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**Agenda Item**

**8**

**Committee** International Ethics Standards Board for Accountants

**Meeting Location:** AICPA, New York, USA

**Meeting Date:** February 17-18, 2010

**Review and Compilation Engagements**

**Objectives of Agenda Item**

1. To provide an update of the work of the IAASB on the revision of ISRE 2400 - Engagements to Review Financial Statements
2. To provide an update of the work of the IAASB on the revision of ISRS 4410 - Engagements to Compile Financial Statements, to request input from the IESBA on issues related to independence and to determine next steps for IESBA.

**Background**

The IAASB has started a project to revise ISRE 2400 and ISRS 4410 to provide standards for services that cater to assurance and related services regarding financial statements, other than audits.. There is a need for other assurance and related services in settings where there is no mandatory audit requirement. There is a need for such services in the regulatory environments of both developed and emerging economies

The IAASB project Task Force is considering pertinent ethical requirements for these engagements in relation to the performance of assurance and related services engagements, and specifically regarding review and compilation engagements. In regard to financial statement reviews the Task Force has considered, from the perspective of the public interest, whether there is need to further explore how the independence requirements of the *Code of Ethics for Professional Accountants* (Code) should apply in the context of the reviews. The IAASB extended an invitation to IESBA to appoint a correspondent member to the Task Force and Isabelle Sapet agreed to fill this role.

The IAASB will consider an Issues Paper and Task Force proposals about the revised standards for reviews and compilations at its March 2010 meeting. Draft sections of the revised standards that are being developed by the Task Force will be included in the agenda papers to illustrate the proposals. The project plan calls for a first read of the exposure draft at the June 2010 IAASB meeting, and it is expected that an exposure draft would be approved by the IAASB at its September 2010 meeting.

## **ISRE 2400 Engagements to Review Financial Statements**

At the IESBA's October 2009 meeting it received a status report on this project. One of the issues considered by the IAASB Task Force was whether there was a need to further explore how the independence requirements of the *Code of Ethics for Professional Accountants* (Code) are applied in the context of reviews of financial statements. The IAASB Task Force received a presentation on the Code. The objective of the presentation was to explain the requirements of the revised Code to identify any areas where it felt there was a need for further discussion with the IESBA on the independence requirements for review engagements. After discussion, the view reached by the Task Force was that, in the context of providing assurance on financial statements, the current provisions of the Code are appropriate. The Task Force considered that the application of independence should not be different, for example because reviews are limited assurance engagements and not reasonable assurance engagements. The consensus view of the Task Force was also that the provisions of paragraph 290.171 concerning the practitioner's involvement in the preparation of accounting records and financial statements of non-public interest entities provided adequate latitude for practitioners to respond appropriately to meet their clients' needs for assistance without impairing their independence in relation to the review of financial statements.

Paragraph 290.171, which applies only to audit clients that are not public interest entities states:

290.171 The firm may provide services related to the preparation of accounting records and financial statements to an audit client that is not a public interest entity where the services are of a routine or mechanical nature, so long as any self-review threat created is reduced to an acceptable level. Examples of such services include:

- Providing payroll services based on client-originated data;
- Recording transactions for which the client has determined or approved the appropriate account classification;
- Posting transactions coded by the client to the general ledger;
- Posting client-approved entries to the trial balance; and
- Preparing financial statements based on information in the trial balance.

In all cases, the significance of any threat created shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include:

- Arranging for such services to be performed by an individual who is not a member of the audit team; or
- If such services are performed by a member of the audit team, using a partner or senior staff member with appropriate expertise who is not a member of the audit team to review the work performed.

At its September meeting, the IAASB agreed with the Task Force's view, noting that in the context of the objective of this project, the current provisions of the Code regarding the practitioner's involvement with an assurance client's accounting records and financial statements are appropriate in the case of review engagements.

### **ISRS 4410 Engagements to Compile Financial Statements**

At its meeting in June 2009, the IAASB agreed that developing a revised standard on compilation of financial information as a concurrent priority (i.e. to be progressed in tandem with revision of the existing International Standard on financial statement reviews). The IAASB also agreed that the revised standard should guide practitioners in meeting the overarching ethical requirement set out in the IFAC *Code of Ethics for Professional Accountants* (IFAC Code), that a practitioner may not be knowingly associated with information that is materially false or misleading, when performing compilations of financial information.

