Engagements to Compile Historical Financial Information—Issues and IAASB Task Force Proposals

A. **Scope of the Draft Revised ISRS**

1. The Task Force has developed the draft revised standard on compilation engagements, ISRS 44102 (see Agenda Item 7-B), with a focus on the compilation of historical financial information using an applicable financial reporting framework. The draft revised standard is constructed on the premise that the IESBA Code of Ethics for Professional Accountants (IESBA Code), or relevant ethical requirements of national standards that are at least as restrictive, and ISQC 1,3 define the responsibilities of the practitioner and the practitioner’s firm in such compilation engagements together with the draft revised ISRS.

2. The draft revised ISRS is to be applied, adapted as necessary, to engagements to compile other financial information. The draft revised standard provides examples of other financial information that practitioners may be involved in compiling.

B. **Nature of the Engagement to Compile Historical Financial Information**

3. Much of the Task Force’s deliberations have focused on obtaining a consensus view, as far as possible, about the nature of a compilation engagement. At the December 2009 and March 2010 Board meetings, the Task Force presented preliminary views on the statement of the practitioner’s objectives to be achieved in the compilation engagement. There is very clear understanding that the compilation engagement is not an assurance engagement. However, there has been much discussion centered on types of activities that are undertaken by the practitioner in a compilation engagement.

4. A strong consensus view has emerged, including through preliminary comments provided by national auditing standard setters (NSS) in the IAASB-NSS liaison group, that the focus activity of a compilation engagement is on presenting financial information of an entity in accordance with the applicable financial reporting framework. The compilation activities may extend to provision of other services provided within one engagement with a client, for example preparing the underlying accounting records that will be used to compile the financial information. It is the presentation of the financial information, however, that is the focus of the engagement, which the practitioner does on the basis of information provided by management (regardless of whether the practitioner also is involved with the assembly or summarization of that underlying information).

5. Accordingly, the draft revised standard reflects this clear focus in the definition of “compile,” which also appears in the statement of the practitioner’s objectives.

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1 International Standard on Related Services.
2 International Standard on Related Services (ISRS) 4410, “Engagements to Compile Financial Statements.”
3 International Standard on Quality Control (ISQC) 1, “Quality Control for Firms That Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements.”
6. The statement of objectives includes the provision of a report by the practitioner on the compiled financial information (see discussion at paragraph 32).

7. As a consequence of the interaction between the statement of the practitioner’s objectives and the definitions of “compile” and “compilation engagement” the Task Force believes that the issues it spent some time considering earlier in the project about addressing practitioners’ association with financial information other than through the mechanism of a compilation engagement are now scoped out of the draft revised standard. Following the advice of the Board at the December 2009 meeting, the Task Force considers this is appropriate, and that questions of practitioners’ association with financial information arising in contexts or settings other than through performing a compilation engagement should not be addressed as part of this project.

Matters for IAASB’s Consideration

The IAASB is asked:

- Whether it agrees that the practitioner’s focus in a compilation engagement is on presenting the financial information in accordance with the applicable financial reporting framework; and
- Whether it agrees with the practitioner’s objectives for a compilation engagement stated in paragraph 12 of the draft revised ISRS.

C. Responsibility of Management, or Those Charged with Governance as Appropriate, for the Compiled Financial Information

8. The Task Force has received strong views from stakeholders that have provided input to this project, including some of the NSS, that the revised standard should be clear that, notwithstanding the practitioner’s involvement with the information through the compilation and the practitioner’s application of accounting and financial reporting expertise in the engagement, management cannot divest themselves of their overall responsibility for the compiled financial information, including:

(a) The preparation of the information, through

(i) selection of the applicable financial reporting framework that is acceptable in view of the intended purpose and the intended users of the compiled financial information, and appropriate description of that framework within the compiled financial information; and

(ii) making the management judgments needed to compile the financial information, for example in relation to accounting estimates and other items that reflect management’s judgments, assumptions and decisions.

