

# Snapshot

## Management review controls

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## Executive summary

Management review controls, commonly referred to as MRCs, are a critical component of management's internal control responsibilities, focusing on the detection and correction of material misstatements through detailed review and investigation of financial and operational results. Their effectiveness relies on the precision of the review and on the quality of information used and necessitates robust documentation.

MRCs typically involve a review of financial and nonfinancial information, often involve significant judgment by the control owner, and are often identified as controls over more judgmental or complex financial statement areas, which typically have a higher risk of material misstatement. Because of the nature of MRCs, it is key that there is sufficient documentation of the design and execution of the control. This includes retention of additional information, data, and reports used by the control owner in executing the control and in reaching subsequent conclusions.

The effectiveness of an MRC depends in part on the controls over the relevance and reliability, including accuracy and completeness, of key information used in the performance of the control.

There are two elements to the effectiveness of the control – design effectiveness and operating effectiveness. Each is evaluated in forming a conclusion on the control's effectiveness:

- With respect to design, effective documentation demonstrates the precision with which the control operates, what triggers the control owner to ask questions, how items are investigated and resolved, and how financial records are updated.
- With respect to operating effectiveness, documentation is key to demonstrating that the control owner is executing the control as intended.

The level of documentation associated with evidencing the effective performance of management review controls is more extensive. It includes demonstration of:

- The precision or depth at which the control operated, such as specific examples of items that were questioned or investigated by the control owner
- Whether, and how, all items that met the criteria for investigation were appropriately investigated and resolved
- The nature of the information (records, documents, reports, or other types of information) inspected to support the conclusion, such as management review notes, emails, and direct observation

Mere "sign off" by the control owner to indicate the review was performed does not provide sufficient detail of the steps taken by the control owner in executing the MRC.





### Considerations for your external audit

Management review controls are critical for detecting and correcting material misstatements. In an audit of internal control over financial reporting, auditors rigorously evaluate sufficient detail of the steps taken by the control owner in executing the MRC and test their operating effectiveness, focusing on the precision and effectiveness of management's review procedures, as well as the adequacy of supporting documentation, to meet regulatory expectations and to address common inspection findings.

## Background

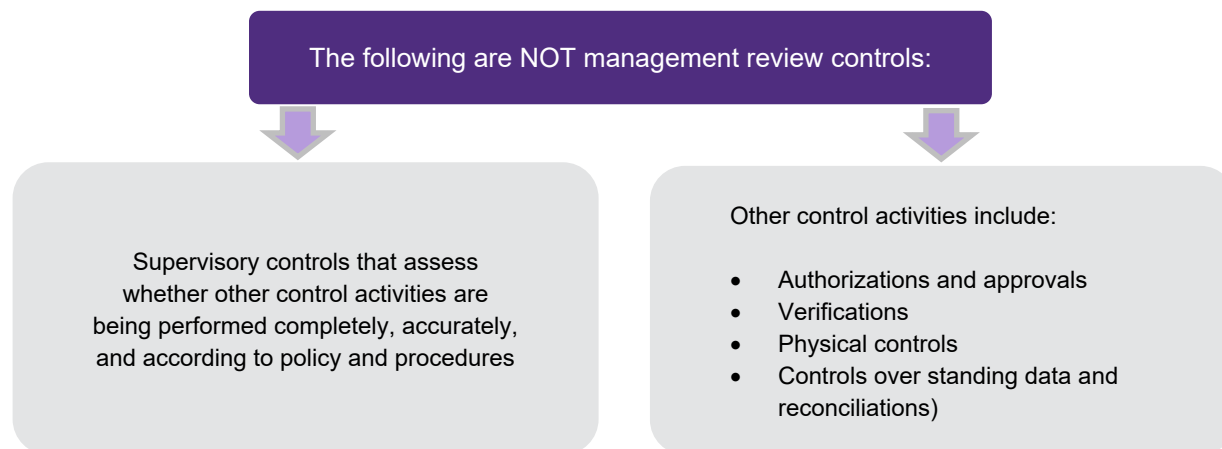
### What types of controls are MRCs

When we refer to MRCs, we generally refer to entity-level controls that involve certain monitoring or review elements, as illustrated in the following table.

