

technical factsheet 184

Audited accounts for IATA agents – interim guidance

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1 INTRODUCTION

This technical factsheet gives a brief summary of the changes introduced by IATA Travel Agent's Handbook 2013 (Resolution 818g edition) in respect of the new UK Local Criteria for the approval and retention of agents and provides interpretations for practitioners to allow them to meet the revised requirements for their clients.

The new Local Criteria for the UK were recommended by the Agency Programme Joint Council (APJC) UK and were approved at the IATA Passenger Agency Conference, the worldwide body supervising all policy development and establishing the rules that govern the reporting and settlement of sales of the IATA Passenger Agency Programme.

In practice the UK Criteria adopt, with modifications deemed necessary for the local market by the APJC UK, the general international rules on agents' financial evaluation included in IATA Resolution 800f. The general financial criteria and the local UK criteria are included in the Travel Agent's Handbook 2013 and can be accessed at <http://www.iata.org/Sites/FMC/Files/TAH818G-English2013.pdf>.

In summary the new UK Criteria require all accredited agents (including therefore small companies, sole traders and partnerships) to provide IATA with audited accounts. These provisions apply for all accounts provided on or after 1 June 2013. Audited accounts covering at least 12 months of trading must be provided by all agents that want to apply to become accredited by IATA, or that want to continue to be accredited, not later than 6 months after each financial period end. If an agent has been in business for less than 6 months at the time of application, it must submit an opening balance sheet certified by a statutory auditor.

Financial information extracted from the agent's audited accounts is then used to apply a set of financial criteria tests to evaluate the agent's financial position. The key criteria assessed by IATA for financial security requirements are:

- a) **Net Equity** – must be positive
- b) **Profitability** – the accounts must show a profit
- c) **Liquidity** – the accounts must show net current assets

Additionally there must have been no defaults against the agent's IATA license in the previous 24 months.

The risks posed by the financial criteria will need to be built into the audit risk assessment.

An agent that has been accredited for more than 2 years and that fails to pass any of the criteria must provide IATA with a financial security calculated in accordance with the Local Criteria rules. Agents accredited for 2 years or less must provide a financial security in any case.

The changes were made to reduce the risk to IATA of bonding arrangements being activated by a firm's insolvency as, according to IATA Bulletin 02/2012, out of 60 defaults in the period from January 2011 to June 2012, only 11 agents had provided audited accounts and all defaults classed as 'bust out' provided certified accounts, some of which were found, following investigation, not to give a true and fair view of the financial status of the business. As a result of the changes increased work is demanded of external professional accountants.

The changes were introduced without prior consultation with ACCA and other UK accountancy bodies and some of the changes are not written in clear terms, nor indicate alternative ways in which professional accountants may report that may be more suitable than the current amended requirements. ACCA has drawn the need for guidance to the attention of IATA, which acknowledges the issues. We will work with IATA in the future to achieve a more appropriate balance of the mitigation of risk and the costs thereof. This guidance has been issued as interim guidance and may be subject to modifications arising from the progress of the work with IATA.

2 UK LOCAL CRITERIA FOR APPROVAL AND RETENTION OF AGENTS

The following are some of the most relevant extracts from the UK Local Criteria in respect of audited accounts:

"1. GENERAL RULES ACCOUNTS

1.1 Audited Accounts means accounts reviewed by an auditor recognized as competent by the regulatory authority in that country to perform an audit, that are provided to IATA.

1.2 Where Accounts are required to be provided, all Agents must provide Audited Accounts.

1.3 Newly formed companies that have traded for less than 6 months must submit an opening balance sheet, certified by a statutory auditor.

1.4 If the Agent is a subsidiary of another company or more than one company ("Parent Company"), registered in the UK, i.e. financial control is vested in one or more UK Parent Company(ies) it will need to submit also a copy of the most recent audited annual accounts of these controlling company(ies). If such Parent Company issues Consolidated Accounts, these will be considered in the determination of the financial standing of an Applicant or Agent (alongside the Agent accounts).

