



AUDIT EXEMPTION :

How can accountants support small businesses?

19 February 2014

 **#SMEsupport**

The Stanhope Hotel, Brussels

SPEAKERS

#SMEsupport



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FEE Deputy President



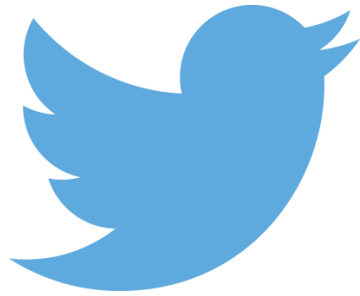
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today's event?*

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AUDIT EXEMPTION : How can accountants support small businesses?



PANEL DEBATE

#SMEsupport



Myles Thompson - *Moderator*

FEE Board Member & Chair of
FEE auditing working party



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Michael Gewehr

Chair of IDW auditing working party



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UEAPME Representative



Jan Wietsma

Founder & business advisor
Coolfacts BV

Developments for SMEs: an IAASB update

Prof. Arnold Schilder, IAASB Chairman

"Audit exemption: how can accountants support small businesses?"

Brussels, Belgium

February 19, 2014

Role accountancy profession for SMEs

- Accountants particularly relevant for contributing to high quality reporting, both for internal decision-making and external transparency
- Impact of 2013 EU Accounting Directive
 - **Fewer audits** because of increased thresholds for small undertakings (Upper limits to define a small undertaking up from €8m to €12m net turnover and from €4m to €6m in balance sheet total)
 - “... for many small undertakings the same persons are both shareholders and managers and, therefore, have **limited need for third-party assurance** on financial statements. However, this Directive should not prevent Member States from imposing an audit on their small undertakings, **taking into account the specific conditions and needs of small undertakings and the users of their financial statements**” (Recital, 43)
 - Demand for wider range of services to meet needs of SMEs?

Services Other than Audits for SMEs

IAASB's response: non-audit standards with special relevance

- ISRE 2400 (Revised): **Engagements to Review Historical Financial Statements** (approved June 2012); limited assurance and less cost compared to an audit
- ISAE 3000 (Revised): **Assurance Engagements Other than Audits or Reviews of Historical Financial Information** (approved September 2013); covers a wide variety of other limited and reasonable assurance engagements
- ISRS 4410 (Revised) **Compilation Engagements** (approved December 2011); assisting management by applying reporting expertise, without verifying

Review Engagements (ISRE 2400 (Revised))

- Revised Standard **effective for reviews of financial statements** for periods ending on or after December 31, 2013
- **Objectives:** (a) Enable the practitioner **to conclude whether anything has come to its attention** that causes the practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework; and (b) **to report** on the FS as a whole, **and communicate** as required by 2400
- **Communication emphasized** throughout standard: Engagement letter; during course of engagement and inquiry; representations; reporting
- **Procedures** must generate “**sufficient appropriate evidence**”:
 - Performing inquiry, analytics and procedures addressing specific circumstances should be sufficient
 - Emphasis on professional skepticism and judgment

Key Differences between Audit and Review Engagements

	Audit Engagement	Review Engagement
Level of Assurance	High, but not absolute	Limited
Obtain an understanding of the entity's internal control and assess fraud risk	Yes	No, except some inquiry
Procedures	Inspection, observation, confirmation, re-calculation, re-performance, inquiry and analytical	Primarily inquiry and analytical procedures
Report contains:	Opinion (Financial Statements 'give a true and fair view')	Conclusion ('nothing has come to our attention ...to believe that FS do not give a true and fair view...')

Review Engagements (ISRE 2400 (Revised))

- **Procedures** must address:
 - All material items in the financial statements, including disclosures
 - Focus on addressing areas where material misstatements are likely
 - Specific circumstances must be covered (related parties; fraud indication; going concern; use of work performed by others)
- Performing **additional** procedures
 - Can occur anytime in the engagement
 - Trigger is ‘when practitioner becomes aware FS may be materially misstated’
 - Not limited to inquiry and analytical, e.g. also substantive tests
 - Conclude that statements are not likely materially misstated
- **Reporting:** Limited assurance conclusion (“nothing has come..”) To note: this is not ‘negative assurance’ !