Type of MRC	Example
 <b>Monitor the results of operations</b>	<ul style="list-style-type: none"> <li>Monthly comparisons of actual results to forecasted revenues or budgeted expenses</li> <li>Comparisons of other metrics (such as gross profit margins and expenses as a percentage of sales)</li> <li>Quarterly balance sheet reviews</li> </ul> <p>Typically, these reviews involve comparing recorded financial statement amounts to expected amounts and investigating significant differences from expectations.</p>
 <b>Involve a management review element</b>	<ul style="list-style-type: none"> <li>Reviews of accounting estimates with higher estimation uncertainty, including fair value measurements</li> <li>Reviews of complex accounting policies or principles (such as convertible debt agreements, nonstandard revenue contracts, and variable-interest entities)</li> </ul>
 <b>Involve a review of infrequent or significant unusual transactions</b>	<ul style="list-style-type: none"> <li>New complex transactions (such as restructurings)</li> <li>Transactions related to income taxes (such as a new tax position on transfer pricing)</li> <li>Business combinations</li> </ul>
 <b>Monitor user access</b>	<p>While different in nature from a financial information-related management review control, a periodic user access review may be an MRC in certain limited circumstances, such as when significant judgment or complexity is involved in performing the review. For example, a control owner may apply significant judgment when:</p> <ul style="list-style-type: none"> <li>Reviewing a large number of users with access</li> <li>There are complex security assignments</li> <li>Access is granted to contractors</li> <li>There are potential segregation of duties conflicts</li> </ul>

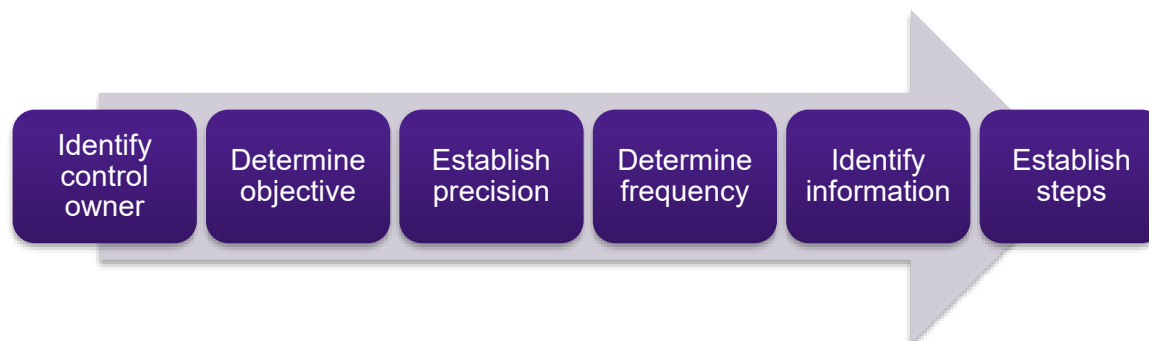
## What types of controls are not MRCs

Management review controls are not intended to include supervisory controls, which assess whether other control activities are being performed completely, accurately, and according to policy and procedures, or other control activities. If the control does not require the control owner to formulate an expectation in assessing the reasonableness of a class of transactions, account balance, or disclosure, or of a method, input, or assumption related to an accounting estimate, then the control generally is not a management review control.



## Designing an MRC

The design of an MRC involves considering whether it is capable of preventing, or detecting and correcting, potential material misstatements in the financial statements. It is important that the design clearly identifies and describes the control attributes that comprise the control. When designing an MRC, consider the following process.



## Identify control owner

The control owner is the individual who is responsible for performing the attributes of the control and for documenting the results thereof. Consider the following when identifying the control owner:

- What are the qualifications or experience of the individual?
- Does the individual have the background and sufficient time to perform the control?
- Does the individual have the necessary status within the entity?

The control owner has the competence and authority to perform the control.

## Determine objective

When designing an MRC, start with determining its objective – that is, what the MRC is being designed to accomplish. Consider the following:

- What are the risks of material misstatement the control needs to address?
- What is the level of precision at which the control needs to operate to identify a material misstatement?
- Does the objective encompass all the attributes of the control?

