore limited to making enquiries of the directors and performing analytical procedures on financial data.

An Independent Professional Review is substantially less in scope than an audit performed in accordance with United Kingdom Auditing Standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly we do not express such an opinion

It is not within the scope of an Independent Professional Review to consider whether fraud or illegal acts have occurred.

Fundamental uncertainty relating to trade accounts receivable

In response to our enquiries, the directors have informed us that the carrying amount of trade accounts receivable includes a debt of \pounds ... which has been outstanding for in excess of one year. The company has no security for this debt. The directors have made no provision against the debt being irrecoverable and they have informed us that they are satisfied that it will be recovered in full. We are not required to and have not performed any procedures to corroborate the directors' views, and we therefore express no opinion on this matter.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the provisions of the Companies Act 1985 applicable to small companies and the requirements of United Kingdom Accounting Standards.

Date

Appendix VII

Example review report including an explanatory paragraph where there is a fundamental uncertainty regarding the entity's ability to continue as a going concern

REVIEWERS' REPORT TO THE MEMBERS OF SMALL LIMITED ON THE UNAUDITED FINANCIAL STATEMENTS OF THE COMPANY

We have reviewed the financial statements on pages ... to ... which are the responsibility of the company's directors and which have been prepared in accordance with the [Financial Reporting Standard for Smaller Entities (effective March 2000) and the] accounting policies set out on page....

Review work performed

We conducted our review in accordance with the United Kingdom Standards for Independent Professional Reviews. The extent of our review was therefore limited to making enquiries of the directors and performing analytical procedures on financial data.

An Independent Professional Review is substantially less in scope than an audit performed in accordance with United Kingdom Auditing Standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly we do not express such an opinion

It is not within the scope of an Independent Professional Review to consider whether fraud or illegal acts have occurred.

Going concern

In forming our conclusion, we have considered the disclosures made in note 1 of the financial statements concerning the uncertainty as to the continuation and renewal of the company's bank overdraft facility. In view of the significance of this uncertainty we consider that it should be drawn to your attention. We are not required to and have not performed any procedures to corroborate the directors' views, and we therefore express no opinion on this matter.

Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the provisions of the Companies Act 1985 applicable to small companies and the requirements of United Kingdom Accounting Standards.

Date Reviewers

NOTICE TO READERS

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