ICAEW

AUDIT & ASSURANCE FACULTY

TECHNICAL RELEASE

November 2010

CHARTERED ACCOUNTANTS' REPORTS ON THE COMPILATION OF FINANCIAL STATEMENTS OF INCORPORATED ENTITIES (UPDATED NOVEMBER 2010 WITH THE CCAB COMPILATION REPORT)

Technical Release AAF 02/10

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This guidance is issued by the Audit and Assurance Faculty of ICAEW in November 2010. The guidance does not constitute an auditing or assurance standard. Professional judgement should be used in its application and, where appropriate, professional legal assistance should be sought.

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CONTENTS

SCOPE

1. This Technical Release is intended to give general guidance to members of ICAEW in practice[1] when they compile financial statements for their clients. The guidance applies to the compilation of financial statements of incorporated entities ie, financial statements prepared in accordance with the Companies Act 2006. Limited Liability Partnerships (LLP) are included in the scope of this guidance[2]. This technical release replaces AUDIT 02/04 *Chartered Accountants' Reports on the Compilation of Financial Statements of Incorporated Entities*.

2. The principles included in this guidance may also be applied, in appropriate circumstances, to entities that prepare financial statements in accordance with legislation other than the Companies Act 2006. Where, however, professional accountants are compiling historical financial information of unincorporated entities for a specific purpose or purposes, for example financial information compiled for tax purposes, partnership accounts or the compilation of financial information (without providing any form of assurance) for grant claims, then professional accountants should follow the principles in AAF 03/10 *Chartered Accountants' Reports on the Compilation of Historical Information of Unincorporated Entities*.

REASONS FOR REVISION OF ICAEW GUIDANCE

3. In 2006 the Public Oversight Board recommended that the UK's accountancy bodies work together to give users of financial statements a clear explanation of the extent and relevance of the involvement of professional accountants in the preparation of financial statements of small and medium-sized entities.[3] This resulted in the development of an illustrative cross-profession compilation report which was agreed by the Consultative Committee of Accountancy Bodies (CCAB)[4] in 2009.

4. The changes made in updating the ICAEW's guidance on compilation reports are to incorporate the CCAB compilation report and include updated references to the ICAEW's Code of Ethics and to accounting and legal requirements governing the preparation of financial statements. However, they do not make any significant changes to the previous guidance on how to compile financial statements.

5. The CCAB compilation report, which forms the main reason for the updated guidance, comprises core and optional paragraphs. Professional accountants are advised to include core paragraphs in all CCAB accounts compilation reports. The CCAB compilation report also includes optional paragraphs that professional accountants may wish to use to facilitate better communication with the users of the accounts compilation report. These optional paragraphs primarily relate to risk management and the respective responsibilities of directors and professional accountants and are included in [square brackets] to indicate that they are optional. ICAEW recommends that, in order to manage their professional liability, practices include the optional paragraphs in their compilation reports.

6. The CCAB accounts compilation report also uses web links. This means that the report remains clear and concise while still providing users with access to information on the ethical and other professional requirements of professional accountants, helping to demonstrate the value of the involvement of a professional accountant in the preparation of the financial statements. Such information, if incorporated within the accounts compilation report would make it disproportionately long and would detract from the purpose of the accounts compilation report.

7. Professional accountants are encouraged to apply this guidance as soon as it is practicable as best practice. AUDIT 02/04 will be withdrawn as of 30 November 2010.

1 Referred to in the remainder of this guidance as professional accountants.

2 When applying the guidance in this Technical Release to an LLP, the terms 'company' and 'directors' should be substituted with the words 'Limited Liability Partnership' and 'members' respectively, except where otherwise marked.

3 See recommendation 6 in 'Review Of How Accountants Support The Needs Of Small And Medium-Sized Companies And Their Stakeholders' published by the Public Oversight Board for Accountancy (now the Public Oversight Board) available from http://www.frc.org.uk/images/uploaded/documents/Final%20POBA%20Review%20of%20how%20accountants%20....pdf.

4 The Consultative Committee of Accountancy Bodies (CCAB) was formed by the major accountancy professional bodies in the UK and Ireland in 1974. For further information on CCAB, go to www.ccab.org.uk. The background as to the development of the CCAB cross profession accounts compilation report is available from icaew.com/index.cfm/route/167603

PROFESSIONAL ETHICS

8. In carrying out financial statements compilation engagements, members of ICAEW are subject to the ethical and other guidance laid down by ICAEW, including the Fundamental Principles of ICAEW's *Code of Ethics* (the Code), as set out in section 100 and other relevant sections of the Code that deal with objectivity in relation to preparation of financial statements.

