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Our ref: ICAEW Rep 29/11

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Dear James

**Proposed International Standard on Related Services (ISRS) 4410 (Revised), Compilation Engagements**

ICAEW is pleased to respond to your request for comments on *Proposed International Standard on Related Services (ISRS) 4410 (Revised), Compilation Engagements*.

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 RELATED SERVICES (ISRS) 4410  
(REVISED), COMPILATION ENGAGEMENTS

**Memorandum of comment submitted in March 2011 by ICAEW, in response to the IAASB exposure draft Proposed International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements* published in October 2011**

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## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Proposed International Standard on Related Services (ISRS) 4410 (Revised), Compilation Engagements* 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.

## MAJOR POINTS

### Support for the initiative

4. We welcome the exposure of ISRS 4410 (Revised) Compilation Engagements. Practitioners in the UK provide compilation reports to their clients as one of their core services. The service has been particularly useful to companies that are no longer subject to audit but where the owners seek to provide a degree of confidence among users of the information that they are responsible for.
5. We have had guidance in place for over ten years and have updated it regularly. Our comments will refer to our guidance where relevant, as this reflects current best UK practice. ICAEW also jointly developed a standard compilation report with other UK and Irish professional accountancy bodies in 2010. We will also draw on our experience from working together with them in developing our response.
6. We welcome the standardisation of compilations led by the IAASB, as it would facilitate consistency and would help communicate what a compilation engagement is to users. We intend to align our existing guidance with ISRS 4410 when finalised and to promote its use along with other UK and Irish professional accountancy bodies if possible.
7. To facilitate the adoption of the standard, we believe that ISRS 4410 should be principles-based and not excessively prescriptive. This is because companies that use compilations are normally not listed on an international capital market and the type of international standardisation necessary in ISAs is not appropriate. Therefore, the standard should allow for a degree of variability to reflect local practice and the local legislative environment while providing an internationally recognisable framework.

## RESPONSES TO SPECIFIC QUESTIONS

**Q1: Proposed ISRS 4410 is designed to apply when the practitioner is engaged to compile financial information in accordance with an applicable financial reporting framework and to provide a compilation report for the engagement performed in accordance with this ISRS. Do respondents believe this scope is appropriate, and is it clear when practitioners undertaking the compilation of financial information are required to apply the standard? What practical challenges, if any, might arise from the proposed scope of the standard?**

8. We believe that in principle the scope is appropriate. It is reasonable that the standard should be used when practitioners are engaged to provide a compilation service in accordance with

an applicable financial reporting framework and practitioners should issue a compilation report at the end of the engagement to communicate the fact.

9. We believe that the main purpose of a compilation report is to facilitate communication with users and demonstrate that professional accountants were involved in the preparation of accounts following an internationally recognisable framework. Ideally, practitioners would use the standard voluntarily because the value of using the standard and issuing a compilation report is widely recognised.
10. Unlike the local statutory requirements for an audit, there is generally no legal obligation to carry out a compilation engagement in the UK and this reduces or possibly eliminates any absolute requirement for such a report. If an audit exempt client insists that he does not want a compilation report, any mandatory requirement in the standard would mean that a member of one of the Professional Institutes would not be allowed to prepare accounts for that client following the rest of the standard. That is unlikely to be in the interest of either the client or the practitioner.
11. We note that where there are circumstances such as a local requirement or because of an agreement with a lender, the issuance of a compilation report may be required. If such a report follows the format as described in the IAASB standard, we believe that the practitioner should follow the standard to avoid an expectation gap.

**Q2: Do respondents believe the compilation engagement performed under the proposed ISRS is clearly distinguishable from assurance services (audits and reviews of financial statements) to users of compiled financial information and the practitioner's report, to those who engage practitioners to prepare and present financial information of an entity, and to practitioners undertaking these engagements?**

