31 May 2011

Our ref: ICAEW Rep 56/11

Your ref:

James Gunn
IAASB Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, New York
10017 USA

Dear James

Proposed International Standard on Review Engagements, (ISRE) 2400 (Revised), Engagements to review historical financial statements

ICAEW is pleased to respond to your request for comments on *Proposed International Standard on Review Engagements (ISRE) 2400 (Revised), Engagements to review historical financial statements.*

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

PROPOSED INTERNATIONAL STANDARD ON REVIEW ENGAGEMENTS (ISRE) 2400 (REVISED), ENGAGEMENTS TO REVIEW HISTORICAL FINANCIAL STATEMENTS

Memorandum of comment submitted in May 2011 by ICAEW, in response to the IAASB exposure draft Proposed International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to review historical financial statements* published in January 2011

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Proposed International Standard on Review Engagements (ISRE) 2400 (Revised), Engagements to review historical financial statements* published by the IAASB.

WHO WE ARE

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

BACKGROUND

4. In the UK, incorporated entities publicly file their financial statements and the credibility of these accounts is vital for the market. Prior to 1993, all UK companies had their financial statements audited because this was required by company law. Therefore, in the UK there was little demand for other types of professional opinion, although there was some practice of giving other types of report for compilation engagements or on the results of performing agreed-upon procedures on financial information. With the raising of the audit exemption thresholds in Europe, the UK Government, after a number of consultations, eventually also raised the statutory thresholds for audit in the UK to the European maximum. By 2006 an increasing and substantial majority of companies were taking advantage of this exemption. Against this backdrop, ICAEW decided to instigate a debate on whether a new alternative to audit was needed in the UK by reference to a specific service that companies could use.

5. ICAEW launched its version of a limited assurance service on the annual accounts of audit-exempt companies in 2006. The interim guidance *The ICAEW Assurance Service on Unaudited Financial Statements* was also supported by a practical information sheet intended to help our members communicate the value of the new service to their clients. The service was not a UK application of the existing International Standard on Review Engagements (ISRE) 2400: in the period since the IAASB originally issued ISRE 2400, it had published the International Framework for Assurance Engagements and ICAEW drew on the thinking in that document to develop the new assurance service.

6. Prior to the launch, ICAEW also carried out a series of in-depth interviews with SMEs, potential users of the service and other interested parties. The report summarising the findings from SME interviews is published in 2006. We continued to monitor how users perceived the service and how practice developed and in 2009 issued *Alternatives to audit: report on the ICAEW Assurance Service consultation*, a summary of our findings at that time in a report. These sources, along with the comments from stakeholders and practitioners we sought in relation to the IAASB exposure draft, have informed this response.

7. Prior to the ICAEW project, the UK Auditing Practices Board (APB) field trialled a form of review engagement in 2001, strictly based on performing inquiry and analytical procedures. We have referred to the findings of these field trials, summarised in the APB's report *Findings of the field trials of the Independent Professional Review*, where relevant.

MAJOR POINTS

Support for the initiative

8. We welcome the exposure of ISRE 2400 (Revised), *Engagements to review historical financial statements*. We developed an equivalent of a review engagement (the ICAEW Assurance Service) and have subsequently revisited how practice has developed in the UK. We have referred to our knowledge and experience in this respect, in developing this response.

9. We support the IAASB initiatives in revising standards on reviews and compilations as they enhance the credibility of accounts. We believe that the confidence of all users in the transparency and integrity of accounts is vital to the effective functioning of the economy, efficient capital allocation, financial stability and sound economic growth. A review is a welcome additional way in which the involvement of an assurance practitioner can improve the public's confidence in such accounts. These services will be particularly relevant to jurisdictions where audit exemption is a new concept.

Differentiating reviews from audits and compilations

10. We note that the IAASB has attempted to differentiate a review from an audit and agree that it is important to do so. There are a number of paragraphs that introduce concepts and terminology from International Standards on Auditing (ISAs), suggesting that the proposed review standard is more akin to the auditing standards. We accept this as inevitable as there are many similarities between reviews and audits because both are assurance engagements on the same subject matter, historical financial information.