At its meeting in December 2009, the IAASB discussed significant issues and Task Force proposals. The issues discussed included independence and the practitioner's compliance with ethical principles. The appendix to this paper contains extracts from the December 2009 Agenda Paper.

With respect to independence, the IAASB Task Force asked the IAASB the following four questions:

- Q1 Does the IAASB agree that the questions of what the concepts of "objectivity" and "independence" mean in a compilation engagement, and how practitioners should assess whether they are objective or independent when performing those engagements (notwithstanding that a compilation is not an assurance engagement) should be addressed in the IFAC Code? Does the IAASB agree that these questions should be referred to the IESBA for consideration?
- Q2 Does the IAASB agree with the Task Force's view (explained in paragraphs 23, 25 and 26(a)) that, although a practitioner performing a compilation engagement is not required to be independent, users of the financial information may assume the practitioner is independent, and therefore should be informed that the practitioner is not required to be independent?
- Q3 Are the public interest reasons explained in paragraph 23 and paragraph 27(c) important to address in the revised standard? If so, how does the Board consider they can best be addressed?
- Q4 Does the IAASB consider that the Task Force's suggested approach to disclosure set out in paragraph 26(a) adequately serves the intended aim of informing users about the practitioner's independence in a compilation engagement?

The Task Force considers that, as a minimum, users should be told in the practitioner's report that independence is not required to perform a compilation engagement. The public interest rationale for this disclosure is that users may expect, or presume, that the

practitioner is independent for purposes of the compilation (which the practitioner may or may not be, depending on what independence means in that context). The IAASB provided direction to the Task Force that the revised standard should require “the practitioner to state in the report that the practitioner is not required to be independent in the context required in an assurance engagement, to undertake a compilation engagement”, or similar wording intended to convey this message to users of the compiled financial information.

The IAASB Task Force has considered the direction provided by the IAASB and the implications on the proposed reporting requirement in relation to practitioners’ independence for purposes of compilation engagements. The Task Force recognizes that users may have a valid interest in understanding anything that might pose a risk to the practitioner’s ability to be objective for the purpose of the compilation. The Task Force proposes, therefore, to recommend to the IAASB that this be addressed through a requirement for the practitioner to disclose, in the report, the fact of the existence of any significant interests or relationships which the practitioner believes are of interest to the intended users of the compiled financial information.

The Task Force has developed draft requirements for the revised ISRS, and the relevant requirements pertaining to ethical matters are presented below. IESBA members are asked to note that this wording is preliminary wording developed by the Task Force for the IAASB’s consideration at its March 2010 meeting. The Task Force is still developing the wording of the requirement that it will put to the IAASB for consideration its March 2010.

*“Ethical Requirements*

6. The engagement team shall comply with relevant ethical requirements relating to compilation engagements.
7. The engagement partner shall take responsibility for the engagement team’s compliance with the relevant ethical requirements in individual engagements.”

*Reporting on the Engagement*

- 20 The practitioner’s report issued for a compilation engagement shall contain the following:.....  
Unless not relevant due to applicable national law or regulation, or a national code of ethics\*
  - (d) A statement that independence, as described in the IESBA Code for assurance engagements, is not required to perform a compilation engagement;
  - (e) Disclosure of the existence of any significant interests or relationships the practitioner has with the entity that the compiled information relates to, that the practitioner believes are of interest to the intended users of the compiled financial information.

- \* Applicable laws or regulation, or the national code of ethics in some countries do require a practitioner performing a compilation to be independent. In that situation, requirement 20(d) is not relevant.

Section 290 of the Code addresses independence requirements for audits and reviews, and Section 291 addresses independence requirements for other assurance engagements. The requirement to be independent is contained in 290.4 and 291.3. As stated in 290.4:

“In the case of audit engagements, it is in the public interest and, therefore, required by this Code of Ethics, that members of audit teams, firms and network firms shall be independent of audit clients.”

The Code defines independence as follows:

“Independence comprises:

INDEPENDENCE OF MIND

The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

INDEPENDENCE IN APPEARANCE

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm’s, or a member of the audit team’s, integrity, objectivity or professional skepticism has been compromised.”

