Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By e-mail <Edcomments@ifac.org>

31 March 2011

Our Ref.: C/AASC

Executive Director, Professional Standards
International Auditing and Assurance Standards Board,
International Federation of Accountants,
545 Fifth Avenue, 14th Floor,
New York 10017, USA.

Dear Sir,

IAASB Proposed International Standard on Related Service 4410 (Revised)
Compilation Engagements

The Hong Kong Institute of Certified Public Accountants is the only statutory licensing body of accountants in Hong Kong responsible for the professional training, development and regulation of the accountancy profession. The HKICPA sets auditing and assurance standards, ethical standards and financial reporting standards in Hong Kong.

We welcome the opportunity to provide you with our comments on the captioned IAASB ED on ISRS 4410 for developing guidance relating to compilation engagements.

We support the proposed plan to revise ISRS 4410 in establishing an international standard as a benchmark for such engagements. Our comments on the Exposure Drafts are set out in the attachment.

We trust that our comments are of assistance to you. If you require any clarifications on our comments, please do not hesitate to contact me at ong@hkicpa.org.hk.

Yours faithfully,

Steve Ong, FCPA, FCA
Director, Standard Setting Department

SO/SH/jn

Encl.

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ATTACHMENT

HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS' COMMENTS ON THE IAASB PROPOSED INTERNATIONAL STANDARD ON RELATED SERVICES 4410 (REVISED) *COMPILATION ENGAGEMENTS*

Request for Specific Comments

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?**

   Overall, we support the development of the proposed ISRS 4410 to provide guidance to practitioners engaged to compile financial information. As highlighted in the Explanatory Memorandum that there is a growing demand for services other than audit to address the needs of small-and medium-sized entities, the proposed ISRS 4410 would serve this purpose.

   However, it would need to be clarified in the proposed ISRS 4410 as to the intended use of the standard – i.e. whether such engagement is envisaged where there is no statutory audit requirement to meet the needs of the users of financial statements of SMEs or whether it may also be used in some situations where the practitioner is compiling information derived from audited or reviewed information. In this case, would there be any benefit in identifying the source of the information to assist a reader to understand how much reliance can be placed on it (obviously without implying any assurance from the practitioner)? Additionally, if an underlying auditor expressed a modified opinion on a material part of the information, should the practitioner have a mechanism in his report to highlight this?

   In addition, we note in paragraph 2 in the Scope section states that the ISRS may be applied, adopted as necessary, to compilation engagements for non-financial information. While it may be reasonably straightforward to adapt the ISRS for engagements to compile financial information other than historical financial information, we feel it is less clear how the standard would be adapted for engagements to compile non-financial information, given the diverse range of engagements that this may comprise. We feel that references to non-financial information in paragraphs 2 and A3 are ambiguous and do not give the practitioner any real direction as to how the ISRS may be adapted. It is our view that, unless the IAASB wishes to invest significant time and effort to appropriately scope the guidance necessary to adequately address the issue of non-financial information, this be removed from the scope of the standard.

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?**

   We believe it is clear from the engagement letter and the practitioner's compilation report that the proposed work is distinguishable from assurance services.

However the illustrative report makes reference to the framework used as follows: "These financial statements are presented in accordance with International Financial Reporting Standards." To an uninformed reader, this could be interpreted as a conclusion by the practitioner (implying some form of assurance) rather than a statement of fact. It may be better to re-word this statement.

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?

Yes. We agree that for the proposed engagement, it would be necessary to obtain the management's acknowledgement of its responsibilities. However, the approach taken in the proposed ISRS is unnecessarily over-engineered in the context of these engagements.

Compilation engagements are often performed for clients whose management does not have a sophisticated understanding of accounting and finance and, therefore, are unlikely to be able to understand and acknowledge the detailed responsibilities set out in paragraph 23(c). This is one of the key drivers that lead to the practitioner being engaged to assist management – to provide the necessary financial reporting expertise.

For these reasons, we believe that acknowledgement can be best achieved by a simple, straightforward requirement that management accept its overall responsibility for, and to approve, the compiled information and for the underlying information and judgements therein. It is not necessary to explicitly set out in a detailed breakdown of the elements of that overall responsibility, such as the selection of the framework and of accounting policies and estimates required under that framework, as described in paragraph 23(c). In our view, this may serve only to confuse management, e.g. in paragraph 23(c)(ii)(b), the ED required the practitioner to obtain agreement from management that it has the responsibility for "Preparation of the financial information in accordance with…", we can anticipate that management's response may be that that the actual "preparation" is the responsibility of the practitioner.

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?

In our view, the requirements in relation to actions by the practitioner when there "are" material misstatements appear overly process oriented and are not reflective of the circumstances that are likely to arise in practice, in the majority of engagements of this type.

In many circumstances, we anticipate that the practitioner will be compiling the financial information from underlying transaction and accounting records. In such circumstances, the likelihood that a material misstatement or misleading information would result is remote. The practitioner is not going to prepare information that contains a material misstatement, or that is misleading, and then proceed to propose that management make the necessary amendments. The practitioner would simply compile the financial information in an appropriate manner and include such disclosures as considered necessary for the compiled financial information not to be misleading.

