

## ***Annual review of APES 315 Compilation of Financial Information***

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## **1. Executive Summary**

### **1.1. Background**

APESB issued APES 315 *Compilation of Financial Information* in July 2008 with an effective date of 1 January 2009. APES 315 replaced APS 9: *Statement on Compilation of Financial Reports*. In December 2009 APESB issued a revision of APES 315 *Compilation of Financial Information* with an effective date of 1 January 2010. The revision took into consideration comments received during the Six-Monthly review process.

### **1.2. Reason for this report**

In accordance with the constitution of the APESB, an annual review needs to be performed 12 months after a new standard becomes effective. This report presents a review of the issues reported to the APESB and proposed recommendations to address the identified issues.

### **1.3. Issues identified**

The following issue has been reported to the APESB for the purpose of the annual review:

At the six monthly review of APES315, a stakeholder commented that the term “accounting expertise” contained within paragraph 4.1 and the example compilation reports in Appendix 1 of APES 315 is onerous and misleading. Whilst the Board considered this issue during the Six-Monthly review process, stakeholders have raised the issue again for the purpose of the APES 315 annual review. Please refer to the report for detailed discussion on the issue.

### **1.4. Summary of Recommendations**

It is recommended that the Board consider the use of the term “accounting expertise” in APES 315 and its related issues, and provide direction to the technical staff on the approach to be adopted to address these issues. It is proposed that if the Board determines that changes are required to the Compilation opinion then an exposure draft be prepared to seek wider consultation on the issue.

#### ***APES Board’s View***

***The Board considered the issue during the annual review process of APES 315 and determined to leave it on the issues register pending the issue of the international exposure draft on Compilation Engagements by IAASB in late 2010.***

## 2 Review of Issue

Stakeholders have reported the following issues related to the use of the term “accounting expertise” in APES 315:

- the use of an undefined term such as “accounting expertise” in paragraph 4.1 and in the example compilation reports in the Appendix 1 of APES 315 can be problematic, particularly in disputes or litigation.
- the use of “accounting expertise” is also contradictory to paragraph 8.2 of APES 315.
- The questions/observations of the stakeholder are as follows:
  - Why is ‘accounting expertise’ not defined?
  - Why use ‘accounting expertise’? Why not use “relevant accounting knowledge” & then the accountant needs to be able to demonstrate the knowledge/skill used was relevant/appropriate to the engagement under scrutiny (not answer to a lawyer’s interpretation of “accounting expertise”)
  - Why does the APES 315 example report, in relation to accounting expertise specify the tasks of “collect, classify & summarise”? Surely any obligation in respect of skills & knowledge should be to the overall compilation engagement, not just 3 (undefined) aspects (that may or may not cover the entire engagement).
  - Why use words in an example report (‘accounting expertise’) that is not defined in the standard?

### Technical Response

The technical response to the issues raised by stakeholders will consider the following matters:

- Scope of the Engagement
- Use of the term “accounting expertise”
- The intent of paragraph 8.2
- The compilation opinion
- Use of NZ equivalent

### Scope of the Engagement

When a Member in Public Practice is approached by a Client to undertake an Engagement they need to consider the scope of the Engagement and whether they have the necessary competence and skills to undertake the Engagement. In accordance with Section 130 *Professional Competence and Due Care* of the Code

the Member must only accept Engagements where they have the necessary skills and competence. If the Member does not have the necessary skills and competence then they must decline the Engagement.

Where the Member is aware that a Compilation Engagement is likely to lead to litigation and that the Member will be engaged as an Expert Witness or another forensic accounting role then the Member will come under the ambit of APES 215 *Forensic Accounting Services* (APES 215).

APES 215 also applies in circumstances where a Member is providing another Professional Service that later leads to a Forensic Accounting Service or Expert Witness Service (paragraphs 1.5 and 1.6 of APES 215).

Accordingly, where the Member has been engaged to perform a Compilation Engagement and the Member is aware that the Engagement is likely to lead to litigation then the Member also needs to comply with the requirements of APES 215.

There will be circumstances where a Member has completed a Compilation Engagement which subsequently (say a few years later) leads to litigation. This issue will be considered below.