A well-designed objective:

- Satisfies the corresponding control objective
- Addresses the risks of material misstatement

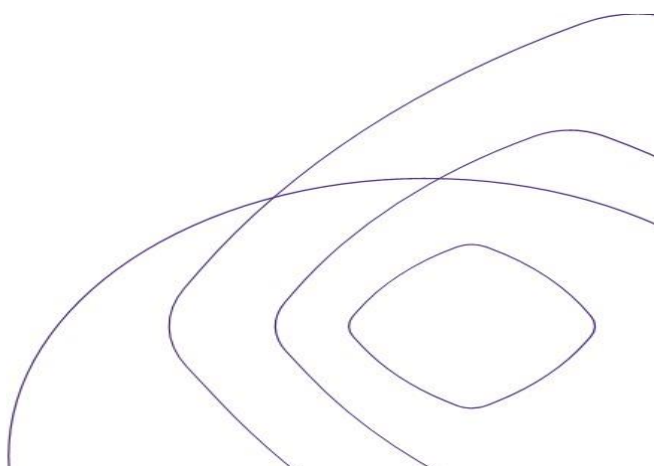
## Establish precision

The precision with which an MRC is performed is important; it takes into account the objective of the control and the nature and types of potential misstatements the control is intended to prevent or detect and correct. The precision of the MRC can be quantitative or qualitative, or both. The MRC needs to be designed and performed with an appropriate level of precision to address the risks of material misstatement. Considerations in determining precision include:

- Should the control be performed at a disaggregated level?
- What level of detail is available for the control owner to review?
- Will executing the control identify errors?

The precision of the control takes into account the:

- Objective of the review
- Level of aggregation (or disaggregation)
- Consistency of performance
- Correlation to relevant assertions
- Predictability of expectations
- Criteria for investigation



## Determine frequency

Consider how often the control needs to be performed in order for it to prevent, or detect and correct, an error on a timely basis, taking the following into account when determining frequency:

- How frequently are the underlying processes or procedures performed?
- How soon after the underlying processes or procedures are performed does the control have to operate to be considered timely?

The review occurs often enough to prevent, or detect and correct, misstatements before they have a material effect on the financial statements.

## Identify information

To perform the MRC, the control owner will likely use information, including data, from various sources. The source of the information influences the procedures necessary to confirm the relevance and reliability of the information, including whether that information is complete and accurate. Consider the following:

- The source of the information used to enable performance of the control and to investigate an item
- The effectiveness of general information technology controls (commonly referred to as “general IT controls” or “IT general controls”) over system-generated information
- The type of records and documents that exist with respect to the items questioned

Sources of information include:

- Information produced by the entity, whether system-generated or manually prepared
- External information sources, such as prices and pricing-related data

## Establish steps

The design of the MRC also includes the steps involved to execute the control. To ensure that the MRC is performed consistently from period to period and by successive control owners, documentation of these steps is essential. Consider the following when determining and documenting the appropriate steps:

- Can pre-defined thresholds for investigation be established?
- Can a framework be established for determining what is “significant” or “unusual”?
- Are there other observations that would trigger a question?
- What will be involved in investigating an item and could these steps differ by the type of item being investigated?
- How will items be resolved and the financial records updated?
- Can the steps be performed consistently?
- How will the review and resolution of items investigated be documented?

Steps in performing an MRC may include those regarding:

- Determining relevance and reliability of information
- Developing an expectation
- Identifying differences from expectations
- Investigating and resolving differences from expectations
- Updating financial records, as applicable

## What is so challenging about MRCs

MRCs can be challenging because they often involve significant judgment by the control owner, and they are often identified as controls over more judgmental or complex financial statement areas, which typically have a higher risk of material misstatement. As the risk increases that the control might not operate effectively or the control objective might not be achieved, the more robust the actions performed by the control owner need to be.

A lack of formality may make it difficult for the control owner:

- To perform the MRC consistently
- To perform the MRC with the appropriate level of precision
- To hand over the MRC to new control owners

The precision with which an MRC is performed is important; it takes into account the objective of the control and the nature and types of potential misstatements the control is intended to prevent, or detect and correct. The MRC, therefore, needs to be designed and performed with an appropriate level of precision to address the risks of material misstatement.

Performance of an MRC often requires the use of data or reports, which may be generated internally by the entity or obtained by the entity from an external information source. Establishing the completeness and accuracy of that information is critical to the effectiveness of the MRC.

Because of the judgment, complexity, or associated risk of material misstatement, it may be more difficult for the control owner to adequately document the actions performed and the precision with which they are performed.