9. The Fundamental Principles are:

   Fundamental Principle 1 – Integrity: A professional accountant should be straightforward and honest in all professional and business relationships.

   Fundamental Principle 2 – Objectivity: A professional accountant should not allow bias, conflict of interest or undue influence of others to override professional or business judgements.

   Fundamental Principle 3 – Professional Competence and Due Care: A professional accountant has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services.

   Fundamental Principle 4 – Confidentiality: A professional accountant should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the professional accountant or third parties.

   Fundamental Principle 5 – Professional Behaviour: A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.

10. Members shall not, therefore, knowingly be associated with financial information where the professional accountant believes that the information:

    - Contains a materially false or misleading statement;
    - Contains statements or information furnished recklessly; or
    - Omits or obscures information required to be included where such omission or obscurity would be misleading.

    When a professional accountant becomes aware that the accountant has been associated with such information, the accountant shall take steps to be disassociated from that information.

11. The independence requirements that apply to audit and other assurance engagements contained within the APB Ethical Standards for Auditors and the Code are not applicable to compilation of financial statements. However, the fundamental principles apply to all professional and business activities. The part of the Code dealing with objectivity highlights that there are certain factors, which by their nature are a threat to objectivity in any professional role and considers appropriate safeguards. These areas of risk include:

    - family and other personal or business relationships;
    - loans;
    - beneficial interests in shares and other investments; and
    - gifts and hospitality.

    See sections 260 and 280 of the *Code* for further explanations.

12. The *Code* also makes reference to conflicts of interest. The relevant section, 220, considers possible safeguards, including disclosure of conflicts of interest to all relevant parties. Further discussion on this and other ethical dilemmas is available at icaew.com/ethics.

QUALITY CONTROL

13. Practice Assurance standards apply to compilation engagements. Practitioners may wish to be aware of the guidance issued as a result of the work done by the Quality Assurance Department on unaudited financial statements prepared by ICAEW members.[5]

5 The latest version of this guidance 'Accounts filed at Companies House – How Good Are Yours?' is available at http://icaew.com/index.cfm/route/168788

COMPILATION OF FINANCIAL STATEMENTS

14. When compiling financial statements, professional accountants use their accounting expertise to collect, classify and present accounting information from the sources made available to them. This normally entails summarising detailed data to a manageable and understandable form. There is no requirement for the professional accountants to test the assertions underlying the information provided to them. This guidance is not designed and does not enable the professional accountants to express any assurance on the financial statements. Nevertheless, users of the financial statements derive benefit because professional accountants are required to carry out work with professional competence and due care and are subject to the ethical and other guidance as stated in paragraph 8.

TERMS OF ENGAGEMENT

15. There needs to be a clear understanding between the client and the professional accountants regarding the terms of the engagement. The client needs to understand from the outset the responsibility which the professional accountants accept in relation to the financial statements. This is best dealt with by a discussion followed by an engagement letter. The engagement letter includes matters such as:

    - the Board of Directors as addressees;
    - the directors' responsibilities with regard to the adequacy of accounting records and the truth and fairness of the financial statements as specified in the Companies Act 2006;
    - the information to be supplied by the client to the professional accountants and a confirmation that any other information that the professional accountants consider necessary for the performance of the engagement will be supplied[6];
    - the nature of the engagement;
    - the professional accountants will make enquiries of management and undertake any procedures that they judge appropriate but are under no obligation to perform procedures that may be required for assurance engagements such as audits or any other type of assurance engagement;
    - the engagement cannot be relied on to disclose errors, fraud, weaknesses in internal controls or other irregularities;
    - an audit or any other type of assurance engagement will not be carried out and so no opinion will be given and no assurance either implied or expressed;
    - the financial reporting framework based on which the financial statements will be prepared and the fact that any known departures will be disclosed;
    - professional accountant's ethical and other professional obligations;
    - written management representations may be required prior to the completion of the engagement and the issuing of the compilation report;
    - the form of report to be issued.

16. In addition, after discussions with the client, it may be appropriate to include a section on the limitation of the professional accountants' liability.

17. ICAEW Helpsheet REF PAS2/HS 13 *Engagement letters* explains the importance of engagement letters and provides sample wordings to help professional accountants draft effective engagement letters for typical engagements including compilation. It is available from icaew.com/practicehelpsheets.