11. More work is, however, needed to differentiate reviews a review engagement from .a compilation engagement. In the UK, a wide variety of audit-exempt companies has their accounts compiled by professional accountants. In fact, for certain types and size of entities, compilations might be better suited than reviews. Reviews and compilations are simply different. This means that the two standards need to communicate clearly the nature and objectives of these services. It would be useful to do so both in the standards and in the reports. However, we recognise that the reports should not be unduly long and that inclusion of technical explanations may reduce their readability to a lay user. We therefore recommend that both compilation and review standards should be clear in terms of what each service is intended to achieve and provides practitioners with the materials they might need when explaining the nature and objectives of these services to their clients and, if appropriate, users.

12. We are also aware that the boundary between compilations and reviews is sometimes blurred where practitioners carry out additional procedures voluntarily to satisfy the requirement of the Code of Ethics in respect of being not knowingly associated with materially false or misleading reports and other information when performing compilations (110.2, IESBA Code of Ethics). Practitioners may also prepare accounts and provide a review service to the same client where appropriate, if they satisfy the requirement for appropriate safeguards to address the threat to their independence (290.171, as above). These instances are a reflection of market needs and useful standards need to be able to accommodate them. The way to do so is again for the standards to clearly define the nature and objectives of compilations and reviews. We also think that it would be helpful to enable practitioners to communicate to the users in the report that, where appropriate, they have carried out both a compilation and a review for the same client. This point was raised by practitioners and users as a possible improvement to our existing Assurance Service. However, we appreciate that this point may be best addressed in the form of practical guidance at the jurisdiction level.

The standard should use the term 'risk'

13. ISRE 2400 should define and use the term 'risk' and 'risk assessment' in the context of reviews. The draft standard currently avoids the concepts 'risk' and 'risk assessment' throughout. We understand that this is due to a concern that practitioners may confuse these concepts with those used in the audit context. If practitioners associate these concepts with specific audit procedures, we accept that the differentiation between audits and reviews might become blurred.

14. This has, however, led the guidance to introduce alternative expressions such as material misstatements being 'likely to arise' or that the practitioner will have 'cause to believe' that material misstatements may exist. 'Likely to arise' and 'cause to believe' differ from each other as well as being different from the expression 'the risks of material misstatements' used in audits.

15. We consider that the standard should simply use the term 'risk.' It should be possible to define and use the concept 'risk', a generic term, and 'risk assessment' in the context of reviews and explain what they mean and how they differ from 'risk' and 'risk assessment' when applied in audits.

16. We believe that the risk assessment appropriate for reviews is the application of professional scepticism throughout the review engagement (paragraph A21-A24), in particular applied during the initial work to obtain an understanding of the entity, its environment and the applicable financial reporting framework (paragraph 43). As the practitioner's understanding is obtained on an iterative basis throughout performance of the review engagement (paragraph A81), the practitioner needs to maintain professional scepticism and remain alert to the risk of material misstatements.

17. The terms risk and risk assessment are used in the International Framework for Assurance Engagements, and in the context of limited assurance engagements, in ISAE 3410. In our view, there is therefore no need to avoid applying them in the review standard.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Q1. Do respondents who are users or preparers of financial statements believe the proposed ISRE will result in an assurance engagement that is meaningful?

18. Yes. Based on our discussion with users of financial statements summarised in *Alternatives to Audit*, the proposed ISRE will result in a meaningful assurance engagement. Users such as credit reference agencies rely on publicly available information, and to them it is essential that publicly available financial information is credible. Lenders consider that the limited assurance report could provide the necessary confidence where the risk and size of lending does not call for an audit. They also believe that the availability of a non-mandatory assurance report increases their confidence in company management, as the business is 'at least trustworthy enough to request and get a clean assurance report.'

19. In our pre-launch interviews, companies told us that triggers for taking up the Assurance Service would include credit availability from lenders, reassurance of the accuracy of internal financial processes and accounts where there are concerns, and confidence in valuing the business when selling. After the launch, companies choosing the Assurance Service thought that limited assurance was sufficient for the needs of directors and external users including funding providers, outside owners and customers. We also learnt that some companies had sought an Assurance Service for more than one financial period and this indicates some degree of satisfaction. Feedback from the engagement partners also indicated that their clients were happy with the report content and there was no issue with the negative assurance conclusion.