### Considerations for your external audit

- Management review controls have been an area of focus by the PCAOB for a number of years. Findings by the PCAOB in this area were highlighted in its Spotlight on 2023 Inspection Activities. These trends have continued to be reported as findings in the PCAOB's 2024 inspections.
- To address these deficiencies, auditors are being expected to obtain more detailed evidence (or documentation) from management about the design of the control, including its precision, and the actions taken by the control owner when executing the control.
- Over time, the detail involved in the procedures performed by the auditor to test management review controls and the level of documentation of those procedures has increased and continues to do so.



## Key information used in MRCs

Reports, data files, or other types of information are often used in the performance of a management review control, (for example, a disaggregated revenue report from the entity's IT system detailing revenue by product line item may be used in an MRC over the entity's financial results). Such data or reports may be important to the effective execution of the control; if such information is not relevant or

The procedures performed by the control owner likely differ based on the nature of the key information. Similarly, the documentation would also differ.

reliable, the operation of the control may fail to prevent, or detect and correct, a material misstatement, and, as such, is considered key information. Accordingly, as part of performing the MRC, management is responsible for performing procedures to evaluate the relevance and reliability of key information used in executing the control. Establishing the relevance and reliability of such key information is, therefore, critical to the effectiveness of the MRC.

Establishing the relevance and reliability of such key information is critical to the effectiveness of the MRC.

Key information may be internally generated or obtained from external information sources. When the key information is generated from the entity's general or subsidiary ledgers, such as an accounts receivable aging report, the attributes of relevance and reliability are typically the accuracy and completeness of that information. When the key information used by the control owner is from an external information source, such as prices or pricing-related data, other attributes, such as the credibility of that external information source, may be more relevant. External data is typically used in accounting estimates.

Detailed below are examples of how the procedures performed by the control owner on the key information may vary based on the nature of that information.

Nature of key information	Potential management procedures	Potential management documentation
<b>System-generated, canned report (accuracy and completeness)</b> <b>Note:</b> Generally, a canned report is embedded within an IT system; its underlying logic is fixed.	<ul style="list-style-type: none"> <li>Obtain support indicating the report is canned, considering IT system documentation, folder, or directory location and naming conventions</li> <li>Determine the report was generated with the correct parameters, such as date range</li> </ul>	<ul style="list-style-type: none"> <li>Support indicating the report is canned</li> <li>Notations indicating the report used in executing the control had the appropriate report parameters</li> <li>Consideration of significant IT events that could impact reliability (for example, a significant system upgrade that could potentially change the report)</li> </ul>
<b>System-generated, custom report (accuracy and completeness)</b> <b>Note:</b> Generally, a custom report is built from scratch or can be modified through changes to source code.	<ul style="list-style-type: none"> <li>Determine the report was generated with the correct parameters, such as date range</li> <li>Agree totals and selected items to source, or other procedures to determine accuracy and completeness</li> </ul>	<ul style="list-style-type: none"> <li>Notations indicating the report used in executing the control had the appropriate report parameters</li> <li>Notations indicating agreement with source or other documentation of procedures related to accuracy and completeness</li> </ul>



Nature of key information	Potential management procedures	Potential management documentation
	<ul style="list-style-type: none"> <li>Consider effectiveness of IT general controls over security management and technology maintenance</li> </ul>	<ul style="list-style-type: none"> <li>Evaluation of the effect of IT general control deficiencies, if any, on the report</li> </ul>
<b>Manually prepared, such as Excel spreadsheets (accuracy and completeness)</b>	<ul style="list-style-type: none"> <li>Agree totals and selected items to source</li> <li>Check formulas, including clerical accuracy</li> <li>Determine appropriate password protection and location (such as secured network folder)</li> </ul>	<ul style="list-style-type: none"> <li>Notations indicating agreement with source</li> <li>Notations indicating formulas were checked</li> <li>Notes related to password protection and secured network location</li> </ul>
<b>Third-party external information or data, such as pricing sources (relevance and reliability)</b>	<ul style="list-style-type: none"> <li>Evaluate reputation and competence of third-party source</li> <li>Determine whether the information provided by the third-party source is suitable for use by a broad range of users</li> <li>Evaluate nature and relevance of information, including how it originated or was obtained</li> </ul>	<ul style="list-style-type: none"> <li>Documentation of the evaluation, which may include:               <ul style="list-style-type: none"> <li>Why data is relevant</li> <li>Third-party's expertise or regulatory oversight</li> <li>Whether the source is independent of the entity</li> <li>Verification procedures performed or obtained by the third party and how data was obtained by the entity</li> </ul> </li> </ul>

### Considerations for your external audit

An auditor may conclude that an MRC is not operating effectively if controls over the reliability (including accuracy and completeness) of key information used in executing the MRC are not operating effectively.