(b) The compiled financial information that results from the engagement, on the understanding and acknowledgement that it is compiled from information provided to the practitioner by management (documents, explanations and other information), and where management is also responsible for the accuracy and completeness of the information provided.
9. The Task Force believes that this can best be achieved by reflecting the above points in preconditions for accepting a compilation engagement in the draft revised ISRS. The revised standard should require the practitioner to obtain management’s written agreement on these points as a pre-condition to accepting the engagement.

10. As further pre-conditions, the Task Force believes that the practitioner should only accept a compilation engagement if the practitioner has identified the intended use of the compiled financial information, and determines that the applicable financial reporting framework is acceptable the intended use of the financial information.

Matter for IAASB’s Consideration

The IAASB is asked:

- Whether it agrees with the statement of the pre-conditions for accepting a compilation engagement as set out in paragraph 18 of the draft revised ISRS.

D. The Level of the Practitioner’s “Knowledge and Understanding”

11. At the March 2010 IAASB meeting, the Board considered the Task Force’s views and preliminary draft requirements about the level of “knowledge and understanding” that the practitioner needs to undertake a compilation of historical financial information in accordance with an applicable financial reporting framework.

12. Questions that have arisen include what the practitioner’s “knowledge and understanding” should cover and “how much” is needed to be able perform the compilation with competence and due care (for example, relative to performing an assurance engagement).

13. The Task Force believes that:

(a) The required “knowledge and understanding” should encompass knowledge and understanding of the entity’s business and its operations, and understanding of the applicable financial reporting framework and how it is applied in the entity’s industry.

(b) The sufficiency of knowledge and understanding would vary depending on the nature and size of the entity, and the level of complexity in financial reporting and related financial information or accounting systems. Also, if a more complex financial reporting framework is to be used, the practitioner will need relatively greater knowledge and understanding to be able to properly apply the framework, including knowing how that framework is applied in financial reporting within the entity’s industry.

(c) The question of how much knowledge and understanding is needed depends on the circumstances of individual engagements, and the practitioner’s professional judgment. Accordingly the requirement in the revised standard needs to be scalable to different sizes of entity. Guided by the ethical principles of competence and due care, the practitioner should only undertake a compilation engagement if the practitioner either has, or is able to obtain, the appropriate “knowledge and understanding” to be able to properly compile the required financial information.
14. The Board agreed with the Task Force’s analysis, and noted that it should be made clear in application guidance that the practitioner’s knowledge and understanding of the entity (its business and operations) and its environment is always less than that which management has.

15. As part of comments provided by NSS participants for the 2010 IAASB-NSS meeting, one NSS participant expressed the view that the requirements imposed on practitioners regarding the nature and level of the practitioner’s “knowledge and understanding” should not “overstate” the knowledge and understanding required to perform a compilation engagement, to avoid implying that it should be at the same level as required for an audit.

16. On the other hand, the Task Force is strongly of the view that the required level of knowledge and understanding is critical for fulfillment of the practitioner’s ethical obligations of competence and due care, and integrity in the context of not knowingly being associated with financial information that is materially false or misleading. The practitioner’s level of knowledge and understanding needs to be at the level expected of a reasonable practitioner. From a legal perspective the practitioner’s knowledge and understanding cannot be inadequate for the reasonable performance of the engagement by the practitioner, or so that the practitioner is “willfully blind” when performing the compilation engagement.

17. The Task Force has come to the consensus view that, regarding paragraph 13(a) above, the practitioner’s knowledge and understanding regarding the entity should as a minimum encompass knowledge and understanding of the entity’s business and operations, including its accounting system and accounting records. It is less than the knowledge and understanding that management has. Regarding 13(b) above, the practitioner’s understanding of the applicable financial reporting framework should extend to how the framework is applied within the entity’s industry. The sufficiency of the practitioner’s knowledge and understanding is for the practitioner to judge, with the practitioner’s ethical obligations front of mind.

