

Bookkeeping Services – Non-listed entities

Background

At the December 2005 CAG meeting there was a discussion as to whether the Code struck the appropriate balance in the area of bookkeeping services for non-listed entities. It was noted that as accounting standards become more complex small entities without depth of accounting expertise might require more assistance from their auditors. The purpose of this paper is to address this issue.

Discussion

Section 290

The general provisions in the Code on accounting services cover technical assistance in paragraph 290.168. Technical advice on accounting principles, financial statement disclosure and the like is generally not seen to create a threat to independence, nor does assisting the client during the audit process. With respect to the preparation of accounting records or financial statements, the Code permits some accounting and bookkeeping services of a “routine or mechanical nature” to be provided to non-listed entities if any self-review threats are reduced to an acceptable level. (The exception for listed entities involving immaterial divisions or subsidiaries would only apply if the accounting and bookkeeping services are of a routine or mechanical nature.)

APB

The APB also makes a distinction between the accounting services that may be provided to listed vs. non-listed entities. In the case of non-listed entities, the APB’s rules provide that a firm should not provide accounting services if the services would involve the audit firm undertaking part of the role of management. Firms should have policies covering when accounting services will not be provided to non-listed audit clients. The guidance also states:

123 For entities other than listed companies or significant affiliates of listed companies, auditors may undertake an engagement to provide accounting services, provided that:

- (a) such services:
 - (i) do not involve initiating transactions or taking management decisions; and
 - (ii) are of a technical, mechanical or an informative nature; and
- (b) appropriate safeguards are applied.

124 The maintenance of the accounting records and the preparation of the financial statements are the responsibility of the management of the audit client. Accordingly, in any engagement to provide the audit client with accounting services, the audit firm does not initiate any transactions or take any decisions or

make any judgments, which are properly the responsibility of the management. These include:

- authorizing or approving transactions;
- preparing originating data (including valuation assumptions);
- determining or changing journal entries, or the classifications for accounts or transactions, or other accountant records without management approval.

125 Examples of accounting services of a technical or mechanical nature or of an informative nature include:

- recording transactions for which management has determined the appropriate account classification, posting coded transactions to the general ledger, posting entries approved by management to the trial balance or providing certain data-processing services (for example, payroll);
- assistance with the preparation of the financial statements where management takes all decisions on issues requiring the exercise of judgment and has prepared the underlying accounting records.

It should be noted that the APB does not include in its definitions of “accounting services” advice on the implementation of current and proposed accounting standards.

The APB also has provisions available for small entities. As noted in paragraph 2 of the standard:

“The APB is aware that a limited number of the requirements in Ethical Standards 1-5 are difficult for certain audit firms to comply with, particularly when auditing a small entity. Whilst the APB is clear that those standards are appropriate in the interest of establishing the integrity, objectivity and independence of auditors, it accepts that certain dispensations, as set out in this Standard, are appropriate to facilitate the cost effective audit of the financial statements of Small Entities (as defined below).”

The standard further states that when an auditor takes advantage of the exemptions set out in the Standard it should disclose in the audit report the fact that the firm has applied APB – Ethical Standard – Provisions Available for Small Entities.

Small entities include entities that are not listed and have:

- Under £5.6 million turnover;
- Not more than £2.8 million balance sheet total
- Not more than 50 employees.

The standard provides an exemption for self-review threats and management threats:

“When undertaking non-audit services for a Small Entity audit client, the audit firm is not required to apply safeguards to address a self-review threat provided:

- (a) the audit client has “informed management”; and

- (b) the audit firm extends the cyclical inspection of completed engagements that is performed for quality control purposes.”

The audit firm extends the number of engagements selected under the ISQC standard to include a random selection of audit engagements where non-audit services have been provided. Particular attention is given to ensuring that there is documentary evidence that “informed management” has made such judgments and decisions that are needed in relation to the presentation and disclosure in the financial statements.

“When undertaking non-audit services for Small Entity audit clients, the audit firm is not required to adhere to the prohibitions in APB Ethical Standard 5, relating to providing non-audit services that involve the firm undertaking part of the role of management, provided that:

- (a) it discussed objectivity and independence issues related to the provision of non-audit services with those charged with governance; and
(b) it discloses the fact that it has applied this Standard in accordance with paragraph 22.”

ES 5 provides that where an audit firm provides non-audit services to an audit client that does not have “informed management”, it is unlikely that any safeguards can eliminate the management threat or reduce it to an acceptable level with the application of safeguards. An audit firm auditing a small entity is exempted from the requirements relating to internal audit services, information technology services, corporate finance services, transaction related services, and accounting services in circumstances where there is no “informed management” provided it discusses objectivity and independence issues related to the provision of non-audit services with those charged with governance and makes the appropriate disclosures in the audit report. The disclosures would be that the auditor has taken advantage of the exemption in the Standard and either the financial statements or the audit report discloses the type of non-audit services provided to the client.

AICPA

The AICPA provides examples of bookkeeping services that would and would not impair independence.