## Documenting the performance of MRCs and evidence retention

### Documenting performance

To be effective, documentation of the control starts with a clear description of the objective of the review, the misstatements that the control is designed to prevent, or detect and correct, including the specific assertions and financial statement accounts. Typically, this includes:

- Whether an expectation is to be set and the criteria for when a variance from that expectation is to be investigated further
- Quantitative considerations, such as thresholds of a certain dollar value or of a percentage variance
- Qualitative considerations, such as items that are significant or unusual or that are otherwise considered to be unreasonable
- Documentation of why the criteria described in the control is appropriate to prevent, or detect and correct, a material misstatement.

### DOCUMENTATION

Documenting the performance of the MRC, including the judgments made in executing the control, is key to demonstrating that the control was performed by the control owner.

### PRECISION

Consider whether the control is sufficiently precise to prevent, or detect and correct, material misstatements.

A clear description of the level of disaggregation is also important (for example, is the review performed at a product level, at a reporting unit level, or at some other level of disaggregation).

Documentation also includes the actions performed by the control owner, including the procedures performed to investigate items and the resolution of those items. Not only will this assist the control owner with performing the control consistently each time the control is performed, it will also help the control owner determine that all steps of the control have been performed, that all items investigated have been satisfactorily resolved, and that the resolution, in totality, makes sense.

Effective documentation includes the conclusions reached and how those conclusions were reached.

### Considerations for the external audit

Clear documentation of the description of the control, the key information used in the performance of the control, and the actions performed by the control owner in executing that control assist the auditor in evaluating whether the control is appropriately designed to address the risk of material misstatement. Clear documentation also assists the auditor in evaluating the consistency and sufficiency of the actions performed by the control owner in executing the control and in evaluating the operating effectiveness of the control. Such documentation may include, among other things, detailed notes of verbal discussions or meetings.

## Evidence retention

When investigating the items that meet the criteria for investigation, the control owner may obtain other information or data to support explanations provided. This may include reports, correspondence with others, journal entries to make corrections, or updated analyses resulting from the operation of the control. In addition, appropriate documentation of the procedures performed and retaining such information also supports the execution of the control. The following table includes examples of evidence that may be retained by the control owner in support of the procedures performed.

Actions taken	Evidence
<b>Discussions with other personnel within the entity</b>	<ul style="list-style-type: none"> <li>• A calendar invite detailing attendees <b>along with detailed notes of the discussions</b> to understand the variances, including:               <ul style="list-style-type: none"> <li>– Questions raised along with respective responses</li> <li>– Information or data reviewed</li> <li>– Follow-up items, if any, and responsibilities for those items</li> <li>– Conclusions reached</li> </ul> </li> <li>• Copies of documents reviewed during a meeting that support the variances</li> </ul>
<b>Emails</b>	<ul style="list-style-type: none"> <li>• Copies of emails that detail:               <ul style="list-style-type: none"> <li>– The control owner's questions and the responses to those questions</li> <li>– Resolution of the items questioned, and conclusions reached</li> </ul> </li> <li>• Copies of documents attached to email correspondence</li> </ul>
<b>Review of information or data</b>	<ul style="list-style-type: none"> <li>• Copies of reports or spreadsheets detailing procedures performed to verify the relevance and reliability (including completeness and accuracy) of the reports or spreadsheets</li> <li>• Copies of memos, for example, a memo analyzing the accounting treatment of a new product line detailing the procedure performed to confirm its appropriateness</li> </ul>
<b>Review of revisions</b>	<ul style="list-style-type: none"> <li>• Copies of journal entries to record necessary revisions, if any</li> <li>• Copies of updated versions of the analysis that evidence the results of investigations, including notations indicating adjustments were correctly made</li> </ul>