Assurance Engagements Other than Audits or Reviews of Historical Financial Information (ISAE 3000 (Revised))

- ISAE 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, issued December 2013
 - Effective for assurance reports dated on or after December 15, 2015
 - ‘Umbrella standard’, supports new and revised ISAEs
 - Includes guidance for **reasonable and limited assurance** engagements
- Significant **enhancements** from extant ISAE 3000 include:
 - Clarity conventions and format
 - Strengthened requirements, with supporting application material
 - ‘Meaningful level’ of **Limited Assurance (LA)** likely to enhance users’ confidence about subject matter information; ranges can vary
 - Enhances the practitioner’s “**risk aware approach**” for LA (understand subject matter and process to prepare information about it)
 - LA engagements driven by **evidence obtained**, rather than procedures
 - Enhanced reporting requirements

Compilation Engagements (ISRS 4410 (Revised))

- Revised Standard applicable to compilation engagements of **historical financial information**, now in effect for compilation reports
- **Objective:** **Apply reporting expertise** to assist management in compilation of financial information in accordance with an applicable framework, **and Report ; no verification**, no opinion or conclusion
- Includes **requirements and guidance** material in relation to:
 - Engagement acceptance and continuance; communication with management and those charged with governance
 - Performing the engagement and documentation
 - Contents of the practitioner's report
- Includes **illustrative examples** for clear communication

Proposed Future Initiatives Relevant to SMEs: Strategy 2015- 2019 and Related Work Program

- Monitor adoption and implementation of review, compilation and new assurance standards
- Professional Skepticism: reinforce concept and guidance
- Quality Control – ISQC 1 and ISA 220
 - Consideration of most appropriate way forward to address concerns about proportionate application of ISQC 1
- Revision of ISRS 4400, Engagements to Perform Agreed-Upon Procedures
 - Such engagements may service as a possible basis for “hybrid” engagements that combine agreed-upon procedures and various types of assurance (e.g., reasonable and limited) to meet specific users’ needs



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IFAC Guide to Review Engagements

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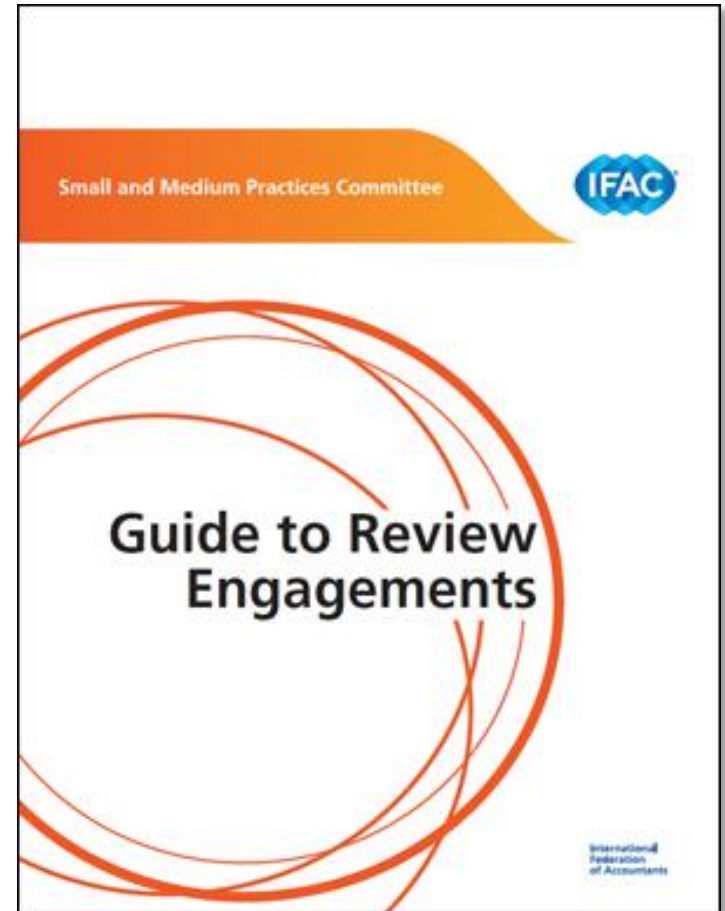
FEE & ICAEW Event
February 19, 2014