20. Lenders also thought the proposed review was easy to differentiate from an audit, in particular because of the negative conclusion. They told us, however, that it might be difficult to differentiate the value of a review from a compilation engagement because both are not well understood. This is not helped by the fact that, to satisfy the requirement in the Code of Ethics of being not knowingly associated with misleading reports and other information, some practitioners carry out additional procedures that are of review or even audit nature when performing compilations. As we are introducing a service that is new to many users, it is crucial that the standard differentiates compilations and reviews as clearly as possible.

21. In our recent discussion with lenders, they also told us that what reduces the usefulness of the reviews is the lack of use, not an imperfect technical definition: it has to be used more and the fact that the accounts have been subject to a review needs to be made visible. As long as review reports are not made public, users remain unaware that review reports exist and therefore ignore them in their decision making process. There will therefore be a need for greater communication about the nature and extent of reviews for it to be better accepted in any market.

Q2. Do respondents who are practitioners believe that proposed ISRE 2400 will result in engagements that can be understood and performed by practitioners in a cost-effective manner in a way that clearly distinguishes the engagement from an audit?

22. Yes. Review procedures do not involve risk assessment as performed in the context of ISA audits or internal control work. Furthermore, the requirements on documentation are less onerous and specific requirements regarding laws and regulations, fraud, and going concern are significantly limited when compared to an audit.

23. However, the proposed standards should more clearly describe the areas where requirements are limited. In addition to 'where there is an indication that fraud or non-compliance with laws or regulations ...,' there should be 'practitioners do not have any responsibilities to carry out specific procedures considering fraud, laws, regulations ... ' In this way, we could reduce the risk of an expectation gap arising from users expecting more than what practitioners should do, as the users may consider that these areas are also covered by the requirement to obtain 'sufficient appropriate' evidence.

24. We welcome the application of inquiry and analytical procedures to financial statements as a whole and the application of additional procedures only to areas where the practitioner identifies that risks of material misstatement exist. Our members who regularly offer the Assurance Service told us that the key aspect and value of the engagement is continuous discussion with clients to focus additional work beyond inquiry and analytical procedures on specific areas. Their clients appear to be happy with the iterative approach including the application of risk judgement and like practitioners to focus on key areas rather than comprehensively working through financial statement assertions line by line.

25. We note that communication with users has never been easy, even where a report explicitly states what it is and what it is not. From our experience, it is insufficient to have merely a clearly worded report, as users do not fully appreciate technical subtleties with which practitioners may be familiar. We produced an information sheet (see paragraph 5) that enables our members to explain concisely to their clients and other users the differences between compilations, the ICAEW Assurance Service and voluntary audits. This has been well used and members here found it useful. We suggest that IFAC may wish to prepare a similar information sheet once they have completed the revision of the compilation and review standards in order to assist practitioners and member bodies in explaining the difference between these engagements and an audit to stakeholders.

26. We also recommend that the standard requires practitioners to discuss with clients the purpose and nature of a review so that the latter understand what the purpose of a review is. A sentence such as 'this includes having a discussion with management so that management understands the purpose of a review engagement' might be added where 'a rational purpose for the engagement' is discussed (Para 29 (a)). In order to avoid being unduly burdensome, this discussion could be restricted to initial review engagements or those where management have changed significantly since the preceding review engagement.

Q3. Do respondents believe that the objectives stated in the proposed ISRE appropriately describe the expected outcome of the practitioner's work in a review engagement, and the means by which the objectives are to be achieved?. . . (to continue)

27. No, this should be expanded. The objective is currently a definition of a review focusing on its output rather than setting out what a review engagement intends to achieve. We believe the objective should incorporate the wording from the International Framework for Assurance Engagements that reviews are designed to enhance the degree of confidence of the intended users; but the risk of material misstatements is too high for the practitioners to express a conclusion in a positive form.