If compilation of financial information that is required to comply with the applicable financial reporting information agreed during engagement acceptance proves impractical in the circumstances (if, for example, the necessary information is not readily available, or because the costs of preparing the information in the circumstances is considered to outweigh the benefits), the practitioner will need to decide whether the resulting basis of preparation will result in financial information that could be misleading in the circumstances, even if the basis of preparation is fully disclosed. If it could be, then the practitioner ought not to be associated with the financial information prepared on that basis. Otherwise, the focus should be on ensuring that the basis of preparing is appropriately described in both the financial information and in the compilation report.

We acknowledge that there may be circumstances when the practitioner completes the financial information, either from a trial balance or from a preliminary, but incomplete, set of financial statements. In these circumstances, it could be possible that the practitioner identifies a misstatement and proposes an amendment to management.

In both cases, however, the desired outcome is to have compiled financial information prepared in accordance with a final agreed basis of preparation that is suitable in the circumstances and transparently disclosed. The focus in the requirements on misstatements and amendments, with reference in the application material to possibly proposing an alternative acceptable framework, seems both process orientated and contrived.

We suggest that the IAASB re-draft these requirements to make them less process oriented. If focuses on the principles above, they should be applicable in any of the likely scenarios of how and when materially misstated or misleading information is likely to arise.

In addition, in paragraph 30, the ED states that if the information is found to be "incomplete, inaccurate or otherwise unsatisfactory", the practitioner should bring this to management's attention and "request the required information". In the context of inaccurate information, this does not appear to be the appropriate response (the response appears to be limited to incomplete information).

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?**

We believe that the manner in which paragraph A49 is written could be considered misleading. Reference to a "proposal to change the applicable financial reporting framework" implies that an entirely difference framework may be adopted. In our view, the reality is that the basis on which the information has been compiled will likely be as initially agreed with management but with one or more departure from that originally envisaged. We suggest that this paragraph would be more appropriately worded by discussing "changes to the description of the basis of preparation", as opposed to a change in framework. We believe that the following two principles are important:

- The financial information should be fully transparent about the basis of preparation; and
- The practitioner needs to be satisfied overall that the compiled financial information is understandable and not misleading.

As long as the practitioner is satisfied that the underlying principles, as set out above, have been met, then the resulting compiled information will not be misleading. We also believe this approach is more readily understandable, for both users and practitioners, than complex analysis of the acceptability of different types of reporting framework.

In the event that the practitioner believes any amended description of the basis of preparation could not overcome the risk of being associated with information that is misleading, then we support the requirement in paragraph 34 for the practitioner to withdraw from the engagement.

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 agree that the illustrative reports address different scenarios of compilation engagements, subject to our comment on the reference to the framework in our response to question 2 above.

   In addition, we suggest using updated terminology in the illustrative engagement letter (e.g. statement of financial position vs. balance sheet etc.)

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.**

   We consider the requirements concerning quality control sufficient and agree that a firm would need to apply ISQC 1 or requirements that are at least as demanding. However, in the application material there is a lot of text devoted to explaining the contents of ISQC 1. We question whether this is really necessary and whether the standard really needs to explore the case where a jurisdiction has not adopted ISQC 1.

Other Comments

Below are comments on the drafting of the proposed ISRS 4410 for IAASB's considerations.

8. Paragraph 27 includes the requirement to obtain certain knowledge about the entity etc, however does not require this understanding to be documented (paragraph 36 on documentation is restricted to discussion of significant matters, reconciliation to underlying data and copy of the compiled financial information). More guidance should be provided on the general standard of documentation required in this type of engagement.

9. Paragraph 31 includes the requirement for the practitioner to "read the financial information with the knowledge and understanding described in paragraph 27". This is an unusual requirement as it is the practitioner who has prepared the information in the first place. It may be better to clarify that at the end of the compilation, the practitioner should perform a "reasonableness check" of the information taken as a whole.

10. Paragraph A15 states that an example of a special purpose framework may be "IFRS as modified by …". This type of framework is also used in Example Report 2 ("IFRS for SMEs was applied but for…"). ISA 800.A2 appears to imply that where a special purpose framework is derived from a general purpose framework, it is misleading to make any reference to the original general purpose framework (i.e. IFRS or IFRS for SMEs). The same concern would seem to be valid in the case of a compilation engagement.

11. Paragraph A39 contains suggestions for the contents of the engagement letter. The first bullet makes reference to the use of experts, but is unclear what role an expert may play in a compilation engagement. The list does not contain reference to managements' and practitioners' responsibilities, although these are included in the example engagement letter. The list could also contain reference to the expected form and content of the compilation report.

12. Paragraph A41 states that it may not be necessary to send an engagement letter every time the compilation is performed. In that case it may be useful to include guidance that the engagement letter would need to be amended accordingly (e.g. to clarify that it is valid for more than the engagement in question).

13. Paragraph A45 contains guidance that if going concern uncertainties are identified, the response may be to identify an alternative framework. This may not be workable in practice, and would a more realistic response be to include an additional paragraph in the report to highlight the existence of such uncertainties?

14. Paragraph A47 refers to the practitioner's consideration of materiality in the context of identifying material misstatements. The concept of materiality in the context of a compilation is however not explored elsewhere in the ED and it may be useful to include some guidance on this issue.

~ END ~