2. CRITERIA FOR EVALUATION OF AGENTS' ACCOUNTS

2.1 All financial information used in the financial criteria will be extracted from the Agent's Audited Accounts and their UK registered Parent Company(ies) as applicable.

2.2 The following financial criteria tests apply to the evaluation of an Agent's Audited Accounts and their UK registered Parent Company(ies) as applicable.

(a) There must be positive Net Equity.

(b) Profitability: the accounts must show that the Agent and their UK registered Parent Company(ies) as applicable, have made a profit before tax at the end of an accounting period.

(c) Liquidity: the accounts must show a positive liquidity ratio i.e. current assets must exceed current liabilities at the end of an accounting period.

2.3. There must have been no Defaults (including Defaults resulting from an accumulation of irregularities) by the Agent in the previous 24 months.

3. ANNUAL FINANCIAL REVIEWS

Agents accredited for two years or less

3.1 All Agents must provide Audited Accounts not more than 6 months old at the time of application to become an Agent, for the purposes of evaluation against the Criteria in Section 2 of this document. The accounts must cover a period of at least 12 months of trading. If an Agent has been in business for less than 6 months at the time of application, it must submit an opening balance sheet, certified by a statutory auditor.

3.2 In any event, all Agents must provide a Financial Security during the first two years as an Agent in accordance with Section 4 of this document.

Agents accredited for more than two years

3.3 All Agents must provide Audited Accounts not later than 6 months after each financial period end of that Agent for the purposes of evaluation against the financial criteria tests in Section 2 of this document. The accounts must cover a period of at least 12 months of trading.

3.4 If an Agent passes all the criteria for evaluation in Section 2 of this document, the Agent will not be required to provide IATA with a Financial Security. If an Agent fails to pass any of the Criteria, the Agent must provide a Financial Security in accordance with Section 4 of this document. “

3 GENERAL RULES ACCOUNTS 1.1

The definition of Audited Accounts is changed to:

1.1. **Audited Accounts** means accounts reviewed by an auditor recognised as competent by the regulatory authority in that country to perform an audit, that are provided to IATA.

3.1 Use of the word 'reviewed'

The definition refers to audited accounts being 'reviewed' by an auditor. A review is a different engagement to an audit and would generally result in a report providing much less assurance that the accounts were appropriate.

The interpretation of this acknowledged by IATA is:

'Reviewed' means, in this context, audited in accordance with the auditing standards and ethical standards for auditors issued for use within the United Kingdom and Republic of Ireland by The Financial Reporting Council (FRC), i.e. International Auditing Standards (ISAs) (UK and Ireland) and Ethical Standards (ESs).

3.2 Specification of auditor

The specification of an auditor as 'recognised as competent by the regulatory authority in that country to perform an audit' is imprecise.

The interpretation of this acknowledged by IATA is:

'An auditor recognised as competent by the regulatory authority in that country to perform an audit' means, in the UK, a person eligible for appointment as a statutory auditor as set out in Part 42 Statutory Auditors of the Companies Act 2006.

4 GENERAL RULES ACCOUNTS 1.2

The requirement for accounts is changed to:

1.2. Where Accounts are required to be provided, all Agents must provide **Audited Accounts**.

This means that audited accounts are required to be filed by both incorporated and unincorporated agents, i.e. including sole traders and partnerships. Reference should also be made to further guidance in section 7 of this document.

4.1 Specification of accounts

The specification of accounts to be provided by all agents is imprecise.

The interpretation of this acknowledged by IATA is:

'Accounts' means, for companies, accounts that comply with the accounting requirements, including the requirement to give a true and fair view, of Companies Act 2006, i.e. accounts prepared in accordance with UK GAAP or IFRSs. 'Accounts' means, for unincorporated agents like sole traders and partnerships, accounts that fairly reflect, as at the end of a reporting period, the results and financial position of the business activity carried on as a IATA agent and that are prepared in accordance with UK GAAP.