IFAC SMP Committee - Overview

- To represent interests of small- and medium-sized practices (SMPs)
- Comprises 18 members from 17 countries
- Regular input to policy, regulation and international standards
 - IAASB on key projects
- Develops tools and guidance
 - *Guide to Review Engagements*
- Promotes the visibility and recognition of SMPs
- IFAC Global Knowledge Gateway (IGKG)

Guide to Review Engagements

- International Standard on Review Engagements (ISRE) 2400 (Revised)
- The ***Guide to Review Engagements*** available on www.ifac.org/SMP



Uses of Review Engagements

Uses	Commentary
Increased Credibility	Independent credibility to the F/S—attract new investors, obtain finance.
Enhanced Confidence	Provides accountability & confidence to shareholders, management, partners, government agencies and regulators, and other stakeholders.
Plan for Success	Enables the business to plan for the future—prepares growing business for transition to audit or preparing to sell.

Benefits of Review Engagements

SME Benefits	Commentary
Alternative to Audit	Audit exemptions for small- and medium-sized entities (SMEs) are becoming more prevalent. Less time consuming for client.
Lower Cost	A review engagement is normally a lower cost for an entity than an audit.
Limited Assurance	Limited assurance obtained on the F/S as apposed to no assurance with a compilation.

Benefits of Review Engagements

SMP Benefits	Commentary
Bespoke Advice	Adds value to the client and provide a basis for bespoke advice
Opportunities— Additional Service	Ensure the client is aware of how and when a review engagement can be used Deepens relationship with the client Opportunities for cross-selling
Flexibility with Consistency	Consists primarily of inquiry and analytical procedures, allowing practitioners to tailor procedures based on their professional judgment and experience

Benefits of the Guide to Review Engagements

Guide Benefits	Commentary
Extracts from the Standard	All requirements from ISRE 2400 (Revised)
Tailored Examples and Consider Points	Illustrated examples and Consider Points including efficiency suggestions
Full Appendix	Checklists and forms for adaption
Staff Training	Day-to-day reference tool for staff—can be used for training Ensure SMP staff develop a consistent approach

The Four Elements

Accepting

Planning

Performing

Reporting

Some Highlights in the Guide from the Practitioner's Point of View

3.1-3 Professional Skepticism

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

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

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

Exhibit 3.1-3A

Professional Skepticism

An essential ATTITUDE to enhance ability to:

Identify/respond to conditions that indicate possible misstatement	Critically assess information and evidence obtained	Remain alert for evidence that: <ul style="list-style-type: none">• is contradictory; or• questions reliability of management	Draw appropriate conclusions
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Some Highlights in the Guide from the Practitioner's Point of View

3.1-3 Professional Skepticism

Paragraph	Requirement
	Professional Judgment

22

Professional skepticism to conditions that indicate possible misstatement

The main element

Exhibit 3.1-3

Examples Where Professional Skepticism Would Have Led to More Questions/Procedures

1. Identifying/Responding to Conditions That Indicate Possible Misstatement

The economy is in recession. Unemployment is very high and sales revenue for most entities in the apparel business is significantly down. In performing the review engagement, Kamal spent 10 minutes of research on the Internet and discovered that apparel sales are down in his country. He asked management about the increase in apparel sales this period and was told it was entirely due to the great sales team the entity employed.

