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IN ENGLAND AND WALES

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Our ref: ICAEW Rep 79/07

Your ref:

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By email

Dear Mr Leonard

**5000 - INVESTMENT REPORTING STANDARDS APPLICABLE TO PUBLIC  
REPORTING ENGAGEMENTS ON FINANCIAL INFORMATION RECONCILIATIONS**

The Institute of Chartered Accountants in England and Wales (the Institute) is pleased to respond to your request for comments on *5000 – Investment Reporting Standards Applicable to Public Reporting Engagements on Financial Information Reconciliations*.

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

ICAEW REP 79/07

### 5000 – INVESTMENT REPORTING STANDARDS APPLICABLE TO PUBLIC REPORTING ENGAGEMENTS ON FINANCIAL INFORMATION RECONCILIATIONS

Memorandum of comment submitted in September 2007 by  
The Institute of Chartered Accountants in England and Wales, in  
response to The Auditing Practices Board Limited's Exposure  
Draft 5000 – Investment Reporting Standards Applicable to Public  
Reporting Engagements on Financial Information Reconciliations  
published in June 2007

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## INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on the Exposure Draft 5000 – *Investment Reporting Standards Applicable to Public Reporting Engagements on Financial Information Reconciliations* published by The Auditing Practices Board Limited (the APB).

## WHO WE ARE

2. The 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, the Institute provides leadership and practical support to over 128,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The ICAEW is a founding member of the Global Accounting Alliance with over 700,000 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. The ICAEW ensures these skills are constantly developed, recognised and valued.

## MAJOR POINTS

### Support for the initiative

4. We are generally in favour of having standards for public reporting engagements and welcome the issue of this Exposure Draft. In our response to Draft SIRs 1000 and 2000, dated 31 May 2005, we mentioned that there are other situations of reporting in connection with investment circulars where we believe standards would be desirable. These include working capital reports and the range of comfort letters.
5. We agree that paragraph 2 of the Exposure Draft should acknowledge that the guidance in the SIR may be helpful to reporting accountants in other circumstances where a public opinion could be required on accounting policy reconciliations. We have in mind examples such as reconciliations given in footnotes to pro forma financial information and those requested by the regulator under Commission Regulation No 211/2007. We recognise however that, in the absence of prescribed regulations covering these potential additional scenarios, that it is not feasible to draft the SIR to cover a speculative position.
6. The Exposure Draft is drafted on the assumption that the reporting accountant has access to information. If no access is provided it is likely that the reporting accountant would have to qualify their opinion. We note that since the Exposure Draft was published the FSA has commented on hostile bid situations in List 16 issued in July 2007, "it is unlikely that a reconciliation under LR 13.5.27 would be included within the document because without access to the targets records it will be difficult for the accountants to give the required confirmations under LR 13.5.27 (2)(b)". We believe that the APB should consider reflecting this in the guidance in the proposed SIR. (See also 21)

7. We have considered the work effort of the reporting accountant described in paragraphs 36 to 40 of the Exposure Draft and the appropriateness for the opinion to be given by the reporting accountant. We are of the view that the opinion required in the proposed SIR may require a more extensive work effort than the “enquiry and analytical review” required in the Introduction to Question 2 in the Invitation to Comment. We contend that, to enable the opinion required by the current Listing Rules and provided over the last two years, it is possible that reporting accountants will have performed additional procedures to those suggested in the Exposure Draft, including tests of detail for certain types of adjustment (though not on the underlying information), where they considered them to be appropriate. We suggest that, as the Listing Rules require a positive assurance opinion, the standard clarifies that either more guidance as to the work to be undertaken on completeness is drafted within the SIR, e.g. on the work effort required in understanding how the accounting policies are applied, or leave the reporting accountant to exercise its judgement as to the work required to express its opinion by converting paragraph 38 of the proposed SIR to Investment Reporting Standard in bold type.
8. The Exposure Draft does not envisage the situation where the investment circular is also required to comply with Prospectus Rules. It would be helpful if the FSA were consulted and its intended approach reflected in the SIR.
9. We consider that there is a lack of clarity in the Exposure Draft over how the reconciliation should treat errors identified by either the issuer or the reporting accountant. In such a situation consultation with the FSA as to the required treatment (and consideration of the impact upon the reporting accountant’s opinion) will be required. In light of this it unlikely to be possible to draft the SIR to address all possible ad hoc solutions. However, in our view, it would be helpful if clear guidance were provided on the reporting accountant’s responsibility for adjustments and errors. To help establish best practice we feel that clarification is needed from the UKLA of its expectations of the reporting accountant’s approach (see also 45).
10. We also believe that clarification should be sought from the London Stock Exchange on whether, with respect to AIM transactions, it intends to follow the UKLA’s approach. It is noted however that the London Stock Exchange has no reconciliation concept for AIM transactions.