Matters for IAASB’s Consideration

The IAASB is asked:

- Whether it agrees with the arguments above regarding the required level of the practitioner’s
  (a) Knowledge and understanding of the entity, including its business and operations, accounting systems and accounting records; and
  (b) Understanding of the applicable financial reporting framework.
- Whether it agrees with the Task Force’s view on the requisite knowledge and understanding that the practitioner should have to perform a compilation engagement, as set out in paragraph 23 of the revised ISRS and explained in the related application guidance (paragraphs A46-A48).
E. **Procedures Which Aim to Reduce the Risk That a Practitioner may be Associated with Financial Information that is Materially False or Misleading**

18. At the December 2009 meeting, the IAASB agreed that the practitioner needs to perform some minimum procedures to properly fulfill the ethical obligation not to knowingly be associated with financial information that is materially false or misleading. In line with the approach required to address threats to complying with ethical standards set out in the IESBA Code, the greater an identified threat the more important it is that the practitioner address it appropriately through applying measure to effectively mitigate the threat. The practitioner’s response and actions will differ in individual cases, but the Task Force believes that for all compilation engagements some minimum actions are appropriate to be able to demonstrate ethical compliance.

19. The Task Force is mindful that the minimum requirements established for compilations should avoid blurring the distinction between compilation engagements and assurance engagements. In a compilation, the practitioner does not perform any evidence-gathering procedures or obtain assurance – and the draft revised standard explains that both the practitioner’s engagement letter and the practitioner’s report should clearly state this fact.

20. Again, the practitioner’s professional judgment is critical. The proposed requirements are that the practitioner read the compiled financial information with a view to being able to become aware of obvious material misstatements in the compiled financial information, and whether the financial information is obviously misleading.

21. The Task Force recognizes that the practitioner’s reading of the compiled financial information needs to take account of the applicable financial reporting framework, and with consideration of the intended use and intended users of the compiled financial information.

22. As part of reading the compiled financial information, the practitioner also takes into account whether the description of the applicable financial framework contained in the compiled financial information is misleading to the intended users (see paragraphs 28 – 31 below).

23. The Task Force believes that if through the practitioner’s reading of the financial information the practitioner does indeed become aware of obvious material misstatements, or that the financial statements are obviously misleading to the intended users, the practitioner should propose appropriate amendments to management. Management is ultimately responsible for the compiled financial information, and accordingly is responsible for the amendments which would resolve or remove material misstatements.

24. If obvious material misstatements are identified that are departures from the applicable financial reporting framework, the practitioner may consider whether it would be appropriate to recommend to management use of another acceptable financial reporting framework which would mean the identified material misstatements would not arise. For example, management may agree to change the applicable financial reporting framework to a “modified basis” that is viewed as acceptable, that would be described within the compiled financial information on a transparent basis.
25. In the event that management were to refuse such amendments the Task Force believes that the practitioner should be required to withdraw from the engagement to avoid breaching ethical standards (to not knowingly be associated with financial information that is materially false or misleading).

26. The Task Force does not believe that it is appropriate for the practitioner to continue the engagement if management does not amend the financial statements so that they are not misleading or not materially misstated. Further, the Task Force’s view is that the practitioner should not issue a report for the engagement that discloses that the compiled financial information is materially misstated or misleading. To do so would blur the distinction between a compilation engagement and an assurance engagement. It would also likely lead to expectation gaps and misunderstandings, as users may believe that any misstatements disclosed by the practitioner are the only ones that exist in the compiled financial information, whereas that may not be true.

27. In the event that the compilation engagement cannot be completed to the practitioner’s satisfaction due to incomplete or inaccurate information, or due to information that is otherwise unsatisfactory, to the extent that means the practitioner is unable to properly complete the compilation engagement in accordance with the ISR (including considering whether, on the basis of a reading of the compiled financial information, it is obviously materially false or misleading), the Task Force believes that the practitioner should withdraw from the engagement.

