



AUDIT &
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TECHNICAL RELEASE

re:Assurance

THE ICAEW ASSURANCE SERVICE ON UNAUDITED FINANCIAL STATEMENTS

Interim Technical Release AAF 03/06

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PREFACE

1 Following the increase in the audit exemption threshold, many companies with a turnover below £5.6 million are no longer required to have a statutory audit of their financial statements although some still choose to do so. As an alternative, directors may however wish to obtain an independent assurance report on their financial statements from chartered accountants ('accountants'). The purpose of this report may be to enhance the credibility of historical financial information with third parties to whom the accountants may agree to provide an assurance report, or to give directors themselves additional comfort about financial statements for which they are responsible.

INTERNATIONAL FRAMEWORK

- 2 In January 2004, the International Auditing and Assurance Standards Board (IAASB) issued the International Framework for Assurance Engagements ('the International Framework') that sets out principles for assurance engagements. The International Framework is applicable to a wide range of assurance services, including services related to historical financial information.
- 3 The International Framework has been the primary source of reference in the development of AAF 03/06 which helps accountants to perform assurance engagements other than audit. AAF 03/06 also has regard to existing guidance and standards on similar types of assurance engagements.
- 4 In an assurance engagement, accountants¹ *'express a conclusion designed to enhance the degree of confidence of intended users about the outcome of the evaluation or measurement of a subject matter against criteria'*. In other words, assurance is a conclusion drawn by accountants where sufficient appropriate evidence has been gathered and evaluated against criteria suitable for the subject.
- 5 The expression of a conclusion separates assurance engagements from engagements to compile financial statements or to perform agreed-upon procedures. With compilation engagements, accountants are involved in the compilation of financial information, but express no conclusion upon that information². When accountants perform agreed-upon procedures, they report on findings of fact rather than giving an overall conclusion derived from their work³.
- 6 Statutory and non-statutory audits⁴ are types of assurance engagements, but are outside the scope of AAF 03/06. In these engagements accountants give a positive conclusion in the form of an audit opinion on financial statements. By contrast, in the engagements illustrated in AAF 03/06, accountants give a negative form of conclusion on unaudited financial statements. Accountants performing statutory and non-statutory audits comply with International Standards on Auditing (ISAs) (UK and Ireland) as adopted in the UK by the Auditing Practices Board (APB). A summary structure of assurance and non-assurance engagements is shown in Appendix A⁵.

¹ The term *Accountant(s)* refers to an individual accountant, firm of accountants, partner, director, or engagement leader who is responsible for an assurance engagement as distinct from auditors who audit financial statements.

² The Faculty has issued specific publications on the compilation of financial information: AUDIT 01/05, *Chartered Accountants' Reports on the Compilation of Historical Financial Information of Unincorporated Entities* and AUDIT 02/04, *Chartered Accountants' Reports on the Compilation of Financial Statements of Incorporated Entities*.

³ Additional information on reporting on agreed-upon procedures is available in AUDIT 1/01, *Reporting to Third Parties*.

⁴ There are different types of audits for companies that are exempt from a statutory audit. Details are available from the Audit and Assurance Faculty publication: *£5.6 million – threat or opportunity? – A guide for practitioners on the audit exemption threshold increase (2004)*.

⁵ AAF 03/06 is consistent with, but does not implement, the International Standard on Review Engagements (ISRE) 2400 *Engagements to review financial statements*. This guidance is specifically developed for unaudited small entities and is distinct from, for instance, ISRE 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*, that is issued in relation to interim review engagements where accountants have accumulated audit knowledge based on audits of annual financial statements.

SCOPE

- 7 AAF 03/06 gives guidance to members of the Institute of Chartered Accountants in England and Wales ('the ICAEW') when they perform an assurance engagement, but not a statutory or non-statutory audit, to provide a conclusion on unaudited financial statements of incorporated entities based on limited work procedures.
- 8 AAF 03/06 principally applies to financial statements prepared in accordance with the Companies Act 1985⁶. Accountants may also find the general principles that follow useful when they perform similar engagements on historical financial statements prepared for limited liability partnerships, or under legislation other than the Companies Act 1985. Financial statements prepared under Schedule 8A 'Form and Content of Abbreviated Accounts of Small Companies Delivered to Registrar' of the Companies Act 1985 are excluded from the scope, because the basis of preparing the abbreviated financial statements is different from that of full financial statements and separate guidance on the special auditors' report is given in the APB Bulletin 2006/3, *The special auditors' report on abbreviated accounts in the United Kingdom*.

TYPES OF ASSURANCE

- 9 The International Framework sets out two types of assurance engagements and associated objectives. These are reasonable and limited assurance engagements. The extent of work required differs based on the type of assurance. AAF 03/06 deals with limited assurance engagements. Existing auditing standards deal with reasonable assurance engagements performed on financial statements.
- 10 In reasonable assurance engagements, accountants seek to obtain sufficient appropriate evidence that enable them to express a positive opinion on the report prepared for users. For instance in an audit, accountants express their opinion that *'... in our opinion the financial statements give a true and fair view, ...'* Accountants perform sufficient work procedures to reduce the risk of a material misstatement so as to support a positive form of conclusion.
- 11 In limited assurance engagements, accountants seek to gather evidence sufficient to obtain a level of assurance which provides the basis for a negative form of conclusion on unaudited financial statements, that is *'... nothing has come to our attention to refute the directors' confirmation that ... the financial statements give a true and fair view ...'*
- 12 A limited assurance engagement consists principally of making enquiries of management and directors, applying analytical procedures to the financial statements and assessing whether the applied accounting policies are appropriate to the circumstances and adequately disclosed. It may include some examination of evidence relevant to certain balances and disclosures in the financial statements. This is, however, limited to situations where, after performing analytical procedures, enquiring of management and assessing the accounting policies, accountants have become aware of matters that might indicate a risk of material misstatement in the financial statements.

⁶ The term 'company' refers to a legal entity, formed and registered under the Companies Act 1985. A company is responsible for keeping accounting records under section 221 of the same Act.

13 In contrast to an audit, a limited assurance engagement does not include a comprehensive assessment of the risks of material misstatement, a consideration of fraud or of laws and regulations or the gaining of an understanding of, or the testing of, internal control performed in accordance with ISAs (UK and Ireland). It also does not include the gathering of evidence in relation to all material areas of the financial statements and in respect of all relevant assertions. It is therefore substantially less in scope and provides a lower level of assurance than an audit performed in accordance with ISAs (UK and Ireland). Accountants clarify this in their engagement letter and in their report.

NATURE OF ENGAGEMENT

14 An assurance engagement involves three separate parties: the accountants, the directors who are responsible for the preparation of the company's financial statements and the users of the accountants' report. The members of the company can also be the users of the accountants' report when the assurance report is addressed to them. This guidance assumes that the directors, and in some cases other parties who are users, will each engage the accountants to provide the assurance service.

DIRECTORS' RESPONSIBILITIES

15 In accordance with the Companies Act 1985, the directors are responsible for ensuring that the company maintains proper accounting records and for preparing financial statements which give a true and fair view and have been prepared in accordance with Generally Accepted Accounting Practice in the UK ('UK GAAP')⁷.