## **RESPONSES TO SPECIFIC QUESTIONS**

***Question 1: Do you support the Standards and guidance in paragraphs 12, 21(d), 22 and 23 that describe the extent to which the engagement team should have knowledge of the target’s financial reporting framework?***

11. We note that paragraphs 13 and 22 will determine engagement terms in that the reporting accountant must decide whether their position enables them to accept the engagement.
12. We believe that the guidance is helpful but could go further in setting out the depth of knowledge needed to be able to identify areas of difficulty. For example, a high to extensive level of knowledge is usually necessary to enable a reporting accountant to identify any potential areas of difference, particularly those which have not been identified from analysis of the accounting policies disclosed or from management procedures. The proposed SIR should make clear that an in-

depth understanding of how the accounting policies have been applied is necessary and is arguably more important than an understanding of why such accounting policies have been applied (ie the accounting framework).

**Question 2: Do you agree that the work effort of the reporting accountant described in paragraphs 36 to 40 of the proposed Exposure Draft is pitched at a level that is appropriate for the opinion to be given by the reporting accountant?**

13. We have considered the work effort of the reporting accountant described in paragraphs 36 to 40 of the Exposure Draft and the appropriateness for the opinion to be given by the reporting accountant. We are of the view that the opinion required in the proposed SIR may require a more extensive work effort than the “enquiry and analytical review” required in the Introduction to Question 2 in the Invitation to Comment. We contend that, to enable the opinion required by the current Listing Rules and provided over the last two years, it is possible that reporting accountants will have performed additional procedures to those suggested in the Exposure Draft, including tests of detail for certain types of adjustment (though not on the underlying information), where they considered them to be appropriate. We suggest that, as the Listing Rules require a positive assurance opinion, more guidance as to the work to be undertaken on completeness is drafted within the SIR, eg on the work effort required in understanding how the accounting policies are applied, and consideration may be given to converting paragraph 38 of the proposed SIR to Investment Reporting Standard (in bold type), although this may not be needed in light of SIR 1000.11. In doing so it would be helpful for the guidance to clearly state that the work effort stated is for illustration only and that the reporting accountant needs to exercise professional judgement in determining the work effort.
14. Moreover, despite the subheading **Completeness of adjustments and consistency of accounting policies**, paragraphs 36 to 40 do not elaborate on how to assess if an adjustment that has been identified has been correctly calculated and, in particular, how to assess the completeness of adjustments. We suggest that more detailed guidance on the completeness of adjustments is drafted within the proposed SIR and that consideration is given to converting paragraph 38 into an Investment Reporting Standard.

**Question 3:**

- (a) Do you support the publication of these conventions by the APB as an Annexure to the proposed SIR? If not, please indicate what existing source of generally accepted criteria should be used by reporting accountants instead?**  
**(b) Do you agree with APB’s description of the conventions?**  
**(c) Are there any significant conventions that you believe should be added to the Annexure?**

15. We support the publication of the conventions as an Annexure to the proposed SIR. We agree with the description of the conventions, other than as noted in response to Question 4 and as described in paragraphs 8 to 17. We currently have no suggestions for other conventions to be included.

**Question 4: Do you agree that the Annexure should include paragraphs 18 to 25 on management’s processes?**

16. We believe that the description in the Annexure of management’s processes is helpful but do not agree with paragraphs 24 and 25 of the Annexure being

focused on groups that undertake many acquisitions. We would expect that all companies would be applying some of the high level controls set out in paragraph 25 of the Annexure. It would be preferable to refer to generic controls which would be applicable to the reconciliation process, for example, independent review.