CONTENT OF FINANCIAL STATEMENTS

18. The directors must not approve financial statements unless they are satisfied that the financial statements give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period[7]. They are subject to the accounting and disclosure requirements of that Act and must be prepared in accordance with the applicable financial reporting framework. At present, this would be either UK GAAP including, where relevant, the Financial Reporting Standard for Smaller Entities (FRSSE), or IFRS as adopted by the European Union.

6 Section 210 of the Code requires that on appointment, professional accountants should assess threats to compliance with the fundamental principles. This implies, amongst other things, that where a member is engaged to prepare or audit accounts, he should always make it clear that he can only do so on the basis of full disclosure of all information relevant to the work in question. If the client will not agree, the member should not act for him.

7 s393 Companies Act 2006.

RESPONSIBILITIES OF DIRECTORS

19. The directors are responsible for ensuring that the company keeps adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006.

20. In preparing UK GAAP financial statements, the directors are required to[8]:

    - select suitable accounting policies and then apply them consistently;
    - make judgements and estimates that are reasonable and prudent;
    - state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements[9]; and
    - prepare financial statements on a going concern basis unless it is inappropriate to presume that the company will continue in business.

    Similar duties apply in respect of IFRS financial statements.

21. The directors are also responsible for safeguarding the assets of the company and for taking steps for the prevention and detection of fraud and other irregularities. An engagement to compile the financial statements cannot be regarded as providing assurance on the adequacy of the company's systems or on the incidence of fraud, non-compliance with laws and regulations or weaknesses in internal controls. Engaging professional accountants to compile the financial statements does not relieve the directors of their responsibilities in this respect.

22. The directors are required[10] to satisfy themselves that it is reasonable for them to conclude whether it is appropriate to prepare financial statements on a going concern basis, considering all available information about the future of the entity at the date they authorise the financial statements for issue. The process carried out by the directors should be proportionate in nature and depth depending on the size, level of financial risk and complexity of the company and its operations. Their review should usually cover a period of at least twelve months from the date of approval of annual financial statements. Furthermore, in order for the financial statements to give a true and fair view, the directors are also required to provide balanced, proportionate and clear disclosures, including any material uncertainties of which they are aware arising from their assessment of going concern that may cast significant doubt on the company's ability to continue as a going concern.

PLANNING

23. The professional accountants plan engagements to compile financial statements. The level of planning may vary according to the complexity of the company's accounting records and the professional accountants' experience of the business.

PROCEDURES

24. The professional accountants obtain a general understanding of the business and operations of the company. They need to be familiar with the accounting principles and practices of the sector in which the company operates and with the form and content of the accounting information that is appropriate in the circumstances. The professional accountants' understanding of the business is usually obtained through experience of the company or enquiry of the company's management and staff.

25. The professional accountants consider whether the financial statements are consistent with their understanding of the business and whether the financial statements are misleading. In so doing, the professional accountants make such enquiries of management and undertake such procedures as they judge appropriate but are under no obligation to perform procedures that may be required for assurance engagements such as audits or any other type of assurance engagement.

26. The professional accountants consider methods available, such as disclosure checklists or software packages, to check that relevant disclosures have been made based on the information available to them.

8 Companies Act 2006 and other relevant regulations. For an example statement of directors' responsibilities see Appendix 11 in Bulletin 2009/2, *Auditor's reports on financial statements in the United Kingdom*, the Auditing Practices Board (April 2009).

9 This duty does not apply to small and medium-sized companies.

10 Required by UK GAAP including FRSSE and IFRS. For further information on directors' responsibilities regarding going concern and example disclosure wordings, see *Going concern and liquidity risk: Guidance for Directors of UK Companies 2009* from the Financial Reporting Council at http://www.frc.org.uk/images/uploaded/documents/Going%20concern%20and%20liquidity%20risk%20-%20guidance%20for%20directors%20of%20uk%20companies%20094.pdf

DOCUMENTATION

27. While there is no requirement to document the work that has been carried out, documentation may help the professional accountants demonstrate the adequacy of the work performed and that the engagement was carried out in accordance with the terms of engagement where the quality of the professional accountants' work is subsequently challenged. The level of documentation may vary according to the complexity of the company's accounting records and accounting procedures, according to the professional accountants' experience with the business and whether any matters have arisen during the course of the engagement.

MANAGEMENT REPRESENTATIONS

28. In compiling financial statements, the professional accountants are normally reliant on representations by management, particularly in relation to estimates and the reliability, accuracy and completeness of information provided. The professional accountants therefore consider obtaining written management representations on these matters.

