

Agenda Paper 7



Meeting Location: Conrad Hotel, Dublin, Ireland

Meeting Date: February 20-22, 2012

SME / SMP Issues

Objective of Agenda Item

To approve starting a project to reconsider and clarify the provisions in the IESBA Code dealing with the preparation of accounting records and financial statements.

Background

At its October 2011 meeting in New York, the IESBA received and discussed a report (Agenda Paper 7-A) on how it might address the unique and challenging issues faced by professional accountants in small- and medium-sized entities (SMEs) and small- and medium-sized practices (SMPs) when complying with the Code. In November, the Chair of the IESBA SME / SMP Working Group met by phone with the IESBA Planning Committee for further discussion of the report.

The report included a recommendation that the Board consider guidance on the preparation of accounting records and financial statements. It is common practice in many jurisdictions around the world for SMPs and others providing services to SMEs to prepare their accounting records and financial statements, and the Working Group studying the challenges faced by professional accountants in SMEs and SMPs encountered confusion about the Code's guidance on such services¹.

In particular, questions were raised about the meaning of services "of a routine or mechanical nature" (paragraph 290.171). In that paragraph, the examples of such services describe the client's involvement with key aspects of the service (e.g., originating data, coding transactions, and determining or approving entries and account classifications). Thus, linking the examples to the term "routine or mechanical" suggests that the type of client involvement described in the examples makes the services routine or mechanical. But this is not clear. Further, questions such as whether it is acceptable to obtain client approval after all transactions have been recorded, and whether recording a complex transaction is mechanical if the client has approved the account classification could be clarified.

¹ Insights were obtained from a variety of sources around the world – see the October report, pages 1-2

Also, many did not see a link between this guidance in paragraph 290.171 and the guidance in paragraph 290.166² dealing with management's responsibility. For example, it was not clear to everyone to what extent a client's understanding of the entries for a complex transaction is relevant if the client approves the account classification. As explained in paragraph 290.166, the risk of assuming a management responsibility is reduced when an auditor or an accountant performing a review engagement "gives the client the opportunity to make judgments and decisions based on an objective and transparent analysis and presentation of the issues." This appears to be the concept embedded in the examples in 290.171.

The IESBA Chair and Working Group Chair have discussed this issue and recommend that the IESBA clarify:

- the guidance in the Code dealing with the preparation of accounting records and financial statements; and
- the importance of an audit or review client making the significant judgments and decisions relevant to the service based on an objective and transparent analysis and presentation of the issues.

As discussed at the IESBA meeting in October, Staff Questions and Answers and other guidance separate from the Code may be useful, but they are not an ideal substitute for clarity of the Code. Understanding the Code has been identified as a challenge for professional accountants in SMEs and SMPs, particularly those whose first language is not English; adding more guidance is less helpful than clarifying the existing guidance.

Clarification will facilitate understanding and compliance with the Code, and highlighting the importance of an objective and transparent analysis and presentation of the issues in this area so that the client can make the necessary judgments will help to strengthen the application of the Code.

Next Steps

If the Board agrees, a project proposal will be prepared for discussion and approval at the next Board meeting.

Action Requested

IESBA members are asked to approve a project in principle, subject to a formal proposal at the next Board meeting to clarify:

- the guidance in the Code dealing with the preparation of accounting records and financial statements and

² Paragraphs 290.166 and 290.171 of the IESBA Code are reproduced in full in the Appendix.

- the importance of giving an audit or review client the opportunity to make judgments and decisions based on an objective and transparent analysis and presentation of the issues.

Other Matters

The October report also recommended preparation of a synopsis of the Code and the development of guidance on the definition of a network. IESBA staff has begun work on both of these.

Material Presented

Agenda Paper 7	This Agenda Paper
Agenda Paper 7-A	IESBA SME/SMP Working Group's October 2011 Report

APPENDIX – EXCERPT FROM THE IESBA CODE

290.166 To avoid the risk of assuming a management responsibility when providing non-assurance services to an audit client, the firm shall be satisfied that a member of management is responsible for making the significant judgments and decisions that are the proper responsibility of management, evaluating the results of the service and accepting responsibility for the actions to be taken arising from the results of the service. This reduces the risk of the firm inadvertently making any significant judgments or decisions on behalf of management. The risk is further reduced when the firm gives the client the opportunity to make judgments and decisions based on an objective and transparent analysis and presentation of the issues.

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.