16 The directors' responsibilities include but are not limited to:

- selecting and applying appropriate accounting policies; and
- making accounting estimates that are reasonable in the circumstances.

The directors are also responsible for safeguarding the assets of the company and for taking steps for the prevention and detection of errors, fraud and other irregularities. The directors' responsibilities are unaffected whether there is a requirement for a statutory audit or not.

17 The accountants' conclusion on unaudited financial statements cannot be regarded as expressing assurance on the adequacy of the company's systems or on the incidence of fraud, non-compliance with laws and regulations or weaknesses in internal controls. Engaging accountants to perform an assurance engagement on unaudited financial statements does not relieve directors of their responsibilities in these respects.

18 So that it is clear where the boundaries between the duties of directors and accountants lie, directors add a brief statement on their responsibilities and Appendix D provides an example. This complements the accountants' report examples of which are set out in Appendix E. The directors' statement is positioned immediately before the accountants' report.

⁷ The components of UK GAAP may vary according to the type of company or entity. In general, UK GAAP can be considered in terms of two elements: mandatory and non-mandatory (in law or in practice). The mandatory elements are: the Companies Act 1985 (for incorporated entities), accounting standards issued by the Accounting Standards Board (ASB), e.g. Statements of Standard Accounting Practice (SSAPs) and Financial Reporting Standards (FRSs) (or Financial Reporting Standard for Smaller Entities (FRSSE)), abstracts issued by the ASB's Urgent Issues Task Force and the Listing Rules (for listed companies). Other elements of UK GAAP may be authoritative but non-mandatory: the ASB's Statement of principles for financial reporting and other statements, statements and recommendations from the professional bodies and established practice.

REPORTING CRITERIA

19 Any assurance engagement requires accountants to express an overall conclusion on the information, assessed relative to certain *criteria*. For engagements performed in accordance with AAF 03/06 the applicable criteria would be accounting policies selected by the directors within the framework of UK GAAP (see paragraphs 15-16). The criteria also help users to understand how the accountants have come to their conclusion and to obtain comfort from it, if appropriate.

PROFESSIONAL ETHICS

20 In carrying out an assurance engagement, accountants who are members of the ICAEW are subject to ethical guidance as laid down by the ICAEW's Code of Ethics. The requirements in the Code include, amongst other things, adherence to the Fundamental Principles in all of their professional and business activities as set out in the introduction. When conducting an assurance engagement, there are additional requirements in *Independence for Assurance Engagements* within the Code. This applies to all assurance engagements outside the scope of audit and is in compliance with the Code of Ethics established by the International Federation of Accountants (IFAC).

COMPLIANCE WITH DATA PROTECTION ACT 1998⁸

21 The accountants and the company are required to comply with the Data Protection Act 1998 ('DPA'). Accountants carrying out assurance engagements can clarify these respective responsibilities in their engagement letters⁹.

ACCEPTING AN ENGAGEMENT

- 22** Accountants discuss the terms of the engagement with the directors and obtain a clear understanding and agreement on the scope and purpose of the engagement, including their respective responsibilities. Where the accountants' report will be addressed to users, the users also become party to the engagement (see paragraph 26).
- 23** Accountants agree the terms of engagement with the parties to the engagement. To avoid misunderstandings, the agreed terms are recorded in an engagement letter. The illustrative contents of an example engagement letter are set out in Appendix B. Accountants may wish to consider this illustration as a basis for their letter.
- 24** Accountants consider the appropriateness of a request, made before the completion of the engagement, to change this type of engagement to a non-assurance engagement and do not agree to a change without reasonable justification. A change in circumstances that affects the users' requirements or misunderstanding concerning the nature of the engagement ordinarily justifies a request for a change in the engagement. If such a change is made, the accountants do not disregard evidence that was obtained prior to the change.

⁸ For more information, the ICAEW's Technical Release TECH 7-04 *Data Protection Act 1998 and its Application to the Major Practice Streams of Accountancy Practices* is available to members from the ICAEW's website.

⁹ Example wording is included in Appendix B. ii.

25 The assurance report may be received by a range of persons who are not party to the engagement. Accountants do not intend to assume responsibility to persons who are not party to the engagement, but legal actions from such persons may nonetheless occur. The accountants therefore need to apply appropriate engagement acceptance procedures in order to assess the risks associated with taking on a particular engagement and accordingly whether to do so and, if so, on what terms. Where accountants do accept such an engagement, suitably rigorous internal risk management policies are applied to manage any increased level of risk. Relevant steps for managing professional liability are covered in the following section.

MANAGING PROFESSIONAL LIABILITY

26 Where accountants are planning to perform an engagement in accordance with AAF 03/06 and intend to issue a report on unaudited financial statements, they consider whether there are any parties other than the addressees of the report who may seek to obtain a copy of the report and place reliance on and, if so, for what purposes. The existence, nature and interest of such third parties affect the accountants' risk assessment and their consideration of whether or not to accept the engagement and, if so, on what terms¹⁰. Depending on the engagement circumstances accountants may:

- (a) accept that they owe a duty of care to the third parties and enter into a tri-partite or multi-partite engagement contract with the board of directors and the third parties, including provisions limiting liability if appropriate;
- (b) proceed with an engagement for the board of directors alone (disclaiming any duty or liability to third parties by notice in the assurance report) and before allowing third parties access to the assurance report, require the third parties to
 - (i) acknowledge in writing that the accountants owe them no duty of care and
 - (ii) agree that they will assert no rights against accountants in connection with the assurance report;
- (c) engage with the board of directors alone disclaiming any duty or liability to third parties by notice in the assurance report¹¹. Accountants also consider supporting this disclaimer with an indemnity from the client to apply where a third party claim is made (recognising that such an indemnity may not be attractive commercially, may not be effective if the client is not financially stable, and may not operate to prevent a claim¹²); or
- (d) decline to accept the engagement.

In all cases, accountants (i) clarify in their engagement letter that the assurance report will be for the use and benefit of the addressees of the engagement letter and that the assurance report will disclaim any duty or liability to any other party and (ii) include a notice in the assurance report disclaiming any duty or liability to any party other than those parties with whom the accountants are engaged under the terms of the engagement letter. Illustrative contents and example wording of an engagement letter are available in Appendix B i and ii. If during the course of the engagement (or at any time thereafter) the accountants' risk assessment of the engagement changes, they consider varying the engagement letter or obtaining an acknowledgement of no duty or liability, in the manner envisaged in (b) above.

¹⁰ For further guidance on managing risk in the light of third party reporting, see AUDIT 1/01.

¹¹ If a disclaimer is used, accountants consider whether it is reasonable and therefore likely to be effective taking account of the requirements of the Unfair Contract Terms Act 1977.

¹² It may be appropriate to obtain an indemnity from the client in respect of claims from third parties arising from the contents of the assurance report. The risk of such claims may arise, for example, where the accountants' report is widely circulated, in breach of confidentiality and disclosure restrictions that have been agreed or where, with the accountants' consent, the report is attached to the financial statements filed with Companies House. However, it must be remembered that an indemnity does not prevent a claim from being brought against the indemnified party. It merely gives him a right to pass on the liability to the indemnifier. It follows, therefore, that if the indemnity is in some way ineffective or the indemnifier does not have adequate resources to meet the liability, the indemnified party may be left unprotected.