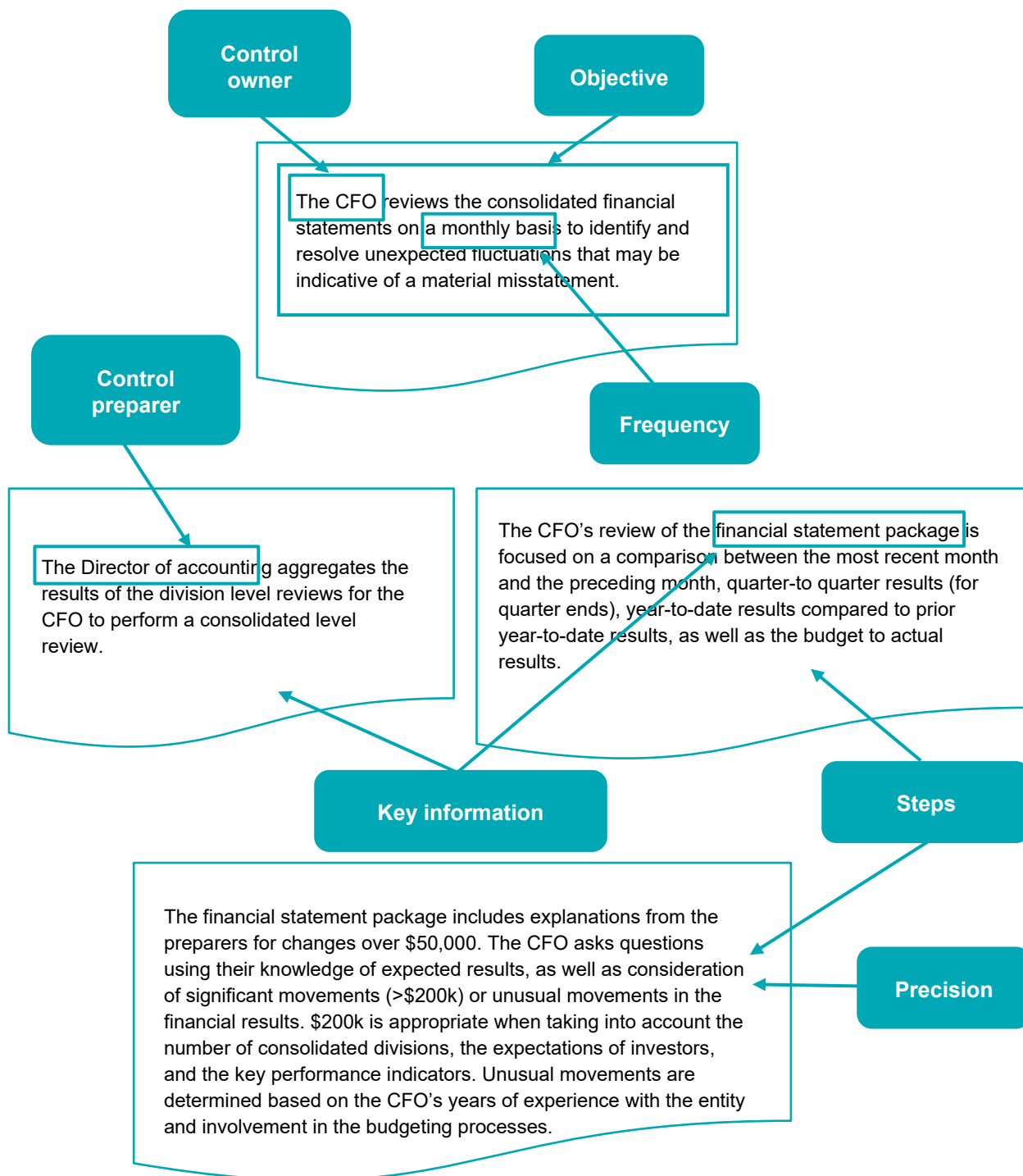
### Considerations for your external audit

Retention of appropriate documentation in support of the execution of the control activities assists the auditor in determining that the control has been implemented and in evaluating whether the control is operating effectively.