On the surface, this seemed to be a reasonable explanation, so Kamal accepted it. However, when a variance is significant, some additional explanations would be helpful. Kamal should have exercised professional skepticism rather than simply accepting management's explanation without further inquiry. He could have asked some additional questions of management or the salespersons involved as to exactly how it was possible that the entity's sales team could have beaten the industry trend.

Such a variance needs to be further explored, as it could well be indicative of fraud. Other analytical review procedures that could have been performed include a review of sales by month, changes in the accounts receivable balance, and inquiries about the new customers.

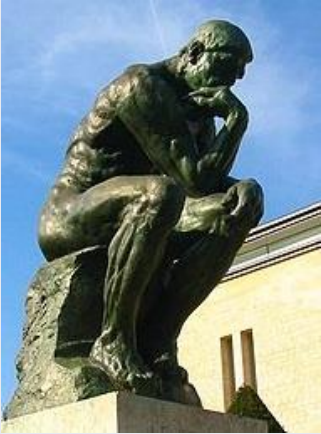
Identify/respond to conditions that indicate possible misstatement

Critically assess information and evidence obtained

Review for evidence that:

- is contradictory; or
- questions reliability of management

Some Highlights in the Guide from the Practitioner's Point of View



Emphasis on Professional Judgment



Limitation of Checklists to a Minimum

Tailoring of Checklists

Some Highlights in the Guide from the Practitioner's Point of View

Example 'Additional Procedures'

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

Some Highlights in the Guide from the Practitioner's Point of View

Example 'Documentation'

Income Statement		
Typical Lines of Inquiry	Oral Discussions (sample text)	Notes for the File (sample text)
Sales Revenue		
Inquire about, and document, the following:	<i>I met with Armin, the sales manager, and discussed the following:</i>	<i>Meeting held on Nov. 30, 20XX, with sales manager. Information obtained:</i>
(a) Composition of sales, new customers, and sales trends;	(a) [Asked Armin about any new sales accounts, new products, or significant new customers during the year.] Sales – No new sales categories (i.e., accounts) during the year. The company still has the same product lines but has been struggling to increase sales in this economy. Sales price increases were not possible and, although the company has two new large customers, some existing customers cut back their orders.	<ul style="list-style-type: none"> • No new product lines. • Sales were sluggish in year but no price increases, reduced prices, or extended credit terms provided.
(b) Any changes in the revenue recognition policies;	(b) [Asked Armin about revenue recognition policy and if any new or existing customers were given better terms or discounts to encourage sales.] Revenue recognition – Per Armin, although they have not been able to pass on price increases, they have not reduced prices or extended credit terms beyond the 30-day norm. Larger customers do get better pricing due to order size, but this has not changed from the prior year. Revenue is only recognized when the complete customer order is shipped. Deposits are booked in Account 3200.	<ul style="list-style-type: none"> • No volume discounts given.
(c) Credit and collection policies;		<ul style="list-style-type: none"> • Two new large customers.
(d) Extent of sales returns and credit memos during the year and, specifically, if any provision has been made for such returns at year end;		<ul style="list-style-type: none"> • No changes in: <ul style="list-style-type: none"> ◦ Credit and collection policies. ◦ Revenue recognition policy. Revenue only recognized when the complete customer order is shipped.
(e) Sales commission structure;		<ul style="list-style-type: none"> ◦ Sales commissions.
(f) Sales completeness; and		
(g) Cutoff procedures.		

IFAC Resources—Review Engagements

- IFAC SMP Committee: www.ifac.org/SMP
 - Article—[*Review Engagements for SMEs: Limited Assurance, Numerous Benefits*](#)
 - Article—[*The Standard for Limited Assurance Review Engagements*](#)
 - Follow us on [Twitter](#): IFAC_SMP
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- IAASB: www.iaasb.org
 - [*ISRE 2400 \(Revised\), Engagements to Review Historical Financial Statements*](#)

Thank You

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