The Code does not contain any specific guidance for compilation engagements. The term “compilation engagement” does not appear in the Code. Under the Code, therefore, the ethical requirements with respect to a compilation engagement would be the same as the ethical requirements for any professional service provided by a professional accountant in public practice. In particular, there are requirements with respect to client and engagement acceptance (201.1-8) and objectivity (280.1 -4). The practitioner also has the overall requirement to apply the conceptual framework to identify threats to compliance with the fundamental principles and apply safeguards to address the threats (100.2).

The IESBA is asked to consider whether any clarification to the Code is necessary to specifically address compilation engagements.

*Points indicating no need for clarification*

- The existing compilation standard states “Independence is not a requirement for a compilation engagement. However, where the accountant is not independent, a statement to that effect would be made in the accountant’s report” (ISRS 4410 paragraph 5). Practitioners currently comply with this requirement even though

- the Code does not contain specific ethical guidance for compilation engagements and the independence sections of the Code apply only to assurance engagements;
- Only a few respondents to the June/July 2009 IESBA Strategic Survey noted that IESBA should undertake a project to address independence requirements for compilation engagements; and
  - The revised ISRS will state that independence, as described in the IESBA Code for assurance engagements, is not required to perform a compilation engagement. The revised ISRS will also address the practitioner's reporting requirements in this area. The IESBA has a correspondent member on the Task Force and has the opportunity to comment on the wording of the standard as it is developed. The guidance can, therefore, be contained with the ISRS.

*Points indicating a need for a clarification*

- The Code does not contain an explicit statement that independence is not required for compilation engagements. Some jurisdictions require the professional accountant in public practice to be independent for compilation and other non-assurance engagements; however, in those cases, independence may not be applied in the same way as it is applied in assurance engagements;
- If the practitioner is required to disclose any significant interests or relationships that the practitioner has with the entity, that the practitioner believes are of interest to the intended users of the compiled financial information, the practitioner needs guidance on the types of interests or relationships would need to be disclosed and when it should be disclosed. While the revised ISRS could contain guidance in this area, it would likely be brief and would not address all of the matters that are addressed, for example, in Section 290. In addition to the nature of the items to be disclosed, the practitioner would need to make a judgment on "significance" which would likely need some guidance. IESBA faced a similar issue when drafting the documentation requirements in 290.29;; and
- While the disclosure requirement as currently drafted is not directly linked to independence (i.e. the reference is to significant interests and relationships that would be of interest to the intended users), in interpreting the requirement, some practitioners may think that Section 290 (or possibly 291) should be the benchmark against which to consider interests and relationships that exist. Sections 290 and 291 address assurance engagements and, therefore, many of the provisions address the self-review risk, which is not as relevant in a compilation engagement. In addition practitioner's may be confused as to whether to look to Section 290 or to Section 291. Alternatively some may feel that the benchmark is threats to objectivity.

**Action requested**

IESBA member are asked whether they believe that the Code needs to be clarified to specifically address compilation engagements.

*Possible clarification*

Should the IESBA be of the view there is a need for clarification, there are three possible approaches:

- Revise the Code;
- Issue an interpretation; and
- Issue a staff Q&A.

Under all three options, it could be noted that the clarification was thought necessary because of the revisions to ISRS 4410.

Revise the Code

This approach would require a project proposal to describe the objective of the project and how it services the public interest, the scope of the project and the major problems and issues that will be addressed, and the project timetable.

Issue an Interpretation

The IESBA has issued three interpretations (IT). Two ITs dealt with the implementation of the Code that was issued in 2001 (in effect transitional provisions that were not issued when the Code was issued). These ITs were no longer applicable when the Revised Code was issued in July 2009 and, therefore, are not contained in the Revised Code. The one IT that remains is IT 2005-01 *Application of Section 291 to Assurance Engagements that are Not Financial Statement Audit Engagements*. The IT, as its name suggests, demonstrates the application of the Section, it does not interpret or clarify any of the wording in the Section.

Staff Question and Answer

To date IESBA has not issued any Q&As. Staff has issued some documents to assist in implementation and adoption of the Code. These documents are factual summarizations of the Code and do not contain any interpretations.