4.2 Auditor's report

The auditor's report on accounts provided to IATA must comply with the requirements of ISA (UK and Ireland) 700 *The auditor's report on financial statements*. Example reports can be found in FRC's Bulletin 2010/2 *Compendium of illustrative auditor's reports on United Kingdom private sector financial statements*. For unincorporated agents the auditor's report should be adapted from those applicable to a company by removing the references and additional reporting in respect of company legislation and by addressing it to the client, i.e. the business partners or the sole trader.

4.3 Letter of engagement

The terms of the audit engagement shall be agreed and documented in a letter of engagement which shall cover the objective and scope of the audit engagement, the respective responsibilities of the auditor and directors/client, the identification of the applicable financial reporting framework and an indication of the expected form and content of the auditor's report.

Whilst for an incorporated entity the letter of engagement would be a standard one, as the auditor will not issue any additional report for the purpose of IATA's rules, for unincorporated clients the letter of engagement will need to be suitably adapted and will still need to comply with the requirements of ISA (UK and Ireland) 210 *Agreeing the terms of audit engagements*. Appendix 1 of ISA (UK and Ireland) 210 includes an example of an audit engagement letter that does not include legislative references and may be of help for unincorporated clients.

It could be possible to limit liability to the client arising from negligence, default, breach of duty or trust in the performance of the audit engagement. In respect of the statutory audit of a company, the limitation of liability needs to be sanctioned by a specific agreement with the company in accordance with sections 534 to 538 of Companies Act 2006. Guidance on limitation of liability agreements for statutory audits has been published by the Financial Reporting Council and can be accessed at <http://www.frc.org.uk/FRC-Documents/FRC/Guidance-on-Auditor-Liability-Limitation-Agreement.aspx>.

In respect of unincorporated IATA clients, any limitation of liability for the audit of their accounts should be included or referenced in the initial letter of engagement. In any case any limitation of liability, relating to both companies and incorporated clients, will only be legally effective if it could be demonstrated to be fair and reasonable. ACCA has published guidance on the professional liability of accountants and auditors that is helpful in establishing limitation of liability to clients and can be accessed at http://www.accaglobal.com/content/dam/acca/global/PDF-members/2012/2012p/Prof_liability.pdf.

A limitation of liability towards the client is generally not effective against a third party.

5 GENERAL RULES ACCOUNTS 1.3 AND ANNUAL FINANCIAL REVIEWS 3.1

The requirement for newly formed companies is changed to:

1.3. Newly formed companies that have traded for less than six months must submit an opening balance sheet, certified by a statutory auditor.

The requirement for agents accredited for two years or less is changed to:

3.1If an Agent has been in business for less than six months at the time of application, it must submit an opening balance sheet, certified by a statutory auditor.

5.1 Specification of auditor

The specification of an auditor as 'a statutory auditor' is imprecise.

The interpretation of this acknowledged by IATA is:

'A statutory auditor' means, in the UK, a person eligible for appointment as a statutory auditor as set out in Part 42 Statutory Auditors of the Companies Act 2006.

5.2 Certification

The interpretation of this engagement (termed a 'certification') acknowledged by IATA is:

'Certified' means, in the UK, audited in accordance with the auditing standards and ethical standards for auditors issued for use within the United Kingdom and Republic of Ireland by The Financial Reporting Council (FRC), i.e. International Auditing Standards (ISAs) (UK and Ireland) and Ethical Standards (ESs) and in accordance with the special considerations in respect of an audit of a single financial statement included in ISA 805 "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" ISA 805 is issued by the International Auditing and Assurance Standards Board (IAASB) and can be accessed at <http://www.ifac.org/sites/default/files/publications/files/A043%202012%20IAASB%20Handbook%20ISA%20805.pdf>.

5.3 Opening balance sheet

The term 'opening balance sheet' is imprecise. An agent could choose the date of the balance sheet and the financial reporting framework used in its preparation to yield a misleading financial position.

The interpretation of this acknowledged by IATA is:

'Opening balance sheet' means a balance sheet or statement of financial position drawn in accordance with UK GAAP or IFRS as at the date of commencement of his activity by the agent.