- 27** Accountants may, during the performance of the engagement or after issuing their report, become aware of third parties, such as banks and other lenders or prospective purchasers of the client, who may request sight of the assurance report¹³. The client or the third party may approach the accountants for consent to make the assurance report available to such third parties, as the engagement contract agreed with the client contains disclosure and use restrictions. Since the assurance report has not been prepared for third parties or with their interests or needs in mind the accountants may decline this request. The accountants will have set out the purpose of their engagement in the assurance report, and will have included a disclaimer of liability to third parties in line with paragraph 26 (c) above in that report. If the request is not declined, the accountants will advise the third party that the assurance report will not be and was not prepared nor will it be completed for the third party or the third party's benefit, that consent to their report being made available to a third party will only be given if the third party agrees that the third party should not rely on the report and acknowledges in writing that the accountants owe the third party no duty of care; and agrees that no claims may be brought against the accountants by the third party in relation to the report.
- 28** Accountants may also receive requests from the client for consent to the release of the assurance report to potential third parties with whom the client may be exploring the possibility of a relationship. The accountants may decline any such request. If the request is not declined, the written acknowledgement and agreement described above in relation to other third parties may be a practical solution to the management of risk in relation to such recipients. Where that is not practical, the accountants require the clients (as a condition for giving consent, where requested) to send all such potential recipients a written statement, to accompany the assurance report, pointing out that the accountants did not undertake the work for potential recipients and do not accept any responsibility to potential recipients and deny liability to them. Accountants may wish to provide the client with a pro-forma statement for this purpose and may wish to include reference to this in their engagement letter.
- 29** Accountants may also become aware that a third party has (despite disclosure restrictions) obtained a copy of the assurance report and may place reliance on it. In such circumstances, the accountants consider writing to the third party informing the third party that the accountants did not undertake the work for third parties and do not accept any responsibility to third parties and deny liability to them. Accountants might also suggest to the third party that, if there are specific matters of interest regarding the client, the third party should let the accountants know, so that the accountants might consider performing a separate engagement for this third party with a separate engagement letter to meet the interests/needs of this third party¹⁴. This would be regardless of whether the new engagement would be an assurance or an agreed-upon procedures engagement with this third party.
- 30** To guard against potential liability, accountants may also wish to consider the guidance provided in the ICAEW's Statement 1.311 *Managing the Professional Liability of Accountants* of Members' Handbook. This includes:
- defining the scope and responsibilities of the engagement;
 - defining the purpose of the accountants' report;
 - restricting the use of the accountants' name;
 - identifying the authorised recipients of report;

¹³ Further guidance may be found in the Audit and Assurance Faculty's guidance AUDIT 4/00, *Firms' Reports and Duties to Lenders in Connection with Loans and Other Facilities to Clients and Related Covenants*.

¹⁴ All the usual client acceptance procedures, including independence considerations, will need to be undertaken but these are outside the scope of AAF 03/06.

- limiting (or excluding) liability;
- obtaining an indemnity¹⁵; and
- defining the scope of professional competence.

PLANNING

- 31** Accountants plan the engagement and in doing so they obtain and update their knowledge of the business and consider the company's organisation, the type of accounting records maintained, operating characteristics, accounting principles and practices and the nature of its assets, liabilities, revenues and expenses. The accountants need to be alert to areas where potential risk of material misstatement may exist and plan their further enquiries in order to be able to assess the extent of that risk. However, they are not expected to carry out a comprehensive risk assessment. The level of planning may vary according to the complexity of the company's accounting records and the accountants' experience of the business.
- 32** To obtain a general understanding of the business and operations of the company, accountants familiarise themselves with the accounting principles and practices of the sector in which the company operates and with the form and content of the accounting information that is appropriate in the circumstances. The accountants' understanding of the business is usually obtained through experience of the company and enquiry of the company's management and staff. The accountants may also perform walk-throughs¹⁶ on the accounting records where considered necessary to support their understanding of the business and operations of the company and plan their further procedures.
- 33** The purpose of the planning process is to establish the nature, extent and timing of the further work to be performed. Further guidance on the work procedures for limited assurance engagements is set out in Appendix F. Factors that accountants take into account include, but are not limited to, their assessment of the risk of misstatement in the financial information and the strength of the accounting and reporting processes.

MATERIALITY AND CONSIDERATION OF RISK

- 34** The definition of materiality is provided in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements' and incorporated in ISA (UK and Ireland) 320 *Audit Materiality*:

'Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.'

- 35** Accountants apply the same principles when considering materiality as would be applied to an audit of the financial statements. The objective is to be able to judge whether, in the event of their enquiries and other procedures identifying a misstatement, it will be necessary to adjust the financial statements. Although there is a greater risk that misstatements will not be detected from limited work procedures, the judgement as to what is material is made by reference to the information on

¹⁵ It may be appropriate to obtain an indemnity from the client in respect of claims from third parties arising from the contents of the assurance report. The risk of such claims may arise, for example, where the accountants' report is widely circulated, in breach of confidentiality and disclosure restrictions that have been agreed or where, with the accountants' consent, the report is attached to the financial statements filed with Companies House. However, it must be remembered that an indemnity does not prevent a claim from being brought against the indemnified party. It merely gives him a right to pass on the liability to the indemnifier. It follows, therefore, that if the indemnity is in some way ineffective or the indemnifier does not have adequate resources to meet the liability, the indemnified party may be left unprotected.

¹⁶ Walk-throughs are performed to trace one or more transactions through the accounting system to obtain an understanding of how the accounting system works. The procedure is not performed to observe the application of the internal control system.

which the accountants are reporting and the needs of those relying on that information, not on the type of assurance provided. Because the accountants are not expected to plan and perform significant substantive procedures when undertaking this type of engagement, ordinarily it will be unnecessary for the accountants to consider the impact of materiality at the account balance or classes of transaction level. Individual misstatements are considered against the materiality applied to the overall financial statements.

36 Matters to consider in relation to the risk of material misstatement include:

- the current financial position and trading environment in which the company operates;
- accumulated knowledge acquired in carrying out such engagements in prior periods;
- the knowledge of the business, including accounting policies and practices of the industry in which the company operates;
- the knowledge of the company's accounting;
- the extent to which a particular item is potentially affected by management judgement;
- management's own assessment of the risks underlying the financial information and the monitoring and other controls established to manage those risks;
- management's own assessment of the company's ability to continue as a going concern and the impact of post balance sheet events; and
- the accountants' assessment of the materiality of transactions and account balances and the impact of any individually significant transactions.

PROCEDURES

37 As explained in paragraphs 12-13, accountants obtain evidence principally through enquiry of management and analytical procedures when performing work in accordance with AAF 03/06.