## Example MRC

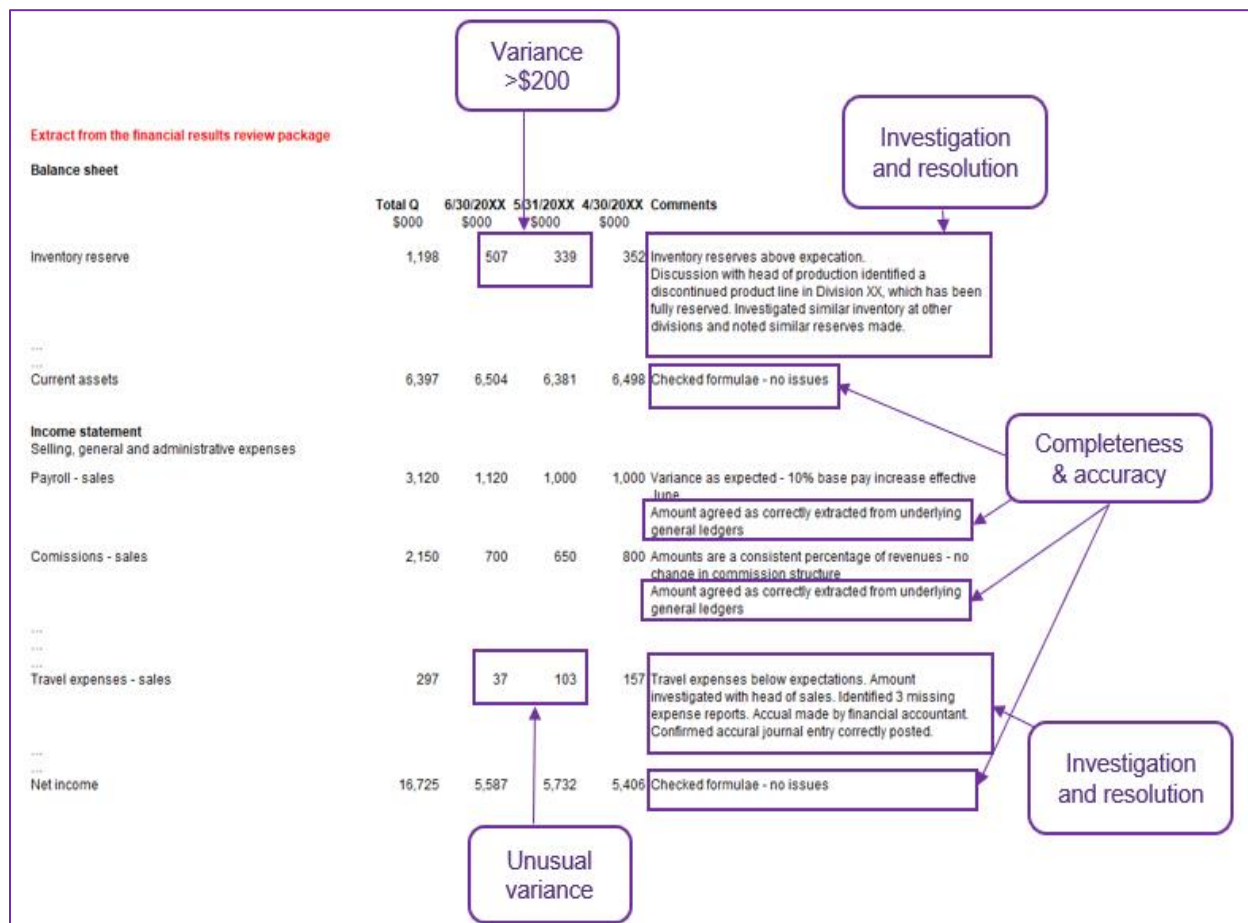
### Financial statements results review – control description

The following extracts from an example MRC highlight the various design attributes of a financial statements results review control. These extracts are for illustration purposes only and are not intended to represent comprehensive documentation of a financial statement results review control.



### Financial statement results review – execution

Illustrated below is an example of how a control owner may document the execution of the control. This illustration evidences the items identified for investigation in accordance with the design of the control as well as the procedures the control owner performed to establish the relevance and reliability of the information and to investigate and resolve the identified items.



### Financial statement results review – retain appropriate evidence

The control owner could retain the following information obtained and reviewed as part of the investigation and resolution of identified variances:

- Inventory reserve:
  - Calendar invite for discussion with head of production and notes of matters discussed
  - Divisional inventory reserve calculations
  - Authorization of the discontinued product line and customer notifications
- Travel expense:
  - Calendar invite for discussion with head of sales and notes of matters discussed
  - Approved journal entry adjusting the travel expense, along with supporting missing expense reports

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