#### **Use of the term “accounting expertise”**

Paragraph 4.1 and 4.2 of APES 315 state:

*The objective of a Compilation Engagement is for the Member in Public Practice to use accounting expertise, as opposed to auditing expertise, to collect, classify and summarise financial information. This will ordinarily entail reducing detailed data to a manageable and understandable form without a requirement to test the assertions underlying that information. The procedures employed are not designed and do not enable the Member to express any assurance on the financial information.*

*A Compilation Engagement may involve the preparation of Financial Statements (which may or may not be a complete set of Financial Statements). It may also involve compilation of other financial information without the compilation of Financial Statements.*

The equivalent Paragraph 3 and 4 of ISRS 4410 state:

***The objective of a compilation engagement is for the accountant to use accounting expertise, as opposed to auditing expertise, to collect, classify and summarize financial information. This ordinarily entails reducing detailed data to a manageable and understandable form without a requirement to test the assertions underlying that information. The procedures employed are not***

*designed and do not enable the accountant to express any assurance on the financial information. However, users of the compiled financial information derive some benefit as a result of the accountant's involvement because the service has been performed with professional competence and due care.*

*A compilation engagement would ordinarily include the preparation of financial statements (which may or may not be a complete set of financial statements) but may also include the collection, classification and summarization of other financial information.*

The NZICA equivalent is also similar to ISRS 4410, however then goes on to give examples of Compilation Engagements.

The key differences are that in the ISRS 4410 (and NZ equivalent) the first sentence of paragraph 3 is a mandatory requirement (i.e. black letter) and there is an additional last sentence that state that users may derive some benefit as the service has been performed with professional competence and due care.

In accordance with APESB drafting conventions, as the first sentence does not impose a mandatory requirement on the Member the bold lettering was not used. Whilst APES 315 does not deal with the benefits a user may derive from a Member performing a Compilation Engagement, paragraph 3.3 of APES 315 refers to Member's professional obligation to have the necessary professional competence and due care.

As noted in the 6 month review of APES 315:

*Paragraph 4.1 notes that the objective of a compilation engagement is for the member to use accounting expertise as opposed to audit expertise, to collect, classify and summarise financial information. The intention of this wording is not to imply a sophisticated collection process. The intention is to state that a member needs to apply relevant accounting knowledge to the engagement to obtain information that is appropriate and relevant to the compilation of financial information (as opposed to the auditing of that information).*

It is noted that some of the stakeholders who have commented on the issue are supportive of the use of the term "relevant accounting knowledge". Accordingly, one option to consider is to incorporate this explanation in to paragraph 4.1 of APES 315.

At the international level, IAASB is currently running a taskforce to update ISRS 4410 (which was previously revised in 1990). The IAASB taskforce has presented its initial proposals at the 2009 December IAASB Board meeting. The IAASB agenda paper includes the following proposals:

A definition of Compilation Engagements:

*An engagement undertaken by a professional accountant in public practice to (as applicable in the circumstances of an engagement) collect, classify, prepare or present financial information in accordance with criteria determined by the party who engages the professional accountant (“the engaging party”), and to read such financial information.*

The IAASB taskforce has also made the following observations in respect of the non-assurance nature of Compilation Engagements:

*Despite the practitioner’s explicit statement in the engagement letter and report that the compilation does not constitute an assurance engagement and other communication requirements in the extant standard, users may still derive comfort from the practitioner’s involvement in the compilation of financial information.*

*Indeed, it is the Task Force’s view that the knowledge, expertise and professionalism that the practitioner applies in performing a compilation engagement represents the value added for users of financial information compiled by a professional accountant.*

*The Task Force believes that the non-assurance nature of the compilation engagement is best addressed in both the revised standard and in the practitioner’s report.*

Accordingly, there is a level of accounting knowledge and expertise applied to a Compilation Engagement and it is not proposed that paragraph 4.1 be amended to remove “accounting expertise”.

A Member in Public Practice who has completed the necessary educational and experience requirements to hold a public practice certificate issued by one of the professional bodies must have general “accounting expertise”. Further, the paragraph should be read in context as it is trying to distinguish between “accounting expertise” and “auditing expertise”. However, the APES Board should consider the insertion of the additional explanation to paragraph 4.1 of applying “relevant accounting knowledge” to the Compilation Engagement.

