

ISRS 4410 (REVISED) COMPILATION ENGAGEMENTS

A proposed International Standard on Related Services issued for comment by
the International Auditing and Assurance Standards Board

Comments from ACCA
March 2011

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Executive Summary

ACCA welcomes the opportunity to respond to the exposure draft of proposed International Standard on Related Services 4410 (Revised) *Compilation Engagements* issued by the International Auditing and Assurance Standards Board.

Compilation engagements, such as preparing financial statements, are important where there is no audit, as the involvement of an external professional accountant enhances the quality of reporting. Such engagements are common in the small and medium-sized enterprise (SME) sector.

In our general comments on the exposure draft we draw attention to the need to revise all of the engagement standards that are relevant to the SME sector when no audit takes place. While there are current projects relating to the standards for reviews and for compilations, we look forward to a revision of the standard for agreed-upon procedures. We also highlight the need, when finalising each standard, to ensure that it may be used in hybrid engagements that combine elements of the subject matter of individual standards to meet client needs.

In our comments on the proposed compilation engagements standard we refer to the difficulty of drafting requirements without the benefit of a theoretical underpinning, such as would have been provided by work on the fundamental principles of assurance, which ACCA and others called for at the commencement of the International Standards on Auditing 'clarity project'. We suggest that some work on the principles could be included in a current project on audit quality and indeed that the project ought to include quality issues for non-audit engagements, which are important for SMEs.

In relation to the proposed compilation engagements standard we agree with the positions it takes on:

- The scope of the standard, as its use must be responsive to commercial need
- Establishing with clarity the non-assurance nature of a compilation (although we do not support a requirement to include explanatory wording in the practitioner's report)
- The practitioner's response where the compiled financial statements are misleading, or contain a material misstatement, as this accords with existing best practice
- The inclusion of illustrative reports, as they are clear and useful
- Premising quality control on a practitioner's application of ISQC 1¹, although we recommend that, in the long term, it be revised on a 'think small first' basis to make ISQC 1 more relevant to smaller practitioners

We do not agree with:

- A requirement to obtain, in detail, management's acknowledgement of its responsibilities, as this is too similar to requirements for an audit
- Other requirements that are consistent with those for audits, as that is not necessarily appropriate
- Including a 'permission' for the practitioner to suggest another financial reporting framework, as the relevant circumstances would be rare
- Including wording about audits and reviews in the illustrative reports; instead we suggest informing users more about the engagement and the practitioner's competencies

¹ International Standard on Quality Control 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

General Comments

ACCA welcomes the opportunity to respond to the exposure draft of proposed International Standard on Related Services 4410 (Revised) *Compilation Engagements* (proposed ISRS 4410) issued for comment by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants.

In this section of our response, we make general comments on proposed ISRS 4410 and on its role as one of the standards that a practitioner may use when carrying out engagements on historical financial information, such as financial statements.

We support the updating of the extant standard for compilation engagements. This allows the standard to be written in the now-familiar clarity style adopted for the International Standards on Auditing (ISAs). It also allows changes to be made to decouple it from the ISAs and to improve the perceived value of the engagement through, *inter alia*, better reporting.

Proposed ISRS 4410 is particularly relevant to the SME sector, as such entities are increasingly exempt from statutory audit. We agree with the proposed scope of the standard, as the compilation engagement will generally be undertaken voluntarily rather than required by law. This makes it important that the practitioner is able to inform a potential client about the nature of the engagement and how it adds credibility to, for example, financial statements. The potential client may also consider a review engagement or an agreed-upon procedures engagement, or the use of a combination of standards in a hybrid engagement (for example a compilation with agreed-upon procedures on key assets). Because of this, we support the continuation of the current IAASB projects to revise both the compilation and review engagement standards while also updating International Standard on Assurance Engagements 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* as the latter is particularly relevant to the concept of limited assurance, which is employed in a review.

In a separate response concerning the proposed IAASB Strategy and Work Program for 2012–2014, we call for acceleration of the project to revise the standard for agreed-upon procedures, so as to ensure that the standards for non-audit engagements are logically and practically fitted for use one with another. However, if that project is not accelerated, we suggest that the current projects to revise standards for review and compilation engagements at least ought to result in standards that are capable of use in hybrid engagements that combine elements of the subject matter of individual standards to meet client needs.

In a later section of this response, we answer the specific questions posed in the exposure draft. In doing so we identify significant difficulties in applying the ISA clarity drafting conventions to a standard that is not an ISA, and in determining the extent to which requirements relevant to an audit ought to be included.

Across the spectrum of engagement standards, the criteria for determining whether a matter should be a requirement should take account of the level of public interest in an engagement, as well as its nature. A requirement restricts a practitioner's professional judgement and, in essence, transfers that judgement to the standard setter. We suggest that for compilations there should be no presumption of consistency with the ISAs; instead, each requirement should be justified solely by its benefit to the engagement.