Independence Would Not Be Impaired

- Record transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client’s general ledger.
- Prepare financial statements based on information in the trial balance
- Post client-approved entries to a client’s trial balance.
- Propose standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client provided the client reviews the entries and the member is satisfied that management understands the nature of

the proposed entries and the impact the entries have on the financial statements

Independence Would Be Impaired

- Determine or change journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval
- Authorize or approve transactions.
- Prepare source documents
- Make changes to source documents without client approval

Canada

The Canadian rules similarly distinguish between listed and non-listed entities.

Audit or review clients that are not reporting issuers

140 Subject to Rule 204.4(23) a member, firm or network firm may provide an audit or review client that is not a reporting issuer with accounting and bookkeeping services provided that any resulting self-review threat so created is reduced to an acceptable level. Examples of such services include:

- recording transactions for which the client has determined or approved the appropriate account classification;
- posting transactions to the client's general ledger;
- preparing financial statements;
- drafting notes to the financial statements;
- posting journal entries to the trial balance;
- performing payroll services which do not involve having custody of client assets; and
- preparing tax receipts for charitable donations or tax information returns, such as T4 slips.

Client approval of journal entries

141 A member, firm or network firm may prepare journal entries for an audit or review client that is not a reporting issuer provided management approves and take responsibility for such journal entries. In obtaining this approval, the member, firm or network firm may choose to obtain approval for each journal entry or, alternatively, to obtain approval following a thorough review of the completed financial statements with management. This approval may also be obtained through the management representation letter.

Complex transactions

143 Preparing the journal entries for a complex transaction would likely create a self-review threat the significance of which could only be reduced to an

acceptable level by applying safeguards that involve consultation with others, for example by:

- obtaining the views of another professional accountant;
- arranging for another firm to review a significant accounting treatment; or
- discussing the proposed accounting treatment with the Institute's practice advisory services.

EU – Commission Recommendation of 16 May 2002

The EU recommendation includes the common prohibition against making management decisions. In the case of entities that are not public interest entities, the statutory auditor's assistance "should therefore be limited to carrying out technical or mechanical tasks and to providing advisory information on alternative standards and methodologies which the Audit Client might wish to apply. Examples similar to those in the AICPA Code are also included.

The Code's provision regarding the preparation of accounting records or financial statements to non-listed entities is generally consistent with the standard-setters noted above. However, the Code is not as clear as it could be regarding which accounting services are covered by paragraphs 290.170 – 290.173. Paragraph 290.169 refers to "the preparation of accounting records or financial statements" whereas paragraphs 290.170 – 290.173 refer to "provision of accounting and bookkeeping services." Since the heading of this section is "Preparing Accounting Records and Financial Statements", the reader might conclude that paragraphs 290.170 – 290.173 in effect override the discussion in 290.168 dealing with technical advice and is not intended to be limited to the preparation of accounting records or financial statements.

Questions considered

1. Should the accounting services that are permitted to be performed for non-listed entities be expanded?
2. Should the reference to "routine or mechanical nature" be modified or deleted to expand the accounting services the auditor may provide to non-listed entities? - The APB includes the notion of "informative nature" whereas Canada deals with the issue by including a separate provision on complex transactions.
3. Is the accounting assistance described in paragraph 290.168 generally permissible for listed and non-listed entities?
4. Should the heading be broader than "Preparing Accounting Records and Financial Statements?"
5. Should the discussion in paragraphs 290.170-173 be limited to preparing accounting records or financial statements or should it cover more broadly, accounting services, including those in paragraph 290.168? If it should not include, would a simple fix be

the addition of a sentence at the end of paragraph 290.168 stating that for purposes of paragraphs 290.169 – 290.173, the term “accounting and bookkeeping services” does not include the type of advice described in this paragraph? Alternatively, the reference to “accounting and bookkeeping services” in such paragraphs could be changed to preparation of accounting records or financial statements.

Conclusion

The Task Force is of the view that the accounting services that are permitted to be performed for non-listed entities should not be expanded. Paragraph 290.170 provides sufficient leeway to assist non-listed entities in preparing accounting records and financial statements. However, the Task Force recognizes that the reference to “routine or mechanical” may be interpreted by some to limit the services to only those services that require no judgment. To provide additional guidance which may help clarify the scope of permitted activities, the Task Force suggests adding to the examples of services in 290.170, the 4th bullet point in the AICPA list of permitted bookkeeping services.

Firms should generally be able to render advice on accounting matters to both non-listed and listed entities. Paragraph 290.168 covers a range of matters on which the accountant can advise without impairing independence, but such paragraph covers advice during the audit process. The Task Force was of the view that the reference to audit process should be expanded to include accounting advice during the year that may not be provided as part of the audit process.

The Task Force believes that the terminology should be made consistent and the heading should be “Accounting and Bookkeeping Services” as the example covers services beyond just “Preparing Accounting Records and Financial Statements.”

Action requested

Members are asked to consider the conclusions of the Task Force and the illustrative wording.

Illustrative wording

Preparing Accounting Records and Financial Statements Accounting and Bookkeeping Services

General Provisions

290.166 Assisting a financial statement audit client in matters such as preparing accounting records or financial statements may create a self-review threat when the financial statements are subsequently audited by the firm.