MISLEADING FINANCIAL STATEMENTS

29. Financial statements prepared under the Companies Act 2006 are required to give a true and fair view[11]. Such accounts should, amongst other things, comply with the requirements of the applicable financial reporting framework including, where necessary, any disclosures required in relation to the use of the true and fair override.

30. Without carrying out an assurance service, the professional accountants cannot form an opinion as to the truth and fairness of the view given by financial statements. During the course of the engagement, however, matters may come to light which appear to indicate that the financial statements may be misleading including the inappropriate use of the going concern basis or inadequate disclosure relating to going concern (see paragraph 22). In other situations, the professional accountant may feel that they have not been provided with all the information required in order to compile the financial statements. The directors of a company are required by law to maintain adequate accounting records, and so in such circumstances they will request the directors to provide the missing information.

31. In such cases, the professional accountants discuss the matter with the client with a view to agreeing appropriate adjustments or disclosures to be made in the financial statements or to provide the missing information. If, despite such a request, the directors refuse to permit the professional accountant to make appropriate adjustments or disclosures in the financial statements or to provide the missing information, the professional accountants may consider that the financial statements are misleading. If they do consider the financial statements to be misleading then they should withdraw from the engagement and should not permit their name to be associated with the financial statements.

32. In considering whether financial statements are misleading, the professional accountants consider whether the financial statements appear to be appropriate in form and free from material misstatements that appear obvious to them as a result of, for example:

    - misclassifications in the financial statements;
    - mistakes in the application of, or non-disclosure of known departures from, any relevant statutory, regulatory or other reporting requirements, including applicable financial reporting framework and non-disclosure of significant changes in accounting policies;
    - other significant matters of which the professional accountants are aware.

33. When the professional accountants withdraw from an engagement, they should normally explain to their clients their reasons for withdrawing, unless this would constitute a breach of legal or other regulatory requirement (such as the 'tipping off' provisions of the money laundering legislation)[12].

34. In rare situations, the accountant may conclude that it remains appropriate for them to be associated with the financial statements despite the fact that they depart from an applicable standard or the fact that incomplete information is available (for example, if stock take records have been lost in a fire). In such situations, the professional accountant will check that appropriate disclosures are made in the financial statements (for example, those required by paragraphs 62–64 of FRS 18 or paragraph 2.3 of the FRRSE when the true and fair override is invoked and the accountant believes that the override is appropriate). They may further wish to highlight these disclosures in their report by way of an explanatory paragraph. For example, where the true and fair override has been used, there will already be extensive disclosure; however, if there is a lack of accounting records, there may not be. The Appendix contains an example wording for such a paragraph.

11 s393 CA 2006 provides that the directors of a Company must not approve accounts unless they give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and, where applicable, group.

12 For further information, see the CCAB anti-money laundering guidance in 9.5 *Anti-money laundering guidance for the accountancy sector* of Members Handbook.

APPROVAL OF FINANCIAL STATEMENTS

35. Financial statements should be approved and signed by the directors[13] before the professional accountants signs the compilation report. The directors are statutorily responsible for the financial statements. The Companies Act 2006 requires that directors approve the financial statements and that the balance sheet states the name of the director signing the financial statements on behalf of the Board. The directors of companies that are audit exempt are required to acknowledge, on the face of the balance sheet, their responsibilities for complying with the requirements of the Act with respect to accounting records and the preparation of accounts in accordance with the provisions applicable to companies as well as entitlement of the company to exemption from audit.

PROFESSIONAL ACCOUNTANTS' COMPILATION REPORTS

36. The professional accountants' report helps users derive comfort from the involvement of Chartered Accountants who are subject to the ethical and other guidance issued by ICAEW in relation to the preparation of the financial statements. It also helps prevent users from deriving unwarranted assurance from the financial statements where no audit has been performed and no opinion is being expressed by the professional accountants.

37. The professional accountants' report on the financial statements of a company may include the following elements. The text in [brackets] indicates that the wording is optional:

