Guidance on Accounts Preparation Engagements

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1. Introduction

The purpose of this document is to provide guidance to IFA members in practice[1] (professional accountants) when they prepare financial statements[2] for clients. This guidance includes:

- an overview of the financial reporting regimes and content of accounts;
- ethical principles of accounts preparation engagements;
- defining the terms of engagement;
- planning, documenting and procedures for accounts preparation engagements; and
- reporting on an accounts preparation engagement.

This guidance covers accounts preparation engagements for a wide variety of different business entities, including:

- sole traders;
- unincorporated entities;
- limited companies;
- partnerships;
- trusts; and
- charitable companies.

While the guidance does not cover certain types of business entities such as unincorporated charities accounts under receipts and payments regime, the general principles and example reports can be adapted and applied when conducting such engagements.

We strongly recommend that the IFA accounts preparation report should be provided when the member's name or the practice's name is associated in any way with the financial statements they have prepared. In addition, a copy of the accounts preparation report should be included in the financial statements which are filed for public record, for example financial statements filed at Companies House, the Charity Commission and OSCR. This recommendation also applies to copies of abbreviated accounts filed at Companies House.

Further guidance on accounts preparation engagements is available from the International Auditing and Assurance Standards Board (IAASB) ISRS 4410 (Revised) – Compilation Engagements.

[1] Referred to in the remainder of this guidance as professional accountants.
[2] Accounts and financial statements are used interchangeably in this guidance.

2. Definitions

In this guidance, unless the context otherwise requires:

‘accounts’ means financial statements of an entity. Throughout this document the term accounts and financial statements are used interchangeably;

‘accounts preparation engagement’ means compilation engagement in accordance with the International Auditing and Assurance Standards Board (IAASB)’s ISRS 4410 (Revised) – Compilation Engagements;

‘directors’ means designated members, partners and those charged with governance of the entity;

‘professional accountant’ means a member of the Institute of Financial Accountants (IFA) engaged in public practice;

‘qualifying partnership’ means a partnership formed under the law of any part of the UK each of whose members, or, in the case of a limited partnership, each of whose general partners is:

- a limited company;
- an unlimited company each of whose members is a limited company;
- a Scottish partnership which is not a limited partnership, each of whose members is a limited company; or
- a Scottish partnership which is a limited partnership, each of whose general partners is a limited company.

3. Objective of an accounts preparation engagement

The objective of an accounts preparation is for the professional accountant to use their expertise to collect, classify and summarise financial information. This process may involve using information from bookkeeping software and/or paperwork such as invoices, payments, bank statements. The procedures undertaken are not designed to enable the professional accountant to express any assurance on the financial statements. Therefore, in this type of engagement, the professional accountant does not provide any assurance on the truth and fairness of the information contained in the financial statements.

However, users of the financial statements derive some benefit from the professional accountant’s involvement because the service has been performed with integrity and competently, in accordance with the ethical guidance contained in the IFA’s Code of Ethics.

4. Professional ethics

Professional accountants inspire confidence and trust by behaving ethically and doing the right thing. As such, professional accountants must comply with the fundamental principles and guidance included in the Code of Ethics. The fundamental principles included in the Code of Ethics are:

(a) Integrity – to be straightforward and honest in all professional and business relationships.

(b) Objectivity – not to compromise professional or business judgements because of bias, conflict of interest or undue influence of others.

(c) Professional competence and due care – to:

(i) attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organisation receives competent professional service, based on current technical and professional standards and relevant legislation; and

(ii) act diligently and in accordance with applicable technical and professional standards.

(d) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships.

(e) Professional behaviour – to comply with relevant laws and regulations and avoid any conduct that the professional accountant knows or should know might discredit the profession.

Professional accountants need to consider whether a particular situation or relationship might constitute threats to adherence to the fundamental principles. If the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the professional accountant shall address the threats by eliminating them or reducing them to an acceptable level.

Of particular relevance to these types of engagements are the principles of integrity and objectivity. The independence requirements that apply to audit and assurance engagements are not relevant to accounts preparation engagements.

The part of the Code dealing with integrity (paragraph R111.2) highlights that a professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:

- contains a materially false or misleading statement;
- contains statements or information provided recklessly; or
- omits or obscures required information where such omission or obscurity would be misleading.

If a professional accountant provides a modified report in respect of such a report, return, communication or other information, the professional accountant is not in breach of the fundamental principle of integrity.