. . . Is there any wording in the objectives that might have unintended consequences, or that may blur understanding of the difference between a review and an audit?

28. Yes. We have following suggestions. If paragraph 14(a), which explains what a review engagement involves, is to remain, it should also incorporate the fact that the practitioner must go further than inquiry and analytical procedures where appropriate, as we believe that this should be a key requirement for a review.

29. The wording of paragraph A13(a) and (b), in relation to paragraph 15 where the ISRE requires the practitioner to disclaim a conclusion or withdraw from the engagement under certain circumstances, is too broad to help readers understand what these circumstances are. It would be helpful to signpost them to specific paragraphs where the proposed ISRE further discusses each circumstance (eg, paragraphs A112-115).

Q4. Do respondents believe that the factors affecting engagement acceptance and continuance, and the preconditions for performing a review under the proposed ISRE, are appropriate and clearly communicated in the proposed ISRE?

30. Yes, in principle. In terms of preconditions, we believe that management of an entity that engages a practitioner to perform a review engagement should be able to fulfil responsibilities set out in paragraph 30.

31. Paragraph 30(b) (ii) refers to management responsibilities regarding internal control. As reviews do not involve testing of internal controls, we understand that this precondition is to provide a degree of confidence to practitioners that the financial information and underlying accounting records are reliable. The proposed ISRE should recognise this purpose explicitly within the Application Material and emphasise there that practitioners need not test internal controls.

32. The requirement to obtain the agreement of management for their responsibilities appears to be repeated in paragraphs 30(b) and 35(c). Unless the ISRE intends that the agreement should be obtained twice, we would suggest that one of these paragraphs is deleted or they have additional wording to clarify this, for example in 30(b): 'Obtain the agreement of management. . . responsibilities (paragraphs A49-A53.) *This should consist of part of the terms of the engagement as described in paragraph 35(c)*.'

Q5. The approach to performing a review set out in the proposed ISRE (paragraphs 43 and 44) requires the practitioner to identify areas in the financial statements where material misstatements are likely to arise, based on the practitioner's understanding of the entity and its environment, and the applicable financial reporting framework, and then to focus the design and performance of inquiry and analytical procedures in those areas.

(a) Do respondents believe this approach is appropriate for a review?

33. It could be improved. The objective of the requirement in paragraph 43 is the identification of areas where material misstatements are likely to arise, and this is similar to what is required in an audit. However, the requirement and application material of the proposed ISRE merely set out factors to consider when obtaining an understanding of the entity and its environment. There is no guidance as to at which stage or how practitioners can satisfy the sufficiency requirement to identify areas where material misstatements are likely to arise and to be able to design procedures to address those areas. This contrasts with ISA 315 that requires the identification of risks of material misstatements through specific risk assessment procedures and highlights the difficulty of developing an assurance standard without using the term risk.

34. In practice, we believe that it would be hard to differentiate the work the practitioner carries out to obtain an understanding of the entity, its environment and the applicable financial reporting framework (paragraph 43) from the performance of inquiry and analytical review (paragraph 44). A practitioner's preliminary consideration of areas where material misstatements are likely to arise, which should form part of procedures to obtain an understanding of the entity, would involve a degree of analytical thinking and an inquiring mind that would lead to challenging management about the information they have thus far obtained. These analytical activities and inquiries should come naturally to a trained professional who would exercise professional scepticism.

35. In our view, it is therefore artificial to draw a line between obtaining the understanding and performing inquiry and analytical procedures in areas where material misstatements are likely to arise. As the ED states in paragraph A81, a review engagement is an iterative process, and we see little benefit in drawing a line between obtaining the understanding and performing inquiry and analytical procedures. The line should be drawn, instead, between the completion of inquiry and analytical procedures and carrying out additional procedures. This is because additional procedures will only be performed with regard to areas where results obtained lead to the need for additional procedures.

36. Although review engagement procedures are limited in contrast to an audit, we believe that there needs to be some work carried out on the financial statements as a whole. Inquiry and analytical procedures are effective means to do so before additional work is carried out. Thus, the work procedures will consist only of two stages rather than of three, and will therefore be simpler to communicate to clients.