The IAASB has issued one Q&A “to highlight how the design of the ISAs issued under the Clarity Project enables them to be applied in a manner proportionate with the size and complexity of an entity.” The IAASB Q&As are described as follows:

“Staff Questions and Answers publication is a staff publication. Staff publications are prepared by staff of the IAASB, have no authoritative status and have not been subject to the IAASB's due process. Staff publications are not meant to be exhaustive and reference to relevant standards themselves should always be made. Reading such publications is not a substitute for reading the standards and other authoritative material, and practitioners should determine whether and how to respond to circumstances highlighted in a staff publication based on the specific facts presented. Statements contained in a staff publication are not rules of the IAASB and do not reflect any IAASB determination or judgment, and accordingly do not constitute authoritative or official pronouncements of the IAASB or IFAC. They are for information purposes only and are in all cases descriptive and not prescriptive.

Staff publications are used to help raise practitioners' awareness in a timely manner of significant new or emerging issues or other noteworthy circumstances relevant to engagements addressed by IAASB pronouncements, to direct their attention to relevant provisions of IAASB pronouncements, or to provide clarification to emerging questions by referring to existing requirements and application material and background information such as that contained in staff Basis for Conclusions documents.

Staff publications do not amend or override the standards or other pronouncements to which they relate that are currently effective, the texts of which alone are authoritative.”

**Action requested**

If IESBA members are of the view a clarification is needed, they are asked to consider which of the methods noted above they favour.

*Feedback to IAASB Task Force*

The IAASB will discuss the Task Force proposals at its March meeting and would welcome feedback from the IESBA on the proposed direction.

**Action requested**

IESBA members are asked to consider the proposals of the Task Force and the draft requirements (recognizing the drafting of these requirements might be refined by the Task Force before presentation to the IAASB). In particular, IESBA members are asked to consider the proposal that the practitioner's reporting: (i) includes a statement that independence is not required; and (ii) discloses the existence of any significant interests or relationships the practitioner has with the entity that the practitioner believes are of interest to the intended users of the compiled financial information.

**Material Presented**

Agenda Paper 8

This Agenda Paper

**Action Requested**

1. IESBA members are asked to consider the questions addressed in this paper.

## **Appendix**

### **Extracts from December 2009 IAASB Agenda Paper**

#### **Independence and Compilation of Financial Information**

21. The broad question of compliance with the fundamental ethical principles contained in the IFAC Code is addressed in paragraphs 33-34 of this Paper.<sup>1</sup>
22. Independence is currently not a requirement for a compilation engagement.<sup>2</sup> The extant Standard states:
  - (a) “Independence is not required for a compilation engagement. However where the accountant is not independent, a statement to that effect would be made in the accountant’s report” (guidance, paragraph 5); and
  - (b) When relevant the report on a compilation engagement should contain a statement that the accountant is not independent of the entity (requirement, paragraph 18(d)).
23. The reporting requirement addresses the possibility that users of compiled financial information may assume the practitioner is independent because he or she is a professional accountant (regardless that practitioners are not required to be independent to provide compilation services). Through the disclosure requirement, users are “put on notice” if the practitioner is not independent when providing the compilation service. However, there is no guidance in the IFAC Code about how the practitioner’s independence could be maintained in a compilation engagement.
24. The IFAC Code requires independence only in the context of assurance engagements, and explains how independence must be maintained in that context (paragraph 280.2, supplemented by sections 290 and 291 of the IFAC Code). However the fundamental ethical principle of objectivity is required of all professional accountants. For the professional accountant in public practice, the practitioner’s objectivity must be maintained for all the practitioner’s professional services.<sup>3</sup>
25. The Task Force believes the underlying rationale for the current reporting requirement is sound. However, without guidance in the IFAC Code for practitioners to be able to assess whether they are independent in the context of a compilation engagement, the requirement is likely to be applied inconsistently by

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<sup>1</sup> See Appendix 2 for extracts from the IFAC Code of particular relevance to compilation engagements.

<sup>2</sup> The Task Force recognizes that some jurisdictions require the professional accountant in public practice to be independent for compilation and other non-assurance engagements; however, in those cases, independence may not be applied in the same way as it is applied in assurance engagements.

<sup>3</sup> Unequivocally, if the professional accountant’s objectivity is impaired in a significant respect and that circumstance cannot be mitigated by application of appropriate safeguards, the practitioner must withdraw from the engagement and not undertake the services where the practitioner’s objectivity is impaired.

practitioners.<sup>4</sup> Furthermore, without clarifying to the user what it means to “not” be independent, the user may react negatively to this statement. Accordingly, the Task Force does not support its continued inclusion in the revised standard.