38 Where, after performing the above procedures, accountants consider that a significant risk of material misstatement has come to their attention, they discuss with management whether further work is required by management to establish if an adjustment is needed. In the event that there is insufficient information on which to base a request to management they may carry out additional work including substantive procedures as they consider necessary to support their conclusion. If management does not make any necessary adjustment, the accountants will consider the impact on their report or for other reporting requirements (e.g. submission of corporation tax returns), including whether to withdraw from the engagement (see paragraphs 57-59). This contrasts with an audit where auditors obtain sufficient appropriate evidence in respect of all material financial statement assertions, following a comprehensive risk assessment.

39 Accountants also consider methods available, such as disclosure checklists or software packages, to check whether relevant disclosures have been made on the basis of the information available. Guidance on work procedures is available in Appendix F.

DOCUMENTATION

- 40** Accountants document matters that, in their professional judgement, are important to support the content of the report. Matters documented usually include:
- the planning and performance of the engagement;
 - the nature, timing and extent of the procedures performed in relation to the financial information, and the conclusions reached;
 - the evidence resulting from the procedures carried out; and
 - the accountants' reasoning and conclusions on all significant matters which require the exercise of judgement.
- 41** The level of documentation may vary according to the complexity of the company's accounting records and accounting procedures, according to the accountants' experience with the business and whether any other matters have arisen during the course of the engagement.

EVENTS AFTER THE BALANCE SHEET DATE

- 42** Accountants enquire about events, subsequent to the date of the financial statements and up to the date that the accountants sign their report, which may require adjustment to, or disclosure in, the financial statements. Examples of specific enquiries which may be made of management include:
- the current status of items involving subjective judgement or which were accounted for on the basis of preliminary data; and
 - whether any events have occurred which might bring into question the appropriateness of accounting policies used in the financial statements.
- 43** Accountants do not have any responsibility to perform procedures to identify events occurring after the date of their report. Accountants may wish to clarify this in their engagement letter.

REPORTING

a. Management representations

- 44** In the course of the engagement, accountants may make enquiries of directors and management to obtain information and explanations concerning specific matters. The possibility of misunderstandings arising from oral responses to such enquiries may be reduced by obtaining confirmations in writing. Accountants may also wish to confirm in writing more general matters such as the completeness of relevant information made available to them for the purpose of their work. Accountants obtain from the directors such written representations as they consider necessary in the circumstances. Such representations by the directors normally include:
- acknowledgment of the directors' responsibility for the financial statements;
 - acknowledgment of the directors' responsibility for the completeness of the financial records and of the minutes of meetings and summaries of any meetings for which minutes have not been prepared that were made available to the accountants for the purposes of the engagement;
 - confirmation that the directors are not aware of any material amounts, transactions, agreements or contingencies not properly reflected in the accounting records underlying the financial information;

- notification of any subsequent events that would require adjustment to, or disclosure in, the financial statements; and
 - other matters, if any, for which the accountants consider written representations are appropriate in the circumstances. Such matters might include the substance of significant assertions, estimates or judgements or interpretations of facts by the directors that have a significant effect on the financial information.
- 45 A management representation letter is normally dated on the day the unaudited financial statements are approved and signed by the directors.
- 46 An illustrative management representation letter is given in Appendix C. Accountants request a representation letter to meet the specific circumstances of the engagement.

b. Approval of financial statements

- 47 The directors are legally responsible for the financial statements. The Companies Act 1985 requires that directors approve the financial statements and that the balance sheet states the name of the director signing the financial statements on behalf of the Board. The directors of companies that are exempt from statutory audit are required to acknowledge, on the face of the balance sheet, their responsibilities for keeping proper accounting records and for preparing true and fair financial statements as well as entitlement of the company to exemption from audit.
- 48 The financial statements contain a reference to the fact that they are unaudited either on the front cover or on each page of the financial statements.
- 49 Financial statements are approved and signed by the directors before the accountants' report is signed. The directors also sign the directors' statement to confirm that they have met their duty in accordance with the Companies Act 1985. An example directors' statement is given in Appendix D.

c. Accountants' reports

- 50 Accountants' reports help addressees derive comfort from the involvement of accountants who are subject to the ethical and other professional guidance issued by the ICAEW in relation to the engagement. It will also assist addressees in clarifying the scope of the engagement and the difference in the level of comfort obtained from an audit and an engagement envisaged in this guidance. Example reports are available in Appendix E.
- 51 Accountants' reports are headed up as 'independent'. This is because they have followed the ICAEW's ethical guidance (see paragraph 20).
- 52 Accountants' reports on the unaudited historical financial statements of a company include:
- a title stating that it is an assurance report, identifying the persons to whom the report is addressed and including the words 'Independent chartered accountants'/accountants¹⁷ report to....';
 - an introductory paragraph identifying the unaudited financial information on which the accountants' conclusion is given;
 - a statement that the report is made in accordance with the terms of engagement;
 - restrictions on the use of the assurance report to the addressees in accordance with the terms of the engagement letter and identification of the purpose for which the engagement is performed;

¹⁷ The title "Accountants' report to..." should be used rather than "Chartered accountants' report to..." where a firm is not permitted to use the term chartered accountant(s). For further details, see footnote 4 in AUDIT 02/04.

- a statement that the directors have acknowledged their responsibility to prepare financial statements that give a true and fair view in accordance with the Companies Act 1985;
 - identification of the purpose for which the engagement was performed;
 - a statement that the work was carried out in accordance with AAF 03/06;
 - a description of the work performed in undertaking the engagement;
 - a negative form of conclusion;
 - the name and signature of the accountants and any appropriate designation (but not 'Registered Auditor');
 - the date of the report; and
 - the details of the accountants (the name of the firm/accountants and the location of the office performing the engagement).
- 53** Accountants' reports are addressed to the parties to the engagement letter and include a disclaimer of any duty or liability to any parties who are not addressees of the report. In a tri-partite or multi-partite engagement, the addressees of the report include others, such as the company's members or identified third parties, who have agreed to be bound by the engagement and to whom the accountants have agreed to report and have accepted a duty of care (Appendix E. b. i). In a bi-partite engagement, the addressees of the report will be the directors alone (Appendix E. a. i)¹⁸.
- 54** If the accountants provide their prior written consent, copies of the accountants' assurance reports may be laid before the members at the annual general meeting (AGM) and attached to the copy of the company's unaudited financial statements and the directors' report for that year to be delivered to the Registrar of Companies. A specific example assurance report is available in Appendix E. b. ii.
- 55** Where inherent uncertainties about the outcome of future events exist and accountants are unable to obtain sufficient evidence to support their conclusion, they consider the impact of such uncertainties on the financial statements as a whole. If the impact of such uncertainties is considered to be material, and these uncertainties are adequately disclosed in the financial statements, accountants consider modifying the report by adding an explanatory paragraph to emphasise the uncertainties and separate the accountants' conclusion from the uncertainties paragraph(s). The addition of such uncertainties paragraph(s) does not affect the accountants' conclusion. Example wording for such a report is suggested in Appendix E. a. ii.
- 56** There are no provisions for the report to be qualified within this guidance. If accountants have any doubt over the validity of the financial statements on which the report is to be given or identify a material limitation of scope, they consider declining to issue any report and resign from the engagement and not permitting their name to be associated with the financial statements.
- 57** In certain circumstances, adjustments or disclosures that accountants consider appropriate may not be made in the financial statements, or information provided in the financial statements may not be satisfactory. If the accountants consider that the financial statements are misleading as a result, then they decline to issue any report and resign from the engagement and do not permit their name to be associated with the financial statements.