(b) Do respondents believe that the requirement and guidance in the proposed ISRE adequately convey this intended approach?

37. We do not believe that the requirement and guidance in the proposed ISRE are sufficient. Please see above for the basis of our view.

(c) Do respondents believe that the requirements and guidance relating to the practitioner's understanding (explained in paragraph 43), and designing and performing inquiry and analytical procedures (explained in paragraph 44), are sufficient to promote performance of reviews on a reasonably consistent basis with the application of the practitioner's professional judgment and understanding, taking account of the circumstances in individual review engagements?

38. Please see our response to Question 5(a). We support varying the extent of analytical procedures and inquiries carried out for different areas based on the understanding the practitioner has obtained. However, we do not believe it is appropriate to limit the application of analytical procedures and inquiry to areas in the financial statements where material misstatements are likely to arise. Obtaining an understanding, performing inquiry and analytical procedures should be treated as one stage and applied to the entity and its environment as a whole in an iterative manner.

39. The standard applies a higher threshold for the identification of material misstatements at an early stage of the engagement ('likely to', paragraphs 43 and 44) while a lower threshold ('may', paragraph 57) is used when determining whether to carry out additional procedures. We prefer using 'may' at both stages. Only by using a lower threshold at an earlier stage, may matters of concern be picked up for additional procedures at a later stage.

6. Do respondents agree with the requirements and guidance in the proposed ISRE (paragraphs 57 and 58) describing the trigger point at which additional procedures are required? Do respondents agree with the related requirements concerning the practitioner's response when there are matters that cause the practitioner to believe the financial statements may be materially misstated?

40. Yes. We agree that the trigger point used in paragraphs 57 and 58 is appropriate. This is consistent with the trigger point proposed in limited assurance engagements under the proposed ISAE 3410. The examples in paragraph A98 are useful.

41. Regarding the related requirements, the guidance should provide more explanation about what is required. Considering that there may be practitioners who perform reviews but do not perform audits, the proposed ISRE appears to assume too much knowledge on the part of the practitioner to know what sufficient additional procedures might constitute. We are also conscious that there are concerns that practitioners may carry out so many additional procedures that the engagement starts to resemble a service similar to what an audit used to be before ISAs were introduced, where the bulk of work was substantive procedures.

42. To differentiate the application of additional procedures in reviews from audits, we encourage the IAASB to consider the methodology that ICAEW adopted. AAF 03/06 requires that, once a matter comes to a practitioner's attention, practitioners should discuss with management whether further work is required by <u>management</u> to establish if an adjustment is needed. In the event that there is insufficient information on which to base a request to management, the practitioners carry out additional procedures as they consider necessary. If management does not make any adjustment and therefore there remains something that causes the practitioner to consider that a material misstatement may exist, the practitioner must consider the impact on their report. In this way, reviews may be clearly contrasted with audits where practitioners obtain sufficient appropriate evidence in respect of financial statement assertions.

43. We note that the description in paragraph 48 appears to discuss the same subject using a different threshold: '. . . address areas in the financial statements where material misstatements are likely to arise.' We are unsure why different descriptions are used. The description should be consistent, and we prefer the use of 'may' instead, thus: '. . . address matters that cause the practitioner to believe the financial statements may be materially misstated'.

7. With respect to the practitioner's review report (as illustrated in Appendix 2 of the proposed ISRE):

(a) Do respondents believe the report adequately communicates to users the work undertaken by the practitioner for the review?

44. Yes. We believe the description in the report is adequate. The proposed report is similar to the assurance report of ICAEW. Based on our discussion with practitioners regarding the ICAEW Assurance Service, the entities will understand the work undertaken by the practitioner. This is because, in addition to the engagement letter that explains the basic procedures, practitioners discuss with their clients why work is done and what additional work is carried out. For other users, the assurance report provides a concise summary of the nature of the work and we have not received any feedback that the work undertaken by the practitioner is unclear, notwithstanding that a positive conclusion is often cited as preferable.