When a professional accountant becomes aware of having been associated with information described in paragraph R111.2 of the IFA Code of Ethics, the professional accountant shall take steps to be disassociated from that information (see section 9.4.3).

The part of the Code that deals with objectivity highlights that the objectivity of the professional accountant may be influenced by family and other personal or business relationships, loans, beneficial interested in shares and other investments, gifts and hospitality and any other conflicts of interest.

Further guidance is available in sections 310 and 340 of the IFA Code of Ethics.

5. Content of accounts

5.1 General considerations

Irrespective of the nature of the accounts produced, accounts should be a well-presented, include a front cover, a contents page and it should be made clear in a prominent position that the accounts are *'unaudited'*.

Comparatives should be given, as should page numbers, and the financial statements should be cross-referenced to supporting notes (where they exist).

If comparatives have been restated, then the column headings on all affected financial statements and notes should be annotated as 'restated'.

Irrespective of any legal requirement, where an entity has a formal constitution it is vital that this is checked to see if it 'imposes' any additional financial reporting (or auditing) requirements.

5.2 Limited companies, community interest companies, qualifying partnerships and limited liability partnerships

With the exception of public limited companies (PLCs), these entities are legally required to produce annual accounts and file them at Companies House within nine months of the year end.

Particularly regarding limited companies, community interest companies (CICs), qualifying partnerships and limited liability partnerships (LLPs), it is essential to determine which financial reporting regimes are available to the client, and then to discuss with the client the options and which regime the client wishes to follow.

These entities have a choice of which financial reporting regime they follow. The decision as to which financial reporting regime is adopted should be made by the directors of the entity. While an professional accountant can provide advice to their clients regarding reporting regimes, it would be unethical for an accountant to determine or dictate which regime a client follows. Confirmation of this discussion with the client should be documented and an appropriate clause added in the letter of engagement confirming the financial regime under which the financial statements will be prepared.

Depending on the client's eligibility most IFA members prepare accounts based on:

- FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime (FRS 105); or
- FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland Section 1A (the small entity regime).

Accountancy practices have a duty of care to ensure that an appropriate financial reporting regime is followed by the entity. For example, if a client was clearly not a micro entity then it would be unethical for an professional accountant to prepare and file accounts under the FRS 105 micro entity regime.

Other points to note:

- whilst not specifically prohibited, given the nature of CICs it is unlikely that preparation of micro accounts would be comparable with the 'transparency' ethos of this sector.
- Limited liability partnerships (LLPs) which follow the micro entity regime are exempt from complying with the Statement of Recommended Practice – Accounting for Limited Liability. Those that follow the micro entity regime are only required to make disclosures about how loans and other debts due to members rank in relation to other unsecured creditors (paragraphs 63 and 64 of this SORP). The SORP also encourages small LLPs to include a reconciliation of movements in 'Members' other interests' and 'Loans and other debts due to members'.

5.2.1 Micro-entities regime

Companies and other entities may choose to prepare and file their accounts in accordance with the small companies regime or the micro-entities regime, subject to meeting the relevant criteria. There is no requirement for shareholder approval when an entity chooses to apply the micro-entity regime. It is for the directors to decide whether or not they want to take advantage of this option to apply the micro-entity regime.

Eligibility

An entity meets the qualifying conditions for a micro-entity if it meets at least two out of three of the following thresholds:

- Turnover not more than £632,000 (adjusted for periods longer or shorter than 12 months).
- Balance sheet total not more than £316,000.
- Average number of employees not more than 10.

The turnover limit is adjusted proportionately if the financial year is longer or shorter than twelve months. For the first financial year of the entity, it needs only meet the qualifying conditions in that year to qualify as a micro-entity.

After the first financial year of the entity, the criteria must be met in two consecutive years for an entity to qualify as a micro-entity and must be exceeded in two consecutive years to cease to qualify.

Any entity that is excluded from the small companies' regime (or small LLPs regime) may not apply FRS 105. In addition, the following types of entity are excluded from being treated as a micro-entity:

- charitable companies;
- investment undertakings;
- financial institutions;
- subsidiaries that are fully consolidated in group accounts; and
- parent companies that prepare group accounts.

Choosing to apply the micro-entity regime

Micro-entity accounts are very simple: there is no requirement for any type of a directors' report, the profit and loss account and balance sheet are akin to 'standard forms', and there are no 'separate' notes and the accounts are presumed in law (Companies Act 2006) to give a true and fair view. However, all micro-entities will have to disclose between two and four notes on the face of the balance sheet.