    - a title identifying the persons to whom the report is addressed (usually the Board of directors) and including the words 'Chartered Accountant's / Accountants' Report to…'[14];
    - a statement that the professional accountants have prepared the financial statements [which comprise state the primary financial statements such as the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement and the related notes] from the company's accounting records and from information and explanations given by the client;
    - [a statement that the report is made to the Company's Board of Directors as a body in accordance with the terms of engagement.]
    - an explanation as to the work carried out being in accordance with the requirements of ICAEW guidance [and the purpose of the work and that, to the fullest extent permitted by law, no responsibility will be accepted for the work or the report to anyone other than the Company and the Company's Board of Directors, as a body].
    - [a statement that it is the directors' duty to ensure that the entity has kept adequate accounting records and to prepare statutory financial statements that give a true and fair view of the assets, liabilities, financial position and profit[/loss] of the entity and that they consider that the entity is exempt from the statutory audit requirement for the year [/period].]
    - [a statement that the professional accountants have not been instructed to carry out an audit or any other type of assurance engagement of the financial statements, verified the accuracy or completeness of the accounting records or information and explanations supplied, and that the professional accountants do not express any opinion on the financial statements];
    - the name and signature of the professional accountant and any appropriate designation (but not 'Registered Auditor' or 'Statutory auditor');
    - the date of the report.

38. The financial statements contain a reference to the fact that they are unaudited either on the front cover or on each page of the financial statements, or both.

39. An example professional accountants' report is set out in the Appendix. The appendix also provides an example explanatory paragraph to be used in the circumstances set out in paragraph 34 above.

13 In the case of an LLP, by a designated member on behalf of the members.

14 A firm may only use the description Chartered Accountant(s) if it complies with the relevant regulations governing the use of the description Chartered Accountant(s). Where a firm is not permitted to use the term Chartered Accountant(s), the title 'Accountants' Report to…' should be used, rather than 'Chartered Accountant(s) Report to… .

FILING THE FINANCIAL STATEMENTS

40. The Professional Oversight Board's report (see paragraph 4 above) recommends that users of financial statements are given a clear explanation of the extent and relevance of the involvement of professional accountants in the preparation of those financial statements. In the light of this, provided the company is exempt from audit, the filing of the compilation report alongside the copy of the financial statements with the Registrar may help increase the credibility of the financial information placed on public record and differentiate the financial statements from those prepared by firms and individuals who are not members of one of the CCAB bodies. However, this consideration does not apply when financial statements contain an audit report, or abbreviated accounts derived from audited accounts contain a special auditors' report under s449 Companies Act 2006, as inclusion of two different reports by professional accountants could be confusing.

APPENDIX

EXAMPLE REPORT

Chartered Accountant's/Accountants'[15] report to the board of directors on the preparation of the unaudited statutory accounts of XYZ Limited for the year [/period] ended dd/mm/20yy[16]

In order to assist you to fulfil your duties under the Companies Act 2006, we[17] have prepared for your approval the accounts of XYZ Limited for the year [/period] ended dd/mm/20yy [as set out on pages x–x/ which comprise of [insert statements]] from the company's accounting records and from information and explanations you have given us.

As a practising member [/member firm of] of the Institute of Chartered Accountants in England and Wales (ICAEW), we are subject to its ethical and other professional requirements which are detailed at icaew.com/membershandbook.

[This report is made solely to the Board of Directors of XYZ Limited, as a body, in accordance with the terms of our engagement letter dated dd/mm/20yy.] Our work has been undertaken [solely to prepare for your approval the accounts of XYZ Limited and state those matters that we have agreed to state to them/ the Board of Directors of XYZ Limited, as a body, in this report] in accordance with AAF 2/10 as detailed at icaew.com/compilation. [To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than XYZ Limited and its Board of Directors as a body for our work or for this report.]

[It is your duty to ensure that XYZ Limited has kept adequate accounting records and to prepare statutory accounts that give a true and fair view of the assets, liabilities, financial position and profit[/loss] of XYZ Limited. You consider that XYZ Limited is exempt from the statutory audit requirement for the year [/period].]

[We have not been instructed to carry out an audit or a review of the accounts of XYZ Limited. For this reason, we have not verified the accuracy or completeness of the accounting records or information and explanations you have given to us and we do not, therefore, express any opinion on the statutory accounts.]

[Explanatory paragraph: eg, records destroyed by fire.][18]

Signature……………………

Typed name of professional accountant[19]

Chartered Accountants

Address

Date …………………………

15 See footnote 12.

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17 Professional accountants use 'I' in place of 'we,' 'my' in place of 'our' etc, as appropriate.

18 Explanatory paragraph may be positioned in other places in the report depending on the nature of the matter described.

19 The report is signed in the name of the professional accountant or, where appropriate, in the name of the accounting firm.

EXPLANATORY PARAGRAPH TO DEAL WITH INFORMATION NOT BEING AVAILABLE

We draw your attention to note x in the financial statements which discloses and explains the year-end stock balance is an estimate derived from management accounts. Following a fire in the warehouse, the records of the year-end stock count were not available.