### **The intent of paragraph 8.2**

A related concern raised by stakeholders is that the wording of the suggested compilation report in APES 315 refers to the “use of accounting expertise” and that this phrase is in potential conflict with paragraph 8.2 of APES 315.

In respect of this issue the APES 315 Six monthly review stated:

*Paragraph 8.2 of APES 315 states that “a Member in Public Practice is not ordinarily required to make any inquiries of management to assess the reliability and completeness of the information provided”. Paragraph 8.2 includes procedures that are generally performed in an audit or review engagement. Accordingly, it should be read in context of the whole standard as it states that these procedures will generally be not performed in a compilation engagement.*

*Whilst paragraph 8.2 states that specific inquiries need not be made (similar to an audit process), it does not absolve a member from applying accounting expertise to the engagement. Further, paragraph 3.3 mandates that the member “shall maintain professional competence and take due care”, both requirements which imply a level of expertise being applied to the engagement.*

Further, whilst the procedures in paragraph 8.2 are not normally performed it is qualified by paragraph 8.3 and 8.4. When read together these paragraphs state that in certain circumstances a Member may perform these procedures where the Member is not satisfied with the information provided by the Client.

The IAASB taskforce has noted the following in respect of paragraph 13 and 14 of ISRS 4410 (equivalent of 8.2 – 8.4 of APES 315) in its December 2009 Agenda paper:

*Extant ISRS 4410 (paragraph 13) states the general principle that “the accountant is not ordinarily required to make any inquiries of management to assess the reliability and completeness of the information provided [by management to the practitioner for purposes of the engagement].”*

*This principle is qualified by the need to undertake further work “if the accountant becomes aware that information supplied by management is incorrect, incomplete or otherwise unsatisfactory” (paragraph 14), specifically by seeking further information from management/those charged with governance.*

*The Task Force agrees with the general principle contained in the extant standard. It considers that the requirements of a revised standard should include a requirement for the practitioner to withdraw from the engagement, when permitted by law or regulation, in the event that management or those charged with governance of the entity, as appropriate, either cannot or will not provide the additional or corrected information or explanations to enable completion of the engagement. The Task Force is of the view that guidance on addressing such circumstances is best dealt with in application material, including examples of*

*procedures the practitioner may view as necessary applying professional judgment, in the specific circumstances encountered in particular engagements.*

Accordingly, no amendments are proposed to paragraph 8.2 of APES 315 at this stage and APESB will continue to monitor the international developments.

### **The compilation opinion**

The relevant paragraphs that deal with “accounting expertise” in the APES 315 example Compilation opinion state:

#### *Our Responsibility*

*On the basis of information provided by [Those charged with governance] we have compiled the accompanying general purpose financial statements in accordance with the (financial reporting framework/basis of accounting) and APES 315 Compilation of Financial Information*

*Our procedures use accounting expertise to collect, classify and summarise the financial information, which [those charged with governance] provided, in compiling the financial statements. Our procedures do not include verification or validation procedures. No audit or review has been performed and accordingly no assurance is expressed.*

*The general purpose financial statements were compiled exclusively for the benefit of [those charged with governance]. We do not accept responsibility to any other person for the contents of the general purpose financial statements.*

NZICA’s SES 2 state:

#### *Responsibilities*

*You are solely responsible for the information contained in the financial statements and have determined that the (financial reporting framework/basis of accounting) used is appropriate to meet your needs and for the purpose that the financial statements were prepared.*

*The financial statements were prepared exclusively for your benefit. We do not accept responsibility to any other person for the contents of the financial statements.*

#### *No audit or review engagement undertaken*

*Our procedures use accounting expertise to undertake the compilation of the financial statements from information you provided. Our procedures do not include verification or validation procedures. No audit or review engagement has been performed and accordingly no assurance is expressed.*



The APES 315 opinion can be read in a manner that it implies accounting expertise has been used in the collection, classifying and summarising process as opposed to the overall Compilation Engagement (as per the NZ standard).