There is no micro-entity filing regime. Micro-entities can, if they wish, take advantage of the small company filing regime, meaning that the profit and loss account does not need to be filed at Companies House. This process is colloquially known as 'filleting'.

However, just because an entity can follow this regime doesn't always mean that it is appropriate to do so. As noted above micro-entity accounts show very little information, and whilst this has the advantage of protecting privacy it does mean that the accounts from a commercial point of view are extremely limited. For example, current and potential creditors and lenders may require more information that is available in the micro-entity accounts. If clients wish to have more detailed financial information, then there is not a problem in producing additional management pages which are appended to the statutory micro entity accounts as long as they are annotated as such. However, what cannot be done is to produce accounts for the shareholders under the small company regimes and then file micro-entity accounts at Companies House. It is only possible to file a redacted (filleted) version of the information that was presented to the shareholders.

If the client chooses to include information in its accounts in addition to the minimum accounting items in the micro-entity regime, care will need to be taken that the relevant provisions of Section 1A of FRS 102 have been followed. This may require manual adjustments if accounts are prepared using software packages. Therefore, in such circumstances, it might be more appropriate that the client applies the small-entity regime.

It is recommended that professional accountants discuss with the client the potential benefits and other factors before the client decides to apply the micro-entity regime. Areas to discuss include:

- Will the entity's credit rating be adversely affected and is this of commercial significance?
- Is the entity or those charged with governance looking to raise finance in the near future, and will this be adversely affected?
- Are the owners of the business considering selling it in the next few years, and will only having micro-entity accounts adversely affect the marketability of the entity?
- If the entity is an LLP, does the members' agreement restrict the use of the micro-entity regime?
- Are there any banking or loan covenants that restrict the use of the micro-entity regime?
- Is the entity going to have a statutory audit? Whilst technically it is possible to audit micro-entities, most registered auditors are not comfortable doing so.
- Will the simplicity of this regime suit the client? The accounting requirements are relatively simple, but this simplicity leads to rigidity, for example, development costs cannot be capitalised, it is not possible to revalue any assets, interest cannot be capitalised into the carrying value of any assets, and promotional stock needs to be expensed.
- Is the format of the profit and loss account in the micro-entity regime suitable for the client? The micro-entity regime is likely to be more suitable for a manufacturing entity than a service-based entity;
- Where the client requires additional information, would it be a more cost-effective option just to produce small company accounts?
- If the entity is growing and will quickly cease to be a micro-entity would it be better to adopt the small company regime from day one as opposed to having to deal with the transition to FRS 102 in a couple of years' time?

5.2.2 Small-entities regime

Eligibility

The Companies Act 2006 (CA 2006) sets out the qualifying criteria to determine whether an entity can take advantage of the small companies regime when preparing its annual reports and accounts. Certain types of entity are excluded from the regime, as are members of an ineligible group, and there are size thresholds to be met.

Micro-entities are a sub-category of small companies and there are additional criteria to be met. For more information on the criteria see 5.2.1.

A company or LLP may follow the small-entity regime if it satisfies **all** of the following criteria:

- It meets the relevant size criteria (CA 2006, s 384A). In the first period of account this means that two out of three of the following threshold conditions are met:

  - turnover not more than £10.2m (on an annualised basis);
  - gross assets (legislation actually refers to 'balance sheet total', however, this means gross assets) not more than £5.1m; and
  - employees not more than 50.

In subsequent accounting periods, the criteria are slightly more complex. If in the first period of account an entity was small then it will continue to be small, unless it has breached the size criteria above for two consecutive accounting periods (i.e. there is a year of grace). However, if in the first period of account the entity was medium, for example, it would not be eligible to adopt the small-entity regime until the criteria have been met for two consecutive accounting periods.

- At no time during the period the entity was:

  - A plc.
  - An authorised insurance company.
  - A banking company.
  - An e-money issuer.
  - Markets in Financial Instruments Directive 2004/39/EC (MiFID) investment firm.
  - An Undertakings for the Collective Investment in Transferable Securities (UCITS) management company.
  - An entity carrying on an insurance market activity (this does not mean that insurance brokers are precluded from small company exemptions unless they are MiFID).