¹⁸ Further guidance may be found in the Audit and Assurance Faculty's guidance AUDIT 4/00, *Firms' Reports and Duties to Lenders in Connection with Loans and Other Facilities to Clients and Related Covenants*.

- 58** In considering whether financial statements are misleading, accountants consider whether the financial statements appear to be appropriate in form and free from material misstatements that appear evident to them as a result of, for example:
- misclassifications in the financial statements;
 - mistakes in the application of, or non-disclosure of known departures from, any relevant statutory, regulatory or other reporting requirements, including applicable accounting standards and non-disclosure of significant changes in accounting policies; and
 - other significant matters of which the accountants are aware.
- 59** When accountants resign from an engagement, they normally explain to the parties to the engagement their reasons for resigning, unless this would constitute a breach of legal or other regulatory requirements (such as the 'tipping off' provisions of the money laundering legislation).

APPENDIX A

Classification of assurance and non-assurance services

Type of engagement			
ASSURANCE Accountants express a conclusion.		NON-ASSURANCE No provision of a conclusion but a report on factual findings (agreed-upon procedures) or a report on collecting, classifying and summarising financial information (e.g. compilation engagement under Audit 02/04, <i>Chartered Accountants' Reports on the compilation of financial statements of incorporated entities</i>).	
Type of information			
Historical financial information		Other information*	
Type of assurance			
Reasonable assurance e.g. Statutory audits	Limited assurance e.g. Assurance Service under AAF 03/06 Independent examination on charities	e.g. Reporting on internal controls Reporting on profit forecast	

* Both reasonable and limited assurance engagements are performed on information other than historical financial information. Technical Release AAF 01/06, *Assurance reports on internal controls of service organisations made available to third parties* is based on reasonable assurance.

APPENDIX B

Illustrative contents and extracts of an engagement letter

i. Illustrative contents

The engagement letter includes matters such as:

- the identity of the addressees;
- the accountants who will conduct the engagement in accordance with AAF 03/06;
- the directors' responsibilities for the accounting records and the financial statements as specified in the Companies Act 1985;
- the information to be supplied by the directors to the accountants and confirmation that any other information that the accountants consider necessary for the performance of the engagement will be supplied;
- the accounting bases on which the financial statements will be prepared and the fact that any known departures will be disclosed;
- written management representations may be required prior to the completion of the engagement and the issuing of the accountants' report;
- the nature of the engagement;
- the accountants will enquire, perform analytical procedures and engage in discussions with management to obtain limited assurance over the information supplied to the accountants. In order to obtain limited assurance over the financial statements, the accountants will perform sufficient additional procedures as required to pursue any material matters that have come to their attention;
- the form of report to be provided, using defined terms appropriate for a limited assurance engagement to avoid misunderstanding, and any restrictions on its use;
- that the engagement cannot be relied on to prevent or detect errors, fraud and weaknesses in internal controls;
- an audit is not being carried out and no audit opinion is being given;
- the accountants' obligation not to be associated with false or misleading financial statements;
- if the accountants' association with the information being reported on is to be communicated to third parties, the accountants' prior written consent will be required, which may (if given) be conditional;
- the addressees of the report, limitations as to the purpose for which the report is prepared and restrictions on who is entitled to see and rely upon the report and on its distribution;
- the limitation of the accountants' liability including any liability cap as negotiated and agreed with the addressees of the engagement letter having regard to the nature and scope of the work being performed (and being fair and reasonable in compliance with the Unfair Contract Terms Act 1977);
- fee arrangement to cover situations where the accountants are unable to issue an assurance report; and
- respective responsibilities under the Data Protection Act 1998.

ii. Example extracts of an engagement letter

This engagement letter relates to a bi-partite engagement as envisaged in paragraph 26 (b); the engagement is formed by two parties, i.e. the accountants and the board of directors. Accountants are advised to use appropriate wording where the engagement involves others, such as members. The extracts are provided as illustrative guidance only.

Scope of our work

You have asked us to report to you on a limited assurance basis on the unaudited financial statements of the company. We shall plan our work on the basis that the company is not required by statute or regulation to have an audit of its financial statements for the year [/period] ended [date], unless you inform us in writing to the contrary. In carrying out this engagement we will make enquiries, perform analytical procedures and assess the consistency of application of your accounting policies in accordance with Generally Accepted Accounting Practice in the United Kingdom ('UK GAAP'). We will perform limited examination of evidence relevant to certain balances and disclosures in the financial statements where, after performing the above work, we become aware of matters that might indicate material misstatements in the financial statements.

Our work will be undertaken and our report will be made in accordance with AAF 03/06 issued by the Institute of Chartered Accountants in England and Wales.

Our conclusion on the unaudited financial statements cannot be regarded as providing assurance on the adequacy of the company's systems or on the incidence of fraud, non-compliance with laws and regulations or weaknesses in internal controls. Engaging us to perform this assurance engagement on the unaudited financial statements does not relieve the directors of their responsibilities in these respects.

You have advised us that the company is exempt from an audit of the financial statements. We will not carry out any work to determine whether or not the company is entitled to audit exemption. However, should our work indicate that the company is not entitled to the exemption, we will inform you of this.

Our work will not be an audit of the financial statements in accordance with International Standards on Auditing (UK and Ireland). Consequently, it does not include a comprehensive assessment of the risks of material misstatement, a consideration of fraud or of laws and regulations, or the gaining of an understanding of, or the testing of, internal control in accordance with International Standards on Auditing (UK and Ireland). It also does not include the gathering of evidence in relation to all material areas of the financial statements and in respect of all relevant assertions.

Since we will not carry out an audit, nor confirm the accuracy or reasonableness of the accounting records maintained by the company, we can only provide a limited assurance report as to whether the financial statements present a true and fair view.

Furthermore, as the Board of Directors, you have a duty to prepare financial statements that comply with the Companies Act 1985 and applicable accounting standards. Where we identify that the financial statements do not conform to UK GAAP or if the accounting policies adopted are not immediately apparent this will need to be disclosed in the financial statements.

We have a professional responsibility not to be associated with financial statements which may be false or misleading. Therefore, although we are not required to search for such matters, should we become aware, for any reason, that the financial statements may be misleading, we will discuss the matter with you with a view to agreeing appropriate

adjustments and/or disclosures in the financial statements. In circumstances where adjustments and/or disclosures that we consider appropriate are not made or where we are not provided with appropriate information, and as a result we consider that the financial statements are misleading, we will withdraw from the engagement.

Basis of the accountants' report

Our report is prepared on the following basis:

- our report is prepared solely for your confidential use. It may not be relied upon by anyone else; and
- except to the extent required by court order, law or regulation, or where required in any court proceedings in which you may be involved, our report must not be made available, copied, referred to or recited to any other person, or included in any other document, nor may you make reference to us or the services, without our prior written permission.