290.167 It is the responsibility of financial statement audit client management to ensure that accounting records are kept and financial statements are prepared, although they may request the firm to provide assistance. If firm, or network firm, personnel providing such assistance make management decisions, the self-review threat created could not be reduced to an acceptable level by any safeguards. Consequently, personnel should not make such decisions. Examples of such managerial decisions include:

- Determining or changing journal entries, or the classifications for accounts or transaction or other accounting records without obtaining the approval of the financial statement audit client;
- Authorizing or approving transactions; and
- Preparing source documents or originating data (including decisions on valuation assumptions), or making changes to such documents or data.

290.168 ~~The audit process involves~~ Extensive dialogue is common between the firm and management of the financial statement audit client. ~~During this process,~~ Management may requests and receives significant input regarding such matters as accounting principles and financial statement disclosure, the appropriateness of controls and the methods used in determining the stated amounts of assets and liabilities. Technical assistance of this nature and advice on accounting principles for financial statement audit clients are an appropriate means to promote the fair presentation of the financial statements. The provision of such advice does not generally threaten the firm's independence.

290.XXX Similarly, during the financial statement audit process, the firm may be requested to involve assisting an audit client in resolving account reconciliation problems, analyzing and accumulating information for regulatory reporting, assisting in the preparation of consolidated financial statements (including the translation of local statutory accounts to comply with group accounting policies and the transition to a different reporting framework such as International Financial Reporting Standards), drafting disclosure items, proposing adjusting journal entries and providing assistance and advice in the preparation of local

statutory accounts of subsidiary entities. These services are considered to be a normal part of the audit process and do not, under normal circumstances, threaten independence.

General Provisions *Preparation of Accounting Records and Financial Statements*

290.169 The examples in paragraphs 290.170 through 290.173 indicate that self-review threats may be created if the firm is involved in the preparation of accounting records or financial statements and those financial statements are subsequently the subject matter information of an audit engagement of the firm. This notion may be equally applicable in situations when the subject matter information of the assurance engagement is not financial statements. For example, a self-review threat would be created if the firm developed and prepared prospective financial information and subsequently provided assurance on this prospective financial information. Consequently, the firm should evaluate the significance of any self-review threat created by the provision of such services. If the self-review threat is other than clearly insignificant safeguards should be considered and applied as necessary to reduce the threat to an acceptable level.

Financial Statements Audit Clients That are Not Listed Entities

290.170 The firm, or a network firm, may provide a financial statement audit client that is not a listed entity with accounting and bookkeeping services that involve the preparation of accounting records and/or financial statements, including payroll services, of a routine or mechanical nature, provided any self-review threat created is reduced to an acceptable level. Examples of such services include:

- Recording transactions for which the audit client has determined or approved the appropriate account classification;
- Posting coded transactions to the audit client's general ledger;
- Preparing financial statements based on information in the trial balance; and
- Posting the audit client approved entries to the trial balance.

The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Making arrangements so such services are not performed by a member of the assurance team;
- Implementing policies and procedures to prohibit the individual providing such services from making any managerial decisions on behalf of the audit client;
- Requiring the source data for the accounting entries to be originated by the audit client;

- Requiring the underlying assumptions to be originated and approved by the audit client; or
- Obtaining audit client approval for any proposed journal entries or other changes affecting the financial statements.

Financial Statement Audit Clients That are Listed Entities

290.171 The provision of accounting and bookkeeping services that involve the preparation of accounting records and/or financial statements, including payroll services and the preparation of financial statements or financial information which forms the basis of the financial statements on which the audit report is provided, including payroll services, on behalf of a financial statement audit client that is a listed entity, may impair the independence of the firm or network firm, or at least give the appearance of impairing independence. Accordingly, no safeguard other than the prohibition of such services, except in emergency situations and when the services fall within the statutory audit mandate, could reduce the threat created to an acceptable level. Therefore, a firm or a network firm should not, with the limited exceptions below, provide such services to a listed entity that is a financial statement audit client.

290.172 The provision of accounting and bookkeeping services of a routine or mechanical nature to divisions or subsidiaries of a financial statement audit client that is a listed entity would not be seen as impairing independence with respect to the audit client provided that the following conditions are met:

- (a) The services do not involve the exercise of judgment.
- (b) The divisions or subsidiaries for which the service is provided are collectively immaterial to the audit client, or the services provided are collectively immaterial to the division or subsidiary.
- (c) The fees to the firm, or network firm, from such services are collectively clearly insignificant.

If such services are provided, all of the following safeguards should be applied:

- (a) The firm, or network firm, should not assume any managerial role nor make any managerial decisions.
- (b) The audit client should accept responsibility for the results of the work.
- (c) Personnel providing the services should not participate in the audit.

Emergency Situations

290.173 The provision of accounting and bookkeeping services to financial statement audit clients in emergency or other unusual situations, when it is impractical for the audit client to make other arrangements, would not be considered to pose an unacceptable threat to independence provided:

- (a) The firm, or network firm, does not assume any managerial role or make any managerial decisions;
- (b) The audit client accepts responsibility for the results of the work; and
- (c) Personnel providing the services are not members of the assurance team.

|