17. Paragraph 16. In the experience of some of our members, in some circumstances, alignment adjustments have been made for differences in accounting estimates, such as for significantly different depreciation rates. There may be benefit in clarifying in the proposed Annexure whether differences in estimate should never be adjusted for, or whether this is acceptable, for example as an adjustment or as a footnote disclosure
18. We believe that reference to the principles in the Annexure should be included in the Responsibilities in the example engagement letter clauses in Appendix 2. Accordingly the first paragraph under Responsibilities would include a (new) second sentence that reads

*“The directors shall also have regard to the processes for preparing a financial information reconciliation as set out in the Annexure to SIR 5000.”*

## **OTHER POINTS**

### **Proposed SIR**

19. Paragraph 2. According to the international framework for assurance engagements issued by the International Auditing and Assurance Standards Board (IAASB), where the reporting accountant gives a positive opinion such as “true and fair for the purposes of the investment circular”, the type of assurance implied is ‘reasonable’ and not ‘high’. Accordingly “high level of assurance” should be replaced with “reasonable assurance”.
20. Paragraph 11. In “..., the reporting accountant determines that it has,...” it is unclear whether ‘it’ refers to the reporting accountant or the target. Similarly in paragraph 12 (a).
21. Paragraph 13. As mentioned in 7, in a hostile bid situation, if no access is provided, the reporting accountant would have to qualify their opinion. Paragraph 13 of the Exposure Draft states that “in a hostile bid situation the reporting accountant is unlikely to obtain the necessary access to the officials and records of the target and, therefore, is unlikely to be in a position to report on a financial information reconciliation”. We note that since the Exposure Draft was published the FSA has commented on hostile bid situations in List!16 issued in July 2007. We consider that the APB should consider reflecting this in the guidance in the SIR.
22. Paragraph 13. In the first sentence, “is likely to” should be replaced with “will” given the publication of the UKLA’s approach suggested in List!16.
23. Paragraph 21. It would seem to us that an additional item is required; namely  
*(f) areas of management judgement*
24. Paragraph 22. The second sentence would describe the usual process more accurately if it were rephrased as

*“The reporting accountant considers whether it might be helpful to meet with the target’s auditor to gain a wider understanding of the target, its financial reporting procedures and the way in which its accounting policies are applied and establishes if the auditor of the target is prepared to assist.”*

25. Paragraph 23. We believe that clarification of an apparent omission in the Listing Rules would be helpful. Specifically the financial reconciliation requirements in the Listing Rules do not appear to address the circumstances where the offeror intends to fund its prospective acquisition by means of a share issue requiring compliance with the Prospectus Rules. Whereas the Listing Rules require financial information to be given by reference to the offeror’s last stated accounting policies, the Prospectus Rules require information to be provided by reference to the offeror’s next accounting policies.
26. Paragraphs 32(b) and 37 refer to completeness of material adjustments (“all...material adjustments” and “thoroughness” etc). We believe that the guidance to reporting accountants, set out in bullet points (a) to (c), with regard to the procedures and controls adopted by directors should be more consistent with the guidance in SIR 4000, paragraph 25.
27. In relation to paragraph 32, we believe that it would be helpful to provide guidance to reporting accountants in circumstances where the reporting accountant considers that, in the light of information obtained subsequent to the issue of the last audit report, the issuer’s accounting policies are no longer appropriate or applicable.
28. Paragraph 32. In the first sentence “issuer’s” not “issuers”.
29. Paragraph 33. Directors’ procedures and controls, would be better located in the Annexure which deals with management’s processes. We also are of the view that the last two bullet points in paragraph 33 are unclear insofar as “closing equity account balances” is not a commonly used term and adjustments to the cash and cash equivalent positions are also not common.
30. Paragraph 37. In the second sentence, “it is likely” should be deleted, and “will have” should be replaced with “should have”.
31. Paragraph 38. We believe that “sufficient appropriate evidence” should be used in accordance with the aforementioned IAASB assurance framework regardless of the type of assurance (reasonable or limited) engagement to be undertaken.
32. Paragraphs 15 and 49. The reporting accountant may also have provided an audit or other opinion on the financial information of the target. Such audit or opinion previously given would have been on the financial information of the target based on the accounting policies of the target. In a reporting engagement on a financial information reconciliation, the reporting accountant is not required to perform specific procedures on the unadjusted financial information other than to assess whether it has been extracted from an appropriate source and to consider the effect on the financial information reconciliation (paragraphs 34 and 35 of the SIR). The reporting accountant will consider its independence in accordance with the relevant ethical standards issued by the APB including the Ethical Standards for Reporting Accountants (ESRA) and, where appropriate, will apply appropriate safeguards.