Data Protection Act

In the conduct of our professional services we may need to collect and use personal information about you, your partners, your company, your trustees, your clients or customers and your or their employees, agents or contractors, which we will hold as data controllers under the Data Protection Act 1998 (DPA). You confirm that you have complied with the requirements of the DPA when providing us with such personal information.

Liability provisions¹⁹

We (that is, [name of firm],) will perform the engagement with reasonable skill and care and we acknowledge that in respect of liability (if any) on our part to the Company for losses, damages, costs or expenses ('losses') caused by our breach of contract, negligence, fraud or other deliberate breach of duty, the following provisions will apply:

- we will not be liable if such losses are due to the provision of false, misleading or incomplete information or documentation or due to the acts or omissions of any person other than us, except where, on the basis of the work normally undertaken by us within the scope set out in these terms of engagement, it would have been reasonable for us to discover such defects;
- we will accept liability without limit for the consequences of our own fraud or other deliberate breach of duty and for any other liability which it is not permitted by law to limit or exclude; and
- subject to the previous provisions of this liability paragraph, our total aggregate liability whether in contract, tort (including negligence) or otherwise, to the Company, for losses arising from or in connection with the work which is the subject of these terms (including any addition or variation to the work), shall not exceed in aggregate the amount of [*To be discussed and negotiated*]²⁰.

The Company and the directors of the Company will not bring any claims or proceedings against any of our individual partners, members, directors or employees. This clause is intended to benefit such partners, members, directors and employees who may enforce this clause pursuant to the Contracts (Rights of Third Parties) Act 1999 ('the Act').

Notwithstanding any benefits or rights conferred by this agreement on such partners,

¹⁹ Accountants may wish to seek independent legal advice on language that addresses the matters covered in the illustrative wording set out in this liability section.

²⁰ *Audit Liability: Claims by Third Parties* published by the Audit and Assurance Faculty in 2005 provides information on third party claims. Appendix 2 of the publication reproduces an article from October 2004 issue of *True & Fair* on liability caps which is relevant to assurance engagements.

members, directors or employees by virtue of the Act, we and the directors of the Company may together agree in writing to vary or rescind the agreement set out in this letter without the consent of any such partners, members, directors or employees. Other than as expressly provided in this paragraph, the provisions of the Act are excluded.

Any claims, whether in contract, negligence or otherwise, must be formally commenced within [years] after the party bringing the claim becomes aware (or ought reasonably to have become aware) of the facts which give rise to the action and in any event no later than [years] after any alleged breach of contract, negligence or other cause of action. This expressly overrides any statutory provision which would otherwise apply.

APPENDIX C

Illustrative management representation letter

A Company Limited

[Address]

[Address]

A Firm of Accountants

[Address]

[Address]

Date.....

Dear Sirs,

Letter of Representation

We confirm that the following representations are made on the basis of enquiries of management and staff with relevant knowledge and experience (and, where appropriate, of inspection of the supporting documentation) sufficient to satisfy ourselves that we can properly make each of the following representations to you in connection with your report on the financial statements of the company for the year ended [date]:

1. We acknowledge that the work performed by you is substantially less in scope than an audit performed in accordance with Auditing Standards and that you do not express an audit opinion.
2. We confirm that the company was entitled to exemption under section 249A (1) of the Companies Act 1985 from the requirement to have its financial statements for the financial year ended [date] audited. We also confirm that the members have not required the company to obtain an audit of its financial statements for the financial year in accordance with Section 249B, (2) of the Companies Act 1985.
3. We acknowledge as directors our responsibility for the financial statements which give a true and fair view of the state of affairs of the company as at the end of the financial year and of its profit or loss for the financial year in accordance with the requirements of section 226 of the Companies Act 1985, and which otherwise comply with the requirements of that Act relating to financial statements, so far as applicable to the company. All the accounting records have been made available to you and all transactions undertaken by the company have been properly reflected in those accounting records. All records and related information, including the minutes of the directors' and shareholders' meetings have been made available to you.
4. We confirm that we have maintained proper accounting records, as required by the Companies Act 1985.
5. We confirm, to the best of our knowledge and belief that there have been no instances of non-compliance or breaches of any laws or regulations which are essential to the activities of the company's business.
6. We are not aware of any pending litigation which may result in a significant loss to the company.
7. There were no contingent liabilities at the balance sheet date.

8. As directors, we have considered the financial position of the company. We are not aware of any material uncertainties or doubts about the ability of the company to continue as a 'going concern' for the foreseeable future.
9. We confirm that there were no transactions with related parties of the company or amounts due to or from related parties at the balance sheet date which are required to be disclosed in the financial statements other than those which are detailed in the notes to the financial statements.
10. There have been no events since the balance sheet date which necessitate revision of the figures included in the financial statements or disclosure in the notes to the financial statements.

Signatures

A Company Limited

Date

APPENDIX D

Example directors' statement

The purpose of the directors' statement is to make clear that responsibility for preparing the financial statements rests with the board of directors and to remove any misconception that the accountants are responsible for the financial statements. The directors' statements should be placed immediately before the accountants' report.

We confirm that as directors we have met our duty in accordance with the Companies Act 1985 to:

- ensure that the company has kept proper accounting records;
- prepare financial statements which give a true and fair view of the state of affairs of the company as at [date] and of profit and loss for that period in accordance with Generally Accepted Accounting Practice in the UK [or Financial Reporting Standard for Smaller Entities]; and
- follow the applicable accounting policies, subject to any material departures disclosed and explained in the notes to the financial statements.

Signatures

A Company Limited

Date

APPENDIX E

Example reports

E. a. i Reporting to the directors

Chartered accountants' independent assurance report on the unaudited financial statements of [name of entity]

To the Board of Directors of [name of entity] ('the Company')

We have performed certain procedures in respect of the Company's unaudited financial statements for the year [/period] ended [date] as set out on pages [] to [], made enquiries of the Company's directors and assessed accounting policies adopted by the directors, in order to gather sufficient evidence for our conclusion in this report.

This report is made solely to the Company's directors, as a body, in accordance with the terms of our engagement letter dated [date]. It has been released to the directors on the basis that this report shall not be copied, referred to or disclosed, in whole (save for the directors' own internal purposes or as may be required by law or by a competent regulator) or in part, without our prior written consent. Our work has been undertaken so that we might state to the directors those matters that we have agreed to state to them in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's directors as a body for our work, for this report or the conclusions we have formed.

Respective responsibilities

You have confirmed that you have met your duty as set out in the directors' statement on page []. You consider that the Company is exempt from the statutory requirement for an audit for the year [/period]. Our responsibility is to form and express an independent conclusion, based on the work carried out, to you on the financial statements.

Scope

We conducted our engagement in accordance with the Institute of Chartered Accountants in England and Wales' Interim Technical Release AAF 03/06. Our work was based primarily upon enquiry, analytical procedures and assessing accounting policies in accordance with Generally Accepted Accounting Practice in the UK [/the Financial Reporting Standard for Smaller Entities]. If we considered it to be necessary, we also performed limited examination of evidence relevant to certain balances and disclosures in the financial statements where we became aware of matters that might indicate a risk of material misstatement in the financial statements.