This circumstance reinforces our long-held view (for example expressed at the commencement of the ISA clarity project²) that standard setting would be improved by a theoretical underpinning. In our separate response to the Consultation Paper *Proposed IAASB Strategy and Work Program for 2012–2014* we call for at least some work on the fundamental principles of assurance to be included in a current project on 'audit quality' and indeed that that project should include quality issues for non-audit engagements, which are important for SMEs.

² In ACCA's response to the September 2004 Proposed Policy Statement *Clarifying Professional Requirements in International Standards Issued by the IAASB* and Consultation Paper *Improving the Clarity and Structure of IAASB Standards and Related Considerations for Practice Statements*.

Should the IAASB have any questions about our response, or require further information, please contact in the first instance:

David York, Head of Auditing Practice, at david.york@accaglobal.com

Matters on which Specific Questions are Asked

In this section of our response we answer the questions posed in the exposure draft.

Question 1

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?

We believe that the proposed scope is appropriate. The standard should be applicable where users demanded a high standard of financial reporting; it is not suitable for use on monthly management accounts for example, as they satisfy a different business need, for which there is a much lower expectation of accuracy in any particular period.

It is correct to apply the criterion of intention to use the standard and report under it. The issuance of such a report clearly identifies an engagement as one to which an international standard applies. This supports the quality of the work and allows the practitioner to better convey the value of the engagement.

It is important that the scope is not drafted in such a way as would require the standard to be applied irrespective of the needs of the client and the users of the compiled financial information. That would deter clients from utilising the services of a professional accountant, which would be against the public interest.

We do not feel that the scope introduces practical challenges; indeed, through introducing clarity, it reduces the likelihood of difficulty.

Question 2

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?

As a professional accountant, the practitioner will have no difficulty in understanding the engagement and distinguishing it from assurance services. As the practitioner agrees the terms of the engagement with the engaging party, the latter will also develop an understanding of the engagement, including the degree of assurance (nil) theoretically communicated to users.

The capacity of users to understand the financial information and the engagement will range between those who have a good grasp and those who have almost no understanding. It is perhaps expecting too much of a practitioner's report to do more than to communicate the international standard followed (to which users may refer), the qualities of the practitioner relevant to the engagement, and the outcome of the engagement itself.

We find the wording in the report concerning audit and review to be unnecessary and indeed its inclusion could cause confusion where none was present before. Those who have little understanding of the compilation will be in a similar position with regard to their knowledge of audit and review.

Question 3

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?

We find the wording in paragraph 23(c) of the proposed standard to be too close to that for an audit to be acceptable. It is difficult to argue convincingly that there is an absolute need for such a requirement in a non-assurance engagement.

The inclusion of a requirement relating to management responsibilities has to be assessed in relation to the need for it in an engagement where no assurance is communicated to users. Even where assurance is gained and professional scepticism is exercised, for example in a review, mere consistency with ISAs is not a strong argument.

We are not convinced, therefore, by the statements in the explanatory memorandum that a requirement is '*consistent with the ISAs*' and '*an important factor to mitigating the risk of the practitioner being associated with information that is materially false or misleading*'. The first statement may be factual but is being presented as an unsupported argument. The second is an argument for inclusion, but mitigation of this risk is a commercial matter and not suitable for an engagement standard. The quality of the practitioner's work in accordance with the standard itself is what contributes to mitigating the risk of inappropriate association.

An audit in accordance with ISAs is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged certain responsibilities that are fundamental to the conduct of the audit. These amount to representations that the auditor confirms as part of the audit evidence and include, for example, the completeness of disclosure. For a compilation proposed ISRS 4410 does not require either the exercise of professional scepticism or the gathering of evidence. There is therefore no reason to treat the responsibilities of management set out in paragraph 23(c) as anything other than simple facts.

We are also mindful of the difficulty of applying the ISA clarity drafting convention to a standard that is not an ISA. Across the spectrum of engagement standards, we would expect that the criteria for determining whether a matter should be a requirement should take account of the level of public interest in an engagement, as well as its nature. A requirement restricts a practitioner's professional judgement and in essence transfers that judgement to the standard setter. We suggest that for compilations there should be no presumption of consistency with the ISAs, instead each requirement should be justified solely by its benefit to the engagement.

The position above has reinforced our view that standard setting would be improved by a theoretical underpinning. We present two further examples from proposed ISRS 4410 of where clarification of thinking may be appropriate. We conclude that much more needs to be done both theoretically and practically to justify the inclusion of every proposed requirement.

Professional judgement

Paragraph 21 requires that *'The practitioner shall exercise professional judgment in planning and performing a compilation engagement.'* but the standard contains no definition of professional judgement. The IAASB Glossary of Terms refers to the term only in the audit context:

Professional judgment—The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

It is not acceptable to have a requirement without certainty over its meaning. This should be remedied before proposed ISRS 4410 is finalised.