- A no time during the year the entity was a member of a group that contained:

  - A traded company (being an entity with shares traded on an EEA regulated market).
  - An authorised insurance company.
  - A banking company.
  - An e-money issuer.
  - MiFID investment firm.
  - An UCITS management company.
  - An entity carrying on an insurance market activity (this does not mean that insurance brokers are precluded from small company exemptions unless they are MiFID).

- The company did not head a group which failed to meet the small group criteria (the small group criteria is calculated in the similar way as an individual company criterion, the only difference is that entities are allowed to meet the turnover and the gross assets criteria's on either a net or gross basis. Gross is simply calculated by adding together the figure in each company, net is calculated by excluding intra group transactions and balances.

Choosing to apply the micro-entity regime

This involves producing accounts based on the measurement principals of FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland, and following the disclosure requirement of Section 1 of the Standard.

Annual accounts will comprise of:

- director's report;
- profit and loss account;
- balance sheet;

- accounting policy; and
- notes to the accounts.

Section 1A contains a number of mandatory disclosures which must be given, it then includes disclosures with are recommended.

If the recommended disclosures are given then this potentially involves presenting two further prime statements:

- statement of comprehensive income; and
- statement of charges in equity.

Even when the mandatory disclosures are given in association with the recommended disclosures then a set of accounts still might not show a true and fair view, for example, if your client had a very significant provision then no disclosures would be required specifically by either the mandatory nor recommended disclosures. However, the Standard also notes that preparers of accounts must have regard to all of the disclosure required for large companies if they are necessary to give a true and fair view. Thus, there is always a risk to practitioners of preparing accounts under the small company regime, as noted above no similar risks arise where you follow the micro regime.

Regarding terminology, there are implications (the adaptive formats regime under the Companies Act is triggered) of using IFRS-based terminology, so the simplest option is to carry on using the following terms, profit and loss account, balance sheet, stock, debtors, creditors, tangible fixed assets.

Directors have a choice whether to have prepared for the shareholder 'full' FRS 102 Section 1 A accounts or abridged accounts. It is not possible to prepare 'full' FRS 102 accounts and then file abridged accounts. To prepare abridged accounts directors need to obtain an annual resolution from the shareholders. It is possible to abridge the profit and loss account, or the balance sheet or both. There is little commercial benefit in abridging the profit and loss account as in the majority of cases it will not be filed at Companies House. Abridging the balance sheet removes all of the analysis notes, however, the 'total' column is still needed from the notes which support tangible fixed assets, investment properties, intangible fixed assets and fixed investments.

Whichever set of financial statements is presented to the shareholder can also be filed at Companies House. Alternatively, the directors can take advantage of the small company filing regime and remove the directors' report, the profit and loss account and the notes that support the profit and loss account. This process is colloquially known as 'filleting', and legally known as redaction.

5.3 'Traditional' partnerships and limited partnerships formed under the 1907 Act which do not meet the definition of a qualifying partnership

Ultimately, these accounts will be used as backing for tax computations and to provide management information. For tax purposes, the debits and credits should be based on either the measurement principles of FRS 105 or FRS 102.

For these types of partnerships there are no specific legal requirements regarding the format of the accounts produced. As noted in section 5 above there are a number of general considerations that practitioners should have regard to.

Normally, the accounts should consist of the following as a minimum:

- profit and loss account;
- balance sheet;
- a tabular note containing details of movements in the partners' current account, for each partner individually, and in total;
- a tabular note (if applicable) containing details of movements in the partners' capital account, for each partner individually; and in total; and
- a basis of preparation note.

It is desirable that the profit and loss account and the balance sheet are based on Companies Act formats.

The basis of preparation note should not refer to the accounts being prepared in accordance with *'generally accepted accountants standards'* 'or '*UK generally accepted accountants standards*' as this is meaningless. Instead, there should be reference to them being prepared either based on the measurement principles of FRS 102 or FRS 105. The caveat '*measurement principles'* is needed, as these accounts are unlikely to contain all of the disclosures required by FRS 102, for example.

It is recommended by the IFA that accounting policies are disclosed, and depending on the complexity of the client and the amount of analysis given on the face of the balance sheet, it may also be desirable to have a suite of supportive balance sheet notes.

It is not uncommon to find accounts for partnerships and sole traders often including un-amortised goodwill or un-depreciated buildings. Ideally, these accounting treatments should be avoided since FRS 105 and FRS 102 requires capitalisation and amortisation of goodwill over the expected useful economic life. There is no option for goodwill to have an indefinite useful economic life.