The terms of our engagement exclude any requirement to carry out a comprehensive assessment of the risks of material misstatement, a consideration of fraud, laws, regulations and internal controls, and we have not done so. We are not required to, and we do not, express an audit opinion on these financial statements.

Conclusion

Based on our work, nothing has come to our attention to refute the directors' confirmation that in accordance with the Companies Act 1985 the financial statements give a true and fair view of the state of the Company's affairs as at [date] and of its profit [loss] for the year [period] then ended and have been properly prepared in accordance with Generally Accepted Accounting Practice in the UK [the Financial Reporting Standard for Smaller Entities].

Name of firm

Chartered accountants

Location

Date

E. a. ii Reporting to the directors with an explanatory paragraph

Chartered accountants' independent assurance report on the unaudited financial statements of [name of entity]

To the Board of Directors of [name of entity] ('the Company')

We have performed certain procedures in respect of the Company's unaudited financial statements for the year [/period] ended [date] as set out on pages [] to [], made enquiries of the Company's directors and assessed accounting policies adopted by the directors, in order to gather sufficient evidence for our conclusion in this report.

This report is made solely to the Company's directors, as a body, in accordance with the terms of our engagement letter dated [date]. It has been released to the directors on the basis that this report shall not be copied, referred to or disclosed, in whole (save for the directors' own internal purposes or as may be required by law or by a competent regulator) or in part, without our prior written consent. Our work has been undertaken so that we might state to the directors those matters that we have agreed to state to them in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's directors as a body for our work, for this report or the conclusions we have formed.

Respective responsibilities

You have confirmed that you have met your duty as set out in the directors' statement on page []. You consider that the Company is exempt from the statutory requirement for an audit for the year [/period]. Our responsibility is to form and express an independent conclusion, based on the work carried out, to you on the financial statements.

Scope

We conducted our engagement in accordance with the Institute of Chartered Accountants in England and Wales' Interim Technical Release AAF 03/06. Our work was based primarily upon enquiry, analytical procedures and assessing accounting policies in accordance with Generally Accepted Accounting Practice in the UK [/the Financial Reporting Standard for Smaller Entities]. If we considered it to be necessary, we also performed limited examination of evidence relevant to certain balances and disclosures in the financial statements where we became aware of matters that might indicate a risk of material misstatement in the financial statements.

The terms of our engagement exclude any requirement to carry out a comprehensive assessment of the risks of material misstatement, a consideration of fraud, laws, regulations or internal controls, and we have not done so. We are not required to, and we do not, express an audit opinion on these financial statements.

Significant uncertainty

Without qualifying our opinion, we draw attention to Note [X] to the financial statements. The Company is the defendant in a lawsuit alleging infringement of certain patent rights and claiming royalties and punitive damages. The Company has filed a counter action, and preliminary hearings and discovery proceedings on both actions are in progress. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial statements.

Conclusion

Based on our work, nothing has come to our attention to refute the directors' confirmation that in accordance with the Companies Act 1985 the financial statements give a true and fair view of the state of the Company's affairs as at [date] and of its profit [/loss] for the year [/period] then ended and have been properly prepared in accordance with Generally Accepted Accounting Practice in the UK [/the Financial Reporting Standard for Smaller Entities].

Name of firm

Chartered accountants

Location

Date

E. b. i. Reporting to the directors and other parties

Chartered accountants' independent assurance report on the unaudited financial statements of [name of entity]

To the Board of Directors of [name of entity] ('the Company') and [X]

We have performed certain procedures in respect of the Company's unaudited financial statements for the year [/period] ended [date] as set out on pages [] to [], made enquiries of the Company's directors and assessed accounting policies adopted by the directors, in order to gather sufficient evidence for our conclusion in this report.

This report is made solely to the Company's directors, as a body, and to [X], [as a body]²¹, in accordance with the terms of our engagement letter dated [date]. It has been released to the directors and [X] on the basis that this report shall not be copied, referred to or disclosed, in whole (save for the directors' own internal purposes or amongst the directors and [X] or as may be required by law or by a competent regulator) or in part, without our prior written consent.²² Our work has been undertaken so that we might state to the directors and [X] those matters that we have agreed to state to them in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's directors as a body and [X] [as a body], for our work, for this report or the conclusions we have formed.

Respective responsibilities

The Company's directors have confirmed that they have met their duty as set out in the directors' statement on page []. They consider that the Company is exempt from the statutory requirement for an audit for the year [/period]. Our responsibility is to form and express an independent conclusion, based on the work carried out, to the Company's directors and [X] on the financial statements.

Scope

We conducted our engagement in accordance with the Institute of Chartered Accountants in England and Wales' Interim Technical Release AAF 03/06. Our work was based primarily upon enquiry, analytical procedures and assessing accounting policies in accordance with Generally Accepted Accounting Practice in the UK [/the Financial Reporting Standard for Smaller Entities]. If we considered it to be necessary, we also performed limited examination of evidence relevant to certain balances and disclosures in the financial statements where we became aware of matters that might indicate a risk of material misstatement in the financial statements.

The terms of our engagement exclude any requirement to carry out a comprehensive assessment of the risks of material misstatement, a consideration of fraud, laws, regulations or internal controls, and we have not done so. We are not required to, and we do not, express an audit opinion on these financial statements.

²¹ The "other parties" ([X]) are described "as a body" on the assumption that they are more than one.

²² This assumes that, if [X] is more than a single party, the relevant parties comprising [X] are few in number and have all signed the engagement letter.

Conclusion

Based on our work, nothing has come to our attention to refute the directors' confirmation that in accordance with the Companies Act 1985 the financial statements give a true and fair view of the state of the Company's affairs as at [date] and of its profit [/loss] for the year [/period] then ended and have been properly prepared in accordance with Generally Accepted Accounting Practice in the UK [/the Financial Reporting Standard for Smaller Entities].

Name of firm

Chartered accountants

Location

Date

E. b. ii. Reporting to the directors and members

Chartered accountants' independent assurance report on the unaudited financial statements of [name of entity]

To the Board of Directors and the members of [name of entity] ('the Company')

We have performed certain procedures in respect of the Company's unaudited financial statements for the year [/period] ended [date] as set out on pages [] to [], made enquiries of the Company's directors and assessed accounting policies adopted by the directors, in order to gather sufficient evidence for our conclusion in this report.

This report is made solely to the Company's directors and the Company's members, in each case as a body, in accordance with the terms of our engagement letter dated [date]. It has been released to the directors and the members on the basis that this report shall not be copied, referred to or disclosed, in whole (save for the directors' own internal purposes or amongst the directors and members or as may be required by law or by a competent regulator) or in part, without our prior written consent.²³ Our work has been undertaken so that we might state to the directors and the members those matters that we have agreed to state to them in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's directors as a body and the Company's members as a body, for our work, for this report or the conclusions we have formed.

Respective responsibilities

The Company's directors have confirmed that they have met their duty as set out in the directors' statement on page []. They consider that the Company is exempt from the statutory requirement for an audit for the year [/period]. Our responsibility is to form and express an independent conclusion, based on the work carried out, to the Company's directors and the Company's members on the financial statements.