**Matters for IAASB’s Consideration**

The IAASB is asked:

- Whether it agrees with the Task Force’s perspectives on what the practitioner is required to do, as a minimum in the compilation engagement, to comply with relevant ethical requirements regarding the possibility of knowingly being associated with financial information that is materially false or misleading. Specifically, is the level of effort directed at becoming aware of obvious material misstatements or that the compiled financial information is obviously misleading sufficient and reasonable in view of the purpose of a compilation engagement?

- Whether it is satisfied with the Task Force’s approach described above regarding actions to be taken by the practitioner when:
  
  (a) Management refuses proposed amendments to the compiled financial information that the practitioner views are necessary.
  
  (b) The practitioner is unable to complete the compilation engagement in accordance with the draft revised ISRS on account of deficiencies in the information provided by management.

**F. The Compiled Financial Information—Describing the Applicable Financial Reporting Framework**

28. As part of performing the compilation engagement, and to avoid association with financial information that is materially false or misleading, the practitioner should address the proper
identification of the applicable financial reporting framework within the compiled financial information so that the intended users are able to understand this key aspect of its preparation and presentation.

29. In the first instance the framework applied needs to be properly described within the financial information so that it will not be misleading to the intended users.

30. Secondly the practitioner’s report either identifies the applicable financial reporting framework or, where appropriate, makes reference within the report to place within the compiled financial information where the applicable financial reporting framework is described.

31. The Task Force believes that the practitioner’s report should not be used as the primary place to communicate the basis of preparation of the information, or the applicable financial reporting framework – that is part of the proper presentation of the compiled financial information so that the information itself is not misleading to the intended users.

Matters for IAASB’s Consideration

The IAASB is asked:

- Whether it agrees with the Task Force’s view that it is important that the applicable financial reporting framework be properly described within the compiled financial information as part of the proper presentation of the compiled financial information, so that it is clear and not misleading to the intended users.

G. The Practitioner’s Report

32. At the December 2009 and March 2010 IAASB meetings, the Task Force presented its view that a compilation engagement should, as part of its defining characteristics, include a report on the compiled financial information. This is important because it is the ability to associate the practitioner with the compiled financial information – with the practitioner’s expertise in accounting and financial reporting – that carries value for the engaging party (usually management or those charged with governance) and the intended users.

33. The primary purpose served by the report is to communicate the practitioner’s level of involvement with the compiled financial information, and its limitations, for the benefit of the intended users. The report also makes it clear that in view of the different nature and purpose of a compilation engagement, the practitioner does not express any opinion or conclusion on the compiled financial information. Users need to be made pertinently aware of that fact to avoid misunderstanding.

34. As mentioned in the Task Force Issues Paper presented in March 2010, and in paragraphs 26 – 27 above, in view of the purpose of the report the Task Force’s consensus view is that the report should not be used as a vehicle to alert users about unadjusted material misstatements in the compiled financial information that the practitioner becomes aware of when performing the compiling engagement.

35. Using the report for that purpose would, in the Task Force’s view, confuse the purpose of the report and the objective of the engagement. The most appropriate response if
management refuses an amendment the practitioner considers necessary so that the information will not be materially misstated or be misleading, is to withdraw from the engagement and not provide the compiled financial information or any report.

Matters for IAASB’s Consideration

The IAASB is asked:

- Whether it agrees with the Task Force’s view about the purpose of the practitioner’s report for a compilation engagement; and
- Whether it agrees that, in view of the purpose of a compilation engagement and the practitioner’s objectives and related work effort in performing the engagement, it is not appropriate for the practitioner’s report to be used to disclose unadjusted material misstatements in the compiled financial information. Does the IAASB agree that the appropriate action by the practitioner is to withdraw without providing the compiled financial information or any report?