Knowledge of the business

Paragraph 27 requires that *'To perform the compilation engagement the practitioner shall obtain:*

- (a) Knowledge and understanding of the entity's business and operations, including the entity's accounting system and accounting records; and*
- (b) An understanding of the applicable financial reporting framework, including its application in the entity's industry, sufficient to be able to compile the financial information.'*

In an audit, knowledge of the entity is required to be obtained as part of risk assessment (this is dealt with at length in ISA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*). However, there is a very important difference from proposed ISRS 4410: in an audit *'The auditor uses professional judgment to determine the extent of the understanding required.'* It seems odd, therefore, that a more onerous requirement is placed on a practitioner carrying out a compilation. The question of what is sufficient also remains unanswered, although if the engagement is carried out and information is compiled the requirement would apparently always be satisfied. This again ought to be addressed before the standard is finalised.

Question 4

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?

Yes: withdrawal as the alternative to a modified report is realistic and is what would take place in practice.

Question 5

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?

The proposed standard should not be complicated by including this rare circumstance, which is addressed in effect by an unnecessary permission (as a non-assurance engagement may always be changed in this way).

Question 6

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?

We welcome the inclusion of the illustrative reports, which are clearly drafted and will assist in the consistent application of the standard.

Especially welcome in the illustrations is the inclusion of the wording: *'This Standard requires that we comply with quality control standards and relevant ethical requirements, including ethical principles of integrity, objectivity, professional competence and due care.'* as this will assist in communicating the qualities of the practitioner that contribute to a high quality engagement.

We agree with the inclusion of wording that briefly explains the nature of a compilation engagement (*'A compilation engagement involves applying expertise in accounting and financial reporting to assist management in preparing and presenting financial information.'*) but we see no merit in continuing from that to present two sentences stating (in part) what a compilation is not. Instead, practitioners should be encouraged to consider expanding the explanation of the engagement itself and their own competencies³ to provide users with a better insight into the value of the engagement. This is important because, in many jurisdictions, compilation work is not restricted by law to professional accountants (in contrast to audit) so there is no statutory underpinning on which users can rely regarding the ability of a particular practitioner to perform the engagement.

In our answer to question 2, we drew attention to the disadvantage of including any mention of audit or review. If, nevertheless, a decision is taken to retain such wording in the standard, we suggest that it be made optional, as the need to differentiate a compilation from an assurance engagement will vary by jurisdiction and circumstance. Moreover, some practitioners may wish to indicate also that a compilation is not, for example, agreed-upon procedures or a tax computation.

The illustrative reports might usefully include guidance as to how to report where a compilation is accompanied by a further engagement; for example some agreed-upon procedures (perhaps in relation to key assets).

³ In the UK, the report currently promulgated by the majority of IFAC member bodies includes such information (directly or through reference to websites). See http://www.ccab.org.uk/documents.php?subaction=showfull&id=1252423539&archive=&start_from=&ucat=2&

Question 7

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.

While ISQC 1 can generally be applied in a proportionate manner, it is currently mainly applied by practitioners who carry out audits (for example in the UK it is not currently mandatory for compilation engagements). As a result, practitioners who do not carry out audits may face implementation costs.

Such costs fall disproportionately on smaller practitioners as ISQC 1 was prepared primarily for use by larger firms. Although the Small and Medium Practices Committee of the International Federation of Accountants has issued an implementation guide, the fact that such a guide exists acknowledges that there is a need for it and that, in the longer term, a 'think small first' approach to setting quality control standards would be better suited to the smaller practice environment.⁴

The adoption of such an approach should include consideration of whether one standard remains appropriate or whether the material should be stratified by reference to the nature of the engagements carried out by a firm.

⁴ We call for this in our separate response to the Consultation Paper *Proposed IAASB Strategy and Work Program for 2012–2014*.

Other matters

The IAASB invites comments relating to the perspectives of:

- Users of financial information or financials statements of SMEs, including regulators
- Developing nations
- Translators

The views we express above have taken the user perspective fully into account as this is vital to the revision of the standard. All the above perspectives would be best served by plain language and concise drafting.

Effective Date

The proposed effective date (18 months after approval of the final revised standard) would appear to be reasonable but it is important to consider several engagement standards as discussed in our earlier general comments. Unless the finalisation of proposed ISRE 4410 properly enables its use in conjunction with other revised standards it may fail to gain widespread acceptance. A delay in finalisation may be the best way to mitigate such difficulties.

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29 LINCOLN'S INN FIELDS
LONDON WC2A 3EE
UNITED KINGDOM

T +44 (0)20 7059 5000
F +44 (0)20 7059 5050

www.accaglobal.com