Scope

We conducted our engagement in accordance with the Institute of Chartered Accountants in England and Wales Interim Technical Release AAF 03/06. Our work was based primarily upon enquiry, analytical procedures and assessing accounting policies in accordance with Generally Accepted Accounting Practice in the UK [/the Financial Reporting Standard for Smaller Entities]. If we considered it to be necessary, we also performed limited examination of evidence relevant to certain balances and disclosures in the financial statements where we became aware of matters that might indicate a risk of material misstatement in the financial statements.

The terms of our engagement exclude any requirement to carry out a comprehensive assessment of the risks of material misstatement, a consideration of fraud, laws, regulations or internal controls, and we have not done so. We are not required to, and we do not, express an audit opinion on these financial statements.

²³ This assumes that the members are few in number and have all signed the engagement letter.

Conclusion

Based on our work, nothing has come to our attention to refute the directors' confirmation that in accordance with the Companies Act 1985 the financial statements give a true and fair view of the state of the Company's affairs as at [date] and of its profit [/loss] for the year [/period] then ended and have been properly prepared in accordance with Generally Accepted Accounting Practice in the UK [/the Financial Reporting Standard for Smaller Entities].

Name of firm

Chartered accountants

Location

Date

APPENDIX F

Work procedures for the engagement

This guidance is intended for accountants who carry out the ICAEW Assurance Service on unaudited financial statements.

As discussed in paragraphs 11 to 13, the engagement procedures consist primarily of making enquiries of management and the directors, applying analytical procedures to the financial statements and assessing whether the applicable accounting policies are appropriate to the circumstances, and adequately disclosed. It may also include some examination of evidence relevant to certain balances and disclosures in the financial statements where, after performing the above work, accountants have become aware of matters that might indicate a risk of material misstatement in the financial statements. The engagement procedures will fall short of those of a full audit performed under ISAs (UK and Ireland), which include a comprehensive assessment of the risks of material misstatement, including a consideration of the risk of fraud and of non-compliance with relevant laws and regulations, the gaining of an understanding of, and where relevant the testing of, internal control, and the gathering of evidence in respect of all material areas of the financial statements and for all relevant assertions.

The objectives stated below are to assist the thought process of accountants in designing and performing engagement procedures. The engagement procedures need not necessarily follow the described order in all respects and the process may be iterative to respond to the findings. The accountants use their professional judgement in establishing the work programme for individual engagements.

Planning

1. Ethical requirements

Accountants ensure that the ICAEW's Code of Ethics, including the Fundamental Principles and the requirements in *Independence for Assurance Engagements* is followed. Accountants check that suitable safeguards are in place if a threat to independence is perceived, for instance, if the accountants have been involved in the compilation of the financial statements.

2. Understanding the entity

Accountants ensure that their understanding of the entity is sufficient to plan appropriate work procedures to issue an assurance report. The objective of gaining the knowledge of the entity is primarily to enable the accountants to establish the accounting principles applied, consider materiality and plan their further enquiries. This knowledge is in particular used to form expectations for and to design appropriate analytical procedures. Understanding the entity may involve:

- discussions with management and, where appropriate, members of staff;
- reviewing minutes of board meetings to ascertain details of major events, plans and decisions;
- obtaining details of accounting records maintained and methods of recording financial transactions;
- understanding areas in which accounting estimates need to be made; and
- walk-throughs of the accounting records.

3. Establishing accounting principles adopted

Accountants establish the accounting principles adopted by the entity and consider if these are appropriate to the circumstances. Considerations include the effect of recent accounting pronouncements and changes in accounting policies because these could affect the work procedures. Accountants also identify areas where accounting estimates are made or management has exercised their judgement.

Accountants stay alert to inconsistencies during the performance of analytical procedures and management enquiry. If matters come to their attention that indicate that the accounting policies may be inappropriate they discuss what action is necessary with management. In certain circumstances in order to obtain further information accountants may perform substantive procedures (see below).

Work procedures may involve:

- reviewing accounting policies;
- discussions with management and where appropriate members of staff; and
- analytical procedures.

4. Establishing materiality

Accountants consider materiality in reference to the information on which they are reporting and the needs of the users of the financial statements. The purpose of establishing materiality is to help accountants to judge whether, having found any misstatements, there is a need to make adjustments; the purpose is not to judge the nature, extent and timing of substantive work in relation to all material assertions.

To establish materiality, accountants may wish to consider the following:

- the entity's size, trading environment, industry and accounting process;
- discussion with management on their assessment of the risks to the financial information and controls in place; and
- the entity's ability to continue in business as a going concern.

Performance

5. Performing analytical procedures

Accountants perform analytical procedures to see if the financial statements are consistent and make sense. Analytical procedures involve identifying unusual items or disclosures in the financial statements. Inconsistencies arising from the analytical procedures may indicate the risk of material misstatement. Accountants seek to address these inconsistencies by discussing them with management. Where further information is needed before agreeing with management what action needs to be taken, substantive procedures may need to be performed (see below).

Analytical procedures may include:

- comparison with expectations based on prior year's figures, budgets and industry statistics; and
- consideration of interrelationships between changes in balances and other fluctuations and significant events during the period.

6. Enquiry of management

Accountants obtain management explanations to understand events and reasoning that underpin the reported financial results. Such explanations may also address any inconsistencies identified from the performance of analytical procedures. Accountants may also wish to view supporting documentation for management explanations, such as reading minutes of board meetings and correspondence with third parties.

7. Performing substantive procedures

As stated in paragraphs 37 to 39, accountants perform substantive procedures to verify balances and transactions where significant risk of material misstatement exists as a result of enquiry of management and performing analytical procedures as described above in 5 and 6. Accountants are not expected to apply substantive procedures to every material balance and relevant financial statement assertion as expected in an audit.

Accountants exercise professional judgement in deciding the extent of substantive procedures to support their conclusions.

Where accountants have decided that substantive procedures may be necessary, these may include:

- comparing the financial statements with underlying accounting records;
- physical inspection of fixed assets/stock;
- verification of title to or the price of an asset;
- inspection of third party documents;
- third party certification of debit/credit balances;
- examination of post year end receipts/payments to confirm recoverability of a debt/the quantum of a liability; and
- checking cut-off.

8. Considering events subsequent to the year end

Accountants enquire of management whether there have been any material events subsequent to the year end to identify items that require adjustment to or disclosure in the financial statements. Accountants may request sight of the supporting documentation.

9. Reviewing the form and content of the financial statements

Accountants may wish to ensure the form and content of the financial statements are in compliance with the adopted accounting principles. This may be assisted by using a disclosure checklist.

THE ICAEW ASSURANCE SERVICE ON UNAUDITED FINANCIAL STATEMENTS

Interim Technical Release AAF 03/06

AAF 03/06 is issued by the Audit and Assurance Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) in August 2006. AAF 03/06 is best practice guidance and professional judgement should be used in its application. No responsibilities for loss occasioned to any person acting or refraining from action as a result of any material in AAF 03/06 can be accepted by the ICAEW.