45. However, for better communication and transparency, we support improvements to the review report. For example, the proposed limited assurance report in ISAE 3410 contains a summary of the work carried out as the basis for the practitioner's conclusion (paragraph A136, ISAE 3410 ED) on the basis that 'the level of assurance that the practitioner obtains can vary significantly depending on the procedures performed in the individual circumstances of the engagement.' One may argue that this basis is fundamentally the same for ISRE 2400 engagements where practitioners may decide to carry out additional procedures where required. While we believe that the existing summary of work should be sufficient based on our experience, the proposal in ISAE 3410 may deserves further consideration in the context of ISRE 2400, not least because there should be a degree of consistency in limited assurance engagements across different standards and subject matters.

(b) Do respondents believe that the form of the practitioner's conclusion (that is, 'nothing has come to the practitioner's attention that causes the practitioner to believe …') communicates adequately the assurance obtained by the practitioner? Is this form of wording of the practitioner's conclusion preferable to other forms that have been explored by the IAASB as discussed above, including those that use wording perceived as being more positive? If not, please explain and provide alternative wording that could be used to express the practitioner's conclusion.

46. Yes. Negative assurance is a clear and distinctive way of differentiating reviews from audits. We had a long debate prior to issuing guidance on the ICAEW Assurance Service and collated views of stakeholders. While all preferred a positively worded conclusion, the degree of opposition differed. Companies expressed mixed views: some thought that the negatively worded conclusion lacks rigour and confidence while others were undisturbed by the negative wording. Furthermore, banks and credit reference agencies were relatively unperturbed.

47. We note a number of alternative forms proposed during the drafting of the standard and discussions held at the IAASB Board meetings. We have noted the IAASB's rationale for discarding other alternative wordings. On that basis, we accept the proposed wording. We support the IAASB to lead a campaign to inform users about the meaning of negative assurance and would be keen to co-operate in this regard.

(c) Is the practitioner's conclusion expressed in this form likely to be understandable and meaningful to users of the financial statements? Does this form of conclusion achieve the intended purpose of properly differentiating the conclusion reported in a review from the opinion expressed in an audit of financial statements?

48. Please see paragraph 46 in our response on the understandability of the negative expression.

49. We consider that the reference to an audit conducted in accordance with International Standards on Auditing in paragraph 83(c) should be deleted. A review is a service provided predominantly to companies that are not subject to an audit, and the standard should not require users to understand the technical difference between reviews and audits.

50. We also believe that the middle part of the sentence in paragraph 83 (d) (… does not enable the practitioner to obtain assurance that the practitioner would become aware of all significant matters that might be identified in an audit...) is unduly negative and is unnecessary. It is a generic expression and if there is a valid reason to have it here, it would probably be valid to have it in any limited assurance report. We do not believe that is the case and thus propose that it should be removed. The expression does not in fact appear in the example review reports, and we believe that this should remain the case.

OTHER POINTS

Reference to the Framework for the Preparation and Presentation of Financial Statements (Footnote 12)

51. The reference is now been superseded by The Conceptual Framework for Financial Reporting 2010 issued by the IASB:

> OB2 The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions

involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.

Reporting criteria (para 66 (v))

52. We question where the criteria of information come from. If it is from the International Framework for Assurance Engagements, it should contain 'completeness'.

53. If it is to follow the Conceptual Framework mentioned in paragraph 51, financial information is useful when it:

- is relevant and faithfully represents (fundamental qualitative characteristics); and
- is comparable, verifiable, timely and understandable.

Going concern and inherent uncertainties

54. While the standard considers the issue of an entity's ability to continue as a going concern in paragraphs 52-54 and A93, there appears to be no requirement or guidance regarding its impact on the review report. We believe that specific requirements or guidance on reporting and relevant disclosures should be provided within the *Practitioner's Report* section (paragraph 82 onwards).

55. When dealing with inherent uncertainties, the IAASB may find the guidance and illustrative disclosure in the Assurance Service useful:

> 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 (paragraph 55, AAF 03/06).

In the report:

> 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 (Example report to the directors with an explanatory paragraph, Appendix E. a. ii, AAF 03/06).

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