6 DUTY OF CARE TO IATA

The performance of an audit engagement for an IATA client is likely to result in the creation of duty of care towards IATA, which would be a third party to the engagement. The creation of a duty of care towards a third party, and any ensuing potential liability in respect of the auditor's negligence in performing the audit engagement, has been the subject of various legal cases that have identified a number of criteria indicating the existence of such duty of care. In particular it has emerged from the decisions of the courts that liability to a third party may arise when the auditor knows, or ought to know, that his work is liable to be relied upon by a third party, that the third party is contemplating a transaction and that it is very likely that the third party intends to rely on the auditor's work in deciding whether or not to engage in the transaction in contemplation.

ACCA has published guidance on the professional liability of accountants and auditors that deals with liability to third parties and the effectiveness of attempts to mitigate such liability. The guidance can be accessed at:

http://www.accaglobal.com/content/dam/acca/global/PDF-members/2012/2012p/Prof_liability.pdf.

Additionally ACCA has also published Technical Factsheet 84 on the use of disclaimers in audit reports that is accessible at: http://www2.accaglobal.com/pubs/members/publications/technical_factsheets/downloads/84.pdf.

In the context of an audit engagement for an IATA client, where audited accounts will be passed to IATA for the purpose of their evaluation against the local financial criteria, a duty of care is likely to be imposed on the auditor and attempts to exclude or limit liability to IATA would only exceptionally be legally effective.

7 ALTERNATIVE REPORTS FOR IATA AGENTS

In some instances the performance of an audit engagement on the financial statements of an unincorporated business may present difficulties, in terms of the cost, scope and extent of the work required in relation to the relative financial size of the business and in terms of the actual definition of the scope of the audit engagement, where substantial adherence to a defined financial reporting framework by the unincorporated business may result particularly difficult or implausible and where the demarcation between assets and liabilities of the owner(s) relating to the carrying on of the business is substantially indistinguishable from the totality of his (their) assets and liabilities.

In circumstances similar to those highlighted above the performance of an audit engagement on the financial statements of an unincorporated IATA agent may be of limited relevance to both the client and IATA and may pose significant questions in respect of the auditor's acceptance of the engagement relating to the existence of the preconditions for an audit, as required by ISA 210 (UK and Ireland) *Agreeing the terms of audit engagements*.

In appropriate cases an unincorporated agent or applicant could contact IATA and suggest the adoption of an alternative report issued by the auditor which should reflect the type and extent of the work that the auditor will effectively be able to perform in respect of the financial information relating to the business.

An alternative report would not constitute an auditor's report issued on the basis of the performance of an audit engagement in accordance with the International Auditing Standards (ISAs) (UK and Ireland) but could be another form of assurance report that conveys a different level of assurance and expresses a different form of conclusion about the financial information of the business. In particular the auditor may be able to perform sufficient work to reduce risk to an acceptable level for her/him to be able express a negative form conclusion about the unincorporated business' financial information; e.g. 'nothing has come to our attention that causes us to believe that the financial information (or another subject matter like appropriate accounting records) of the business is fairly represented (or have been kept)...'.

Guidance on the performance of such alternative assurance engagements can be found in the framework for assurance engagements provided by the International Audit and Assurance Standards Board (IAASB) and in particular in the International Standards on Assurance Engagements (ISAEs) issued by that body, which outline principles and procedures to be applied, as well as guidance for practitioners, in the performance of this type of work.

ISAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* is the standard that is written for general application to all other assurance engagements and that clarifies that different types of assurance engagements are possible which result in different work performed, different levels of assurance conveyed and different forms of conclusion expressed by the practitioner. Reasonable assurance engagements are those for which work is planned and performed and evidence is obtained to reduce risk to an acceptable low level for the practitioner to express a conclusion in positive form, whilst limited assurance engagements are those where the practitioner's work reduces risk to an acceptable level, which is however higher than for reasonable assurance engagements, for her/him to be able express a negative form conclusion. For both types of engagement the practitioner should obtain sufficient appropriate evidence on which to base the conclusion.