26. The Task Force recommends the following approach in the revised standard:

- (a) Both the revised standard and the practitioner’s report should contain a factual statement that the “practitioner performing a compilation is not required to be independent.” This serves the purpose of putting a user “on notice” that the practitioner is not required to be independent, and therefore, may not be independent. This would replace the guidance and reporting requirement in the extant standard (see paragraph 23 above). The Task Force acknowledges that the statement in the report would raise a question in the users’ minds about whether the practitioner is independent; however, the question cannot be answered under the current IFAC Code.
- (b) The IESBA should be asked to clarify what objectivity and independence mean in a compilation engagement (and also in other non-assurance engagements where independence is relevant, for example agreed-upon procedures). If this were accomplished, the practitioner would then be able to indicate in the report whether he or she was independent. The primary reason is to meet the expectations of users who may assume that the professional accountant providing the services is “independent.”

The Task Force is not proposing that independence be made a requirement for compilations – only that it be described in the context of a compilation.

27. The Task Force believes the following questions needs to be addressed:

- (a) How does a practitioner apply the concept of objectivity in relation to an entity for which the practitioner is compiling financial information (or other types of subject matter information)?
- (b) How does the concept of independence apply in a compilation engagement?
- (c) If independence is not required to perform a compilation of financial information (and some Task Force members believe there are sound public policy reasons why it should not be required), does the IESBA agree that it is nevertheless important to establish how a practitioner’s independence is assessed in such engagements, so practitioners can inform users whether they are independent when performing the compilation engagement?

This presumes recognition of a public interest rationale for the need to clarify this point for users’ benefit. For example, because users may have a valid expectation that the professional accountant in public practice is independent when performing the engagement. Though independence may not be a requirement, it is not in the public interest for users to be inadvertently misled on that point. Bankers have been cited as users who are interested in whether

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<sup>4</sup> Some commentators believe this requirement may not be consistently followed in practice.

the professional accountant compiling financial statements or other financial information is independent.

### **Matters for IAASB Consideration**

- Q10. Does the IAASB agree that the questions of what the concepts of “objectivity” and “independence” mean in a compilation engagement, and how practitioners should assess whether they are objective or independent when performing those engagements (notwithstanding that a compilation is not an assurance engagement) should be addressed in the IFAC Code? Does the IAASB agree that these questions should be referred to the IESBA for consideration?
- Q11. Does the IAASB agree with the Task Force’s view (explained in paragraphs 23, 25 and 26(a)) that, although a practitioner performing a compilation engagement is not required to be independent, users of the financial information may assume the practitioner is independent, and therefore should be informed that the practitioner is not required to be independent?
- Q12. Are the public interest reasons explained in paragraph 23 and paragraph 27(c) important to address in the revised standard? If so, how does the Board consider they can best be addressed?
- Q13. Does the IAASB consider that the Task Force’s suggested approach to disclosure set out in paragraph 26(a) adequately serves the intended aim of informing users about the practitioner’s independence in a compilation engagement?

### **Pre-Conditions for Accepting a Compilation Engagement**

32. The Task Force believes that a revised standard should clearly establish the premises upon which an engagement to compile financial information is performed. This is important for proper understanding of the nature of the engagement and the respective responsibilities of the parties to the engagement.

#### *Premises About Ethical Matters Underlying Engagements to Compile Financial Information*

33. The Task Force views it as a premise<sup>5</sup> that the practitioner will, in undertaking the engagement, be able to comply with the fundamental principles contained in the IFAC Code. This premise should be clearly established as a pre-condition for an engagement to compile financial information. If the pre-condition is not satisfied, the practitioner must not undertake the engagement.
34. As a matter of complying with the IFAC Code (or other relevant ethical requirements), the Task Force considers that the fundamental principle of

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<sup>5</sup> The Task Force considered the relevance of concepts described in the Assurance Framework for compilation of financial information (paragraph 17).

professional competence and due care is important in a compilation engagement.<sup>6</sup>  
The practitioner must approach the engagement with:

- (a) An adequate level of “understanding” of the entity, its industry and environment (see further discussion at paragraphs 45-54); and
- (b) Sufficient understanding of the basis of accounting or applicable accounting framework that is to be applied to compile the financial information under the agreed terms of engagement.

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<sup>6</sup> See Appendix 2, extracts from the IFAC Code: Section 130 “Professional Competence and Due Care.”