12. Yes. We believe that the definition, guidance, the wording and title of the report are all made as clear as possible to differentiate a compilation from assurance services. Notwithstanding that Appendix 3 is for illustrative purposes only, we recommend that the report is as concise as possible to avoid potential confusion with an audit report. For example, the last two sentences in the last paragraph of the report may be made optional as we have done so in the cross-profession compilation report used in the UK and Ireland. This is based on the feedback from practitioners that reference to audits and reviews is not helpful unless users clearly understand the difference between these services.
13. 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 that may be familiar to practitioners. A practical information sheet might be produced to facilitate communication with users. For example, the practical guide attached enables our members to compare compilations, the ICAEW Assurance Service (our equivalent of reviews) and statutory audits.
14. We also recommend that the standard requires practitioners to discuss with clients the purpose and nature of what is being done so that the latter understand what a compilation is when engaging practitioners to perform compilation engagements. A sentence such as 'this includes having a discussion with management so that management understands the purpose of a compilation engagement and that it is not an assurance engagement' might be added where 'a rational purpose for the engagement' is discussed (Para 23 (a)).
15. In reality, because of the ethical requirements, in particular the integrity requirements of not knowingly be associated with information that contains, for example, a materially false or misleading statement. In consequence, practitioners tend to carry out procedures that go beyond what are envisaged under compilations. It is therefore important that the IAASB recognise this tension between compilations and reviews and clarify the purpose of each service. This is because there are certain procedures that are likely to be carried out both in compilations and reviews but the purpose of carrying out these procedures are likely to remain different: in compilations it is for

practitioners to satisfy themselves meeting ethical requirements, while in reviews the purpose is to test the assertions with the need of the intended users in mind.

**Q3: Is the requirement for the practitioner to obtain management's acknowledgement of its responsibilities as specified under the proposed ISRS an acceptable premise for the practitioner undertaking a compilation engagement under the standard?**

16. Yes, we agree that the requirement to obtain management's acknowledgement of its responsibilities is necessary. In reality, however, we are concerned that management may sometimes 'acknowledge' their responsibilities if asked by the practitioner, even if they lack the competence to understand or fulfil these responsibilities.
17. We recommend that the list of responsibilities are converted into a discussion guide rather than being a requirement at the engagement acceptance stage. The wording that the draft standard has directly derived from an ISA should be made softer and less prescriptive than it currently is. We would also encourage the standard to recognise the difficulties and risks that the practitioner may face due to the clients' limited knowledge.
18. We also suggest that management's acknowledgement of its responsibilities could be a requirement forming part of a management representation letter (or 'management approval' letter). In this way, the practitioner would only need to obtain management's agreement at the engagement acceptance stage to confirm their responsibilities before the compilation report is to be signed.

**Q4: Do respondents believe the proposed requirements dealing with the responses and actions by the practitioner when the practitioner believes the compiled financial statements contain a material misstatement, or are misleading, are appropriate?**

19. Yes, in particular we are pleased that withdrawal from an engagement is an option. We do not believe a qualified report in compilations is practical or helpful for the sake of users. It is difficult to qualify a statement that is not an opinion. We also believe that this requirement is in line with the position in the Code of Ethics that requires professional accountants not to be associated with reports where they believe that the information contains a materially false or misleading statement.
20. We recommend that the standard states either in paragraph 34 or A51 that non-issuance of a compilation report as a result of resigning as required under paragraph 34 does not imply that the practitioner has not followed the standard. This is because the scope of the standard states that the standard applies when the practitioner issues a compilation report.
21. We note that there is no guidance as to how practitioners may disclose in a compilation report a material uncertainty arising from situations such as the loss of records. Practitioners would use their knowledge and skills to help their clients to reconstruct the relevant information. However, the compiled information may still be misleading without the report disclosing the fact. While such a situation may be rare in practice, our guidance AAF 02/10 *Chartered accountants' reports on the compilation of financial statements of incorporated entities* provides an example: '*We draw your attention to note x in the financial statements which discloses and explains that the year-end stock balance is an estimate derived from management accounts*'. *Following a fire in the warehouse, the records of the year-end stock count were not available.*
22. We also note that it would be useful if the standard provides guidance as to what practitioners should do if they are uncertain about the completeness of information. This could be as a result of information being missed out or there may be issues with management integrity. We would like some guidance such as a factual statement describing the issue objectively or suggesting actions incorporated under paragraph 37 or A47.

**Q5: When the practitioner identifies the need to amend the compiled financial information so that it will not be materially misstated or misleading, do respondents agree that the practitioner may, in appropriate circumstances, propose the use of another financial reporting framework as long as the proposed alternative framework is acceptable in the circumstances of the engagement and is adequately described in the financial information?**

- 23.** Yes, but A49 needs to remind practitioners of associated guidance in A32 –A36 that discusses the acceptability of the proposed financial reporting framework. This is in particular so because practitioners are supposed to have established the acceptability of the original financial reporting framework at the engagement acceptance stage. For example, compilation engagements are mostly provided to incorporated entities for their year-end accounts in the UK, and the UK Companies Act 2006 prohibits a departure from a generally accepted accounting framework. In this circumstance, we cannot envisage an alternative financial reporting framework exists.
- 24.** We believe that practitioners need to consider the change in the applicable financial reporting framework with caution. Even where the applicable financial reporting framework is not specified in applicable law or regulation, for example, for unincorporated entities, practitioners consider carefully that the conditions in A31-A36 are met so as not to complete a compilation engagement to the detriment of the intended users.