The appropriate work to be performed for an alternative assurance engagement will vary according to the circumstances of the assignment, however in establishing the work to be performed and the evidence required, the practitioner should apply assurance skills and techniques as part of a systematic and continual approach throughout the engagement. An important aspect when undertaking other assurance work is the agreement of the terms of the engagement with the engaging party. In particular the terms should be recorded in a specific letter of engagement that should set out the scope of the work required, the subject matter information to be evaluated, the criteria that should be used for such purpose, the type of assurance and report that will be provided and the respective responsibilities and involvement of the parties interested. Planning the engagement so that it will be performed effectively is essential to achieve the objectives of the assignment, to reduce risk and to ensure that the work is carried out within budget. The detail and extent of planning vary according to the circumstances, such as the size and complexity of the business and the auditor's previous knowledge of it. Planning should in any case include developing an overall strategy for the scope, timing and conduct of the work and a detailed approach in terms of nature, timing and extent of evidence-gathering procedures and the reasons for selecting them.

The International Framework for Assurance Engagements, ISAE 3000 and other ISAEs in issue can be accessed at <http://www.ifac.org/publications-resources/2013-handbook-international-quality-control-auditing-review-other-assurance-a>.

The following report is an example of an alternative report that may be agreed with IATA, subject to any appropriate modifications, in respect of an assurance engagement that conveys a lower level of assurance than an audit and in respect of which the auditor is able to perform sufficient work, as outlined in the body of the report, in order to express a negative form conclusion.

“Report from the Auditor to (insert name of client(s)) on the accounts of XYZ, Unincorporated Entity for the year ended DD/MM/YY

We report to you in accordance with the terms of our letter of engagement dated DD/MM/YY.

Respective responsibilities

As stated on page X, you acknowledge your responsibility for the preparation of financial statements and for the maintenance of accounting records which reflect and explain the transactions and assets and liabilities arising from your activity as an IATA agent. You have also agreed to make available to us all books and records relating to that activity and to provide any further information and explanations as we consider/ are necessary to make our report.

It is our responsibility to report to you on whether, in our opinion, the accounts have been prepared in accordance with the accounting policies as specified in Note 1 to the financial statements. In addition we report to you on the basis of the audit procedures carried out by us, whether anything has come to our attention to indicate that:

- (1) the statement of assets and liabilities does fairly reflect, in all material respects, the assets and liabilities of your activity as an IATA agent;
- (2) the books and records maintained by you do not record and explain the transactions, assets and liabilities of your activity as an IATA agent consistent with our understanding of that activity, based on discussions with you; and
- (3) the income figure as stated in the financial statements has not been properly extracted from the books and records relating to your activity as a an IATA agent.

Work performed

We carried out those audit procedures that we considered necessary to enable us to report to you on the above matters. This included testing, on a sample basis, commission and fee income earned from your activity an IATA agent to ensure it had been reflected in the books and records relating to that activity.

We have also relied on written representations from you that:

1. the statement of assets and liabilities reflects, in all material respects, all assets and liabilities relating to your activity as an IATA agent;
2. appropriate accounting records have been maintained by you; and
3. all income has been reflected in the books and records maintained for the purpose of your activity as IATA agent.

[Exceptions

Specify]

Conclusion

Except for the matters noted above/Other than clerical errors or omissions which we are satisfied have been isolated occurrences and which have been corrected, our conclusion is that, in our opinion, the accounts in respect of your activity as an IATA agent have been prepared in accordance with the accounting policies set out on page ... , and nothing came to our attention to indicate that:

1. the statement of assets and liabilities did not reflect the net assets/liabilities arising from your activity as an IATA agent;
2. the books and records of your activity as an IATA agent did not reflect the transactions and assets and liabilities arising from this activity; and
3. the income as stated in the financial statements for the year ended DD/MM/YY had not been properly extracted from the books and records maintained for your activity as an IATA agent.

Signature

ABC & Co
Chartered Certified Accountants and Registered Auditors