



Agenda Item 2

Performance of a Review Engagement in an Electronic Environment

Objective of Agenda Item

To discuss how review engagements are performed in an electronic environment and consider whether additional guidance or requirements are necessary in order to ensure that engagements are performed in a high quality manner.

Background

Practitioners performing audits, reviews, compilations, and financial statement preparation services have increasingly utilized automated tools in an attempt to perform more effective and efficient engagements. Staff has had conversations with several practitioners regarding the usage of such tools and has become concerned that certain required review performance procedures are not being performed as intended and in a way as to ensure high-quality engagements.

Discussion With ARSC

How are analytical procedures performed?

Peer review inspections have indicated that some accountants have been performing analytical procedures in a way that may not result in the most effective review. Some accountants believe that analytical procedures simply consist of comparing prior year amounts to current year amounts and are performing the same analytical procedures on all review engagements. Such prescriptive procedures results in reduced insight into the client's financial statements and decreases the value of the review.

The use of an effective automation tool may allow the accountant to take a deeper look into the client's underlying financial data and perform more effective analytical procedures. More effective analytical procedures would also result in the performance of more effective inquiry and other review procedures by focusing the accountant on those areas where there is a higher risk of material misstatement.

How are inquiry procedures performed?

Paragraph .17 of AR-C section 90 reads as follows:

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- .17** The accountant should design and perform analytical procedures and make inquiries and perform other procedures, as appropriate, to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework based on the accountant's
- a. understanding of the industry,
 - b. knowledge of the entity, and
 - c. awareness of the risk that the accountant may unknowingly fail to modify the accountant's review report on financial statements that are materially misstated.

Paragraph .22 of AR-C section 90 requires that the accountant inquire of members of management who have responsibility for financial and accounting matters concerning the financial statements and provides a list of specific required inquiries.

The AICPA Guide, *Preparation, Compilation, and Review Engagements* provides additional guidance with respect to the performance of inquiry procedures (note that the following is an excerpt from the Guide and does not provide all of the relevant guidance):

- 1.120** Inquiry is a fundamental technique used in a review engagement to collect evidence relevant to the financial statements. Although the process of inquiry is simple, successful use of the technique depends on the individual who makes the inquiries. Specifically, the inquiry procedures are most effective when the accountant considers what questions to ask and pursues a significant line of aggressive questioning. The quality of the review engagement is reduced if the accountant performs inquiry in a mechanical fashion and accepts responses from entity personnel without exercising an appropriate level of professional skepticism.
- 1.121** A variety of similar questions apply to almost all review engagements. Most of these standard questions are asked in a somewhat formal manner, interviewing appropriate entity personnel and recording their responses directly in the review documentation.
- 1.122** Inquiry certainly is not limited to the formal process previously described. As the accountant becomes aware of a circumstance, fact, or relationship, the accountant will logically see a number of questions that can be asked. On the basis of responses given by the entity's personnel, the direction of the questioning may change or it may stop because the accountant is satisfied with the answer. In a review engagement, the inquiry process is an ongoing activity, reflecting the accountant's inquisitive nature and professional judgment.
- 1.123** The review engagement does not contain a specific place where inquiry should begin or end. The effectiveness of the review engagement is improved when the accountant remains inquisitive throughout the review engagement,

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raising appropriate questions and carefully evaluating the responses in the context of the specific engagement. In addition, it is not possible to script the inquiries that should be made in a review engagement. Each engagement is unique, and each practitioner is unique. Nonetheless, effective inquiries are focused and relevant. Asking irrelevant questions results in an inefficient review engagement and can damage entity confidence.

In short, the intent of the inquiry process is an in-depth and probing conversation with members of management who have responsibility for financial and accounting matters concerning the financial statements. The conversation, along with the results of analytical procedures and other review procedures performed, will provide the accountant with the appropriate review evidence in order to be able to conclude on the financial statements.

If the inquiry process is done with a checklist mentality or in some other fashion that lessens the effectiveness of the procedures, the accountant's ability to build on inquiries asked to ask further inquiries or perform other procedures is dramatically and negatively affected.

In discussions with practitioners, certain practices have come to light that raise questions as to whether reviews are being conducted in a manner that results in high quality engagements. With respect to inquiry procedures, those practices include the following:

- Inquiry procedures being performed remotely. Certain practitioners determine whether to "go into the field" based on the size and complexity of the entity and whether they have had communications with the entity prior to the review engagement. Staff has been told that as much as 50% of review engagements are being performed remotely. Staff is not aware what the prior communications consist of and what professionals may be having those communications. For instance, those communications may be conducted by tax accountants or others within the firm that are not part of the review engagement team.
- Inquiries being performed by less experienced accountants. Staff has been made aware that some firms are assigning less experienced accountant to perform the inquiry procedures – which lessens the ability of the accountant to ask follow-up questions and thus negatively effects the quality of the review evidence obtained.

Questions for ARSC Consideration:

The ARSC will have an open discussion about how review engagements should be performed and how the accountant should consider whether he or she has obtained sufficient appropriate review evidence to base the conclusion in the accountant's review report. ARSC members will specifically be asked whether:

- Technology results in more effective analytical review procedures.

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- Adequate inquiry procedures can be performed remotely and whether they are aware of any tools that assist in effective remote communications.
- There are certain aspects of the client and the accountant's relationship with the client that should be considered in making a decision as to whether to perform inquiry procedures in person or remotely.
- Inquiry procedures can be adequately performed by less experienced accountants and whether additional requirements or guidance is needed to ensure that high quality engagements are being performed.

Agenda Items Presented:

No additional agenda material is presented.