In most instances the collection process may be as simple as obtaining the trial balance from the Client and then compiling the financial statements. In circumstances where there is litigation on a previously issued Compilation report it is possible that the Courts will imply a higher degree of expertise in the collection process than what is actually intended by APES 315 due to the existing wording in the opinion.

Whilst some stakeholders have advocated replacing “accounting expertise” in the opinion with “relevant accounting knowledge”, another stakeholder has significant concerns on the use of subjective terms in the opinion and has commented as follows:

*I believe part of the problem lies in the “internationalisation” of the Australian Professional Standards. The respective Boards are using the international standards as a base document and are then seeking to make as few as possible changes to those standards in developing the relevant Australian Standards. That is understandable. But it has unintended consequences. When a practitioner comes before Australian Courts and Tribunals, the members of the Australian legal profession, who make up the overwhelming composition of the officers in the Courts, apply Australian language and customs to the matter at hand, they have no understanding of nor do they have any regard for international language or customs. This is a real trap for the Australian professional.*

*It therefore is vital that Australian professionals in drafting their respective reports use precise, clear and objective language. Use of subjective terms should not be used. The language of “Our procedures use accounting expertise” are subjective and should not be used by practitioners. I would replace the offending sentence with “Our procedures involve obtaining data from the directors of the company and preparing the attached financial statements from that data”. I would not add the words “using relevant accounting knowledge”. That is a subjective term inviting legal argument.*

The issue raised by this stakeholder is relevant and the subjective nature of the language in the opinion should be minimised as much as possible. The options to consider are:

*Option 1*

Amend the paragraph along the lines recommended by the stakeholder noted above in the following manner:

Our procedures involve obtaining information from ~~use accounting expertise to collect, classify and summarise the financial information, which~~ [those charged with governance] ~~provided, in~~ and compiling the attached financial statements from that information.

### *Option 2*

As per the recommendation of some stakeholders replace “accounting expertise” with “relevant accounting knowledge” in the following manner:

*Our procedures use relevant accounting knowledge ~~accounting expertise~~ to collect, classify and summarise the financial information, which [those charged with governance] provided, in compiling the financial statements. Our procedures do not include verification or validation procedures. No audit or review has been performed and accordingly no assurance is expressed.*

### *Option 3*

Amend the paragraph in a similar manner to NZ SES2:

*Our procedures use accounting expertise to undertake the compilation of the financial statements from information you provided.*

### *Option 4*

No changes are required to the existing APES 315 opinion.

### **Use of NZ equivalent**

Some stakeholders have raised concerns regarding the comparison to the NZ equivalent. The reasons for the use of the NZ equivalent were:

- The close co-operation between Australia and New Zealand in the development of Professional Standards;
- Whilst ISRS 4410 dates back to 1990 the NZ standard was updated in 2006 and is one of the most up to date compilation standards in the world. Even the AICPA only issued an ED on its revision of Compilation Engagements in May 2009. As noted above currently the IAASB is working on its revision of ISRS 4410;
- NZ standard has been in operation since that date and thus has been in operation for a longer period than APES 315;
- Discussions held with Director Professional Standards of NZICA indicate that the use of the term “accounting expertise” in New Zealand has not been raised by NZICA members as an issue.

### **Issues for APES Board's consideration**

1. Should an additional explanation be inserted to paragraph 4.1 of APES 315 to clarify that a Member is applying relevant accounting knowledge?
2. Does the Board agree that at this stage no further amendments are required to paragraph 8.2 – 8.4 of APES 315?
3. The Board to consider the different options provided above in respect of the Compilation opinion and provide direction on the most suitable option(s).

### **Impacted Stakeholders**

Members in public practice, firms and professional accounting bodies.

### **Recommendation**

It is recommended that the Board consider the above issues and provide direction to the technical staff on the approach to be adopted. It is proposed that if the Board determines that changes are required to the Compilation opinion then an exposure draft be prepared to seek wider consultation on the issue.

### ***APES Board's View***

***The Board considered the issue during the annual review process of APES 315 and determined to leave it on the issues register pending the issue of the international exposure draft on Compilation Engagements by IAASB in late 2010.***