**Q6: Appendix 3 of the proposed ISRS sets out several illustrative practitioners' compilation reports. Do respondents agree these reports provide useful additional material to illustrate some different scenarios for compilation engagements? Do respondents believe the communications contained in these illustrative reports are clear and appropriate?**

- 25.** Yes, we agree that these reports provide useful additional material.
- 26.** We note that, in the paragraph that starts with 'A compilation engagement involves...', the second sentence goes '... A compilation engagement does not include gathering evidence. ...' We note that 'gathering evidence' has a specific meaning for practitioners as it relates to assurance engagements. However, it is unlikely to mean anything specific to users and in fact it may be just confusing. We suggest keeping the first sentence but deleting the rest of the paragraph.
- 27.** We found the heading 'Alert to Reader' in illustrative reports 2-4 rather an odd heading and propose 'Explanatory Paragraph' instead.

**Q7: Proposed ISRS 4410 is premised on the basis that a firm providing compilation engagements under the standard is required to apply, or has applied, ISQC 1 or requirements that are at least as demanding. In light of this, are the requirements concerning quality control at the engagement level sufficient? Does this approach to specifying quality control provisions in proposed ISRS 4410 create difficulty at a national or firm level? If so, please explain.**

- 28.** We fully support the requirement that professional services provided by practitioners should be of high quality in order to enhance user confidence and to provide consistency if the service is provided on a cross-border basis. For the purpose of non-audit services including compilation engagements, however, we do not support mandating ISQC 1 as we do not believe its detailed requirements being proportional in its present form.
- 29.** We currently have our own quality assurance regime that we believe to be proportional and appropriate for the purpose of non-audit engagements. We believe that these requirements are as demanding as ISQC1 in terms of the quality required by practitioners carrying out compilations. We recognise however, it is not a straightforward task for each jurisdiction to establish whether their existing quality assurance regime is fit for the purpose of compilation engagements performed in compliance with ISRS 4410. It will inevitably lead to a degree of variability across jurisdictions, although in itself variability may not be a significant issue, as compilation engagements are most likely to be offered within a particular jurisdiction.

- 30.** We note in A5-A9 that the standard accepts that each jurisdiction may currently have a different quality control arrangement other than ISQC1. Considering that the adoption of ISQC1 has been slow and limited in some jurisdictions, we encourage the IAASB to commence a project to consider quality control requirements in the context of non-audit services, in particular for compilations and reviews. This may mean that the IAASB could revise or amend ISQC1 for the purpose of non-audit engagements possibly in the form of ISQC2 for non-audit services.
- 31.** ICAEW will fully support the IAASB should it commence a project to develop ISQC2. This could be linked to one of its suggested activities in the Proposed IAASB Strategy and Work Programme for 2012 – 2014 to consider actions to assist in the application of ISQC1 for smaller firms. We have experience of implementing ISQC1 to smaller audit-registered firms and are aware of specific difficulties that include hot and cold file review and documentation requirements. We also have experience of applying our own quality assurance regime to practising firms that no longer carry out audits. We would be delighted to share what we have learnt from the experience with the IAASB to consider what would constitute a proportional and appropriate quality control requirement.
- 32.** We recognise, however, that there may be some timing issues as the development of ISQC 2 may take some time should the IAASB decides to commence such a project. Given that proposed ISRS 4410 already has a number of quality control requirements, we suggest that the IAASB also adds to ISRS 4410 any further quality control requirements that it considers critical and removes references to ISQC1. When ISQC2 becomes available, ISRS 4410 may be revised.

## **OTHER POINTS**

### **General versus Special purpose**

- 33.** We thought A15 with examples of general and special purpose financial reporting frameworks could be usefully expanded. For example, we consider standards in unmodified forms issued by recognised standard setters, such as IFRS for SMEs should be classified as general purpose financial reporting frameworks.
- 34.** We understand that special purpose means either the framework used is only meaningful to specific users or a modified general framework is used. In both cases, there should always be a disclosure in the compilation report to notify readers and distribution should be restricted.

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