33. Paragraph 55. As it is the issuer who has responsibility for the financial information reconciliation and its preparation, we suggest that the paragraph is rephrased as follows:

*“In the event that the reporting accountant concludes that it is necessary to express a modified opinion it explains the circumstances to the issuer so that the issuer has an opportunity to amend the financial information reconciliation to alleviate the concerns of the reporting accountant.”*

34. The approach to **Events occurring between the date of the reporting accountant’s report and the completion date of the transaction** in paragraph 58, should be aligned with that in other SIRs (eg there may be circumstances, as dealt with at paragraph 66 of SIR 4000, where a supplementary investment circular will need to be prepared).

### **Proposed Appendices**

35. In Appendix 2, we believe that the sentence *“The directors shall also have regard to the processes for preparing a financial information reconciliation as set out in the Annexure to SIR 5000.”* should be inserted at the end of the first paragraph under Responsibilities. This point is also made in our response to Question 4 and is included here for completeness.
36. The proposed SIR correctly refers to “reconciliation” in the singular and, in the example engagement letter clauses in Appendix 2 and the example report in Appendix 4, references to “reconciliations” and “reconciliation[s]” should be replaced with “reconciliation”.
37. The list of specific representations in the example management representation letter in Appendix 3 should include additional representations that the issuer’s accounting policies remain applicable and appropriate and that the financial information reconciliation has been prepared on the basis of SIR 5000.
38. SIR 5000 attempts to follow the principles set out in ISAE3000. In our view, the title of the report in Appendix 4 should be amended to ‘Example independent assurance report on a financial information reconciliation in accordance with the Listing Rules’. This would be consistent with the bold type requirement in paragraph 49 of ISAE 3000. .
39. The terms “profit and loss statement” and “income statement” are used interchangeably in the example report on a financial information reconciliation in Appendix 4 and, for clarity, we suggest that only one of these is used. The Annexure tends to refer to “income statement”.
40. In making amendments to paragraph 32 of the Exposure Draft, as recommended above, consequential changes would be needed to the first paragraph under ‘Basis of opinion’ in Appendix 4, which would bring it more into line with that in SIR 4000.
41. The Declaration will only be relevant if the document is a combined Prospectus and Circular. We recommend that the wording of the Declaration be aligned with the other SIRs.



## Proposed Annexure

42. The Annexure is drafted on the assumption that the issuer's last set of published financial statements are correct. It is possible that the issuer may have published financial information, subsequent to the last annual financial statements, which is inconsistent with such last annual financial statements. We believe that, following consultation with the UKLA, there should be guidance on how to address changes to the issuer's last set of accounts.
43. Paragraph 8. In the first sentence "significant" should be replaced with "material".
44. Paragraphs 9 and 10. The majority of financial information reconciliations have been of line items (such as profit before tax and net assets / shareholders' equity) rather than entire balance sheets or income statements. We recommend that the first sentence in paragraph 9 be amended to read as follows:
- "Financial information reconciliations typically address adjustments to line items such as profit before tax and net assets."*
- The format usually adopted is not the columnar form as reconciliations tend to be line item adjustments and we suggest that the second sentence in paragraph 10 is amended.
45. Paragraph 11. The issue of errors in the underlying financial information impacts on part (a) of the reporting accountant's opinion on a financial information reconciliation. We believe that there is a lack of clarity over how the reconciliation should treat errors identified by either the issuer or the reporting accountant. Given the general expectation however, that a listed company's accounts will not include errors then it is likely that errors will be identified in only a very small number of cases. In such a situation, consultation with the FSA as to the required treatment (and consideration of the impact on the reporting accountant's opinion) will be required. In light of this it is acknowledged that it is unlikely to be possible to draft the SIR to address all ad hoc situations. We do however consider that help for preparers would be very useful and urge the APB to incorporate this into the Annexure.
46. Paragraph 16. In the experience of some of our members' experience, in some circumstances, alignment adjustments have been made for differences in accounting estimates, such as for significantly different depreciation rates. There may be benefit in clarifying whether differences in estimate should never be adjusted for, or whether this is acceptable, for example as an adjustment or as a footnote disclosure
47. Paragraph 23. As discussed in 30 above regarding paragraph 33 in the proposed SIR, we are of the view that the last two bullet points in paragraph 23 are unclear insofar as "closing equity account balances" is not a commonly used term and adjustments to the cash and cash equivalent positions are also not common.
48. Paragraphs 24 and 25. We do not agree that the frequency with which a listed company prepares financial information reconciliations should determine the existence [or effectiveness] of controls over that process. Companies should have some controls irrespective of how often acquisitions take place, or are considered, or how experienced the company is. We suggest that these paragraphs are amended to state that internal controls should be established.

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