It will be vital that the exact format of the accounts is discussed with the client in advance of their production, and fully documented in writing, maybe in the letter of representation if one is prepared.

5.4 Sole traders and trusts

The guidance in section 2.3 will generally apply to sole traders and trusts. However, where trust accounts are prepared then practitioners may want to consider following the guidance issued by the Society of Trust and Estate Practitioners (STEP), STEP Accounting Guidelines for the Preparation of Trust and Estate Accounts in England & Wales.

5.5 Charities (unincorporated, charitable companies and charitable incorporated organisations (CIOs))

All charitable companies (irrespective of income) need to file accounts with Companies House within 9 months of the year end and with the Charity Commission within 10 months of the year end.

All CIOs (irrespective of income) are required to file accounts with the Charity Commission within 10 months of the year end.

Unincorporated charities need to file accounts with the Charity Commission within 10 months of the year end only if their gross income exceeds £25,000.

Unincorporated charities and CIOs with gross income of more than £250,000 during the financial year, and all charitable companies, must prepare their accounts on the accruals basis in accordance with the Charities Statement of Recommended Practice (FRS 102) (Charities SORP). They contain a balance sheet, a statement of financial activities and explanatory notes. These accounts are required in accountancy terms to show a 'true and fair view'.

Where an unincorporated charity or CIO has a gross income of £250,000 or less during the year, they are entitled to use receipts and payments for preparing accounts. This consists of an account summarising all money received and paid out by the charity in the financial year, and a statement giving details of its assets and liabilities at the end of the year. Charitable companies are not allowed by company law to adopt this method.

Where a charity is entitled to prepare receipts and payments this still might not be possible, due to a clause in its constitution, a direction from the Charity Commission, or commercial issues such as clauses in grant documentation or a banking covenant.

Further information is available on the Charity Commission website. Although the accounts and filing requirements are similar for charities operating in Scotland and Northern Ireland, professional accountants preparing accounts for charities in these jurisdictions should be familiar with the requirements from OSCR for Scotland and CCNI for Northern Ireland.

Please note that professional accountants preparing accounts for charities which require independent examinations will need to take into account the Charity Commission's guidance on independent examinations to determine whether the professional accountant can be involved in the preparation of accounts as well as conducting the independent examination. For example, a professional accountant might be able to perform both types of engagements if they prepare financial statements from a trial balance and are not involved in writing up accounting records.

6. Defining the terms of the engagement

There should be a clear understanding of the terms of the engagement between the professional accountant and the client. An engagement letter includes information on the objective and scope of the engagement, directors' and professional accountant's responsibilities, management representations, form and content of the report to be issued. Having an engagement letter confirms the client's agreement of the engagement and the professional accountant's acceptance of the appointment which avoids any misunderstandings.

The IFA's Framework for Regulation and Best Practice states that 'members engaged in public practice must issue terms of engagement (usually an engagement letter) to clients at the commencement of their engagement'. The IFA has issued guidance notes and a suite of proforma letters of engagement which can be tailored as appropriate.

7. Responsibility of directors

The professional accountant may wish to obtain a letter of representation confirming the responsibilities of directors for the accuracy and reliability of the information provided (see section 11.6).

In the case of a company, Companies Act 2006 requires directors to:

- keep adequate accounting records and preparing accounts which give a true and fair view;
- select suitable accounting policies and then apply them consistently;

- make judgements and estimate that are reasonable and prudent;
- state whether applicable UK accounting standards have been followed, and any material departures disclosed and explained in the financial statements; and
- prepare accounts on a going concern basis unless it is inappropriate to presume that the company will continue in business (see section 11.3).

The directors are also responsible for safeguarding assets of the entity and for taking steps for the prevention and detection of fraud and other irregularities. Engaging professional accountants to compile financial statements does not relieve directors of this responsibility nor does it provide assurance on the adequacy of systems and controls or the incidence of fraud.

8. Management approval of accounts

The directors are responsible for the financial statements. Financial statements should be approved and signed by the directors (or in the case of an LLP by a designated member on behalf of members) before the professional accountant signs the financial statements. Directors' approval is normally evidence by a signature on the balance sheet which states the name of the director signing the accounts on behalf of the board. If a balance sheet is not presented, for example, financial statements are prepared under the micro-entities regime, then the statement should be on the face of the profit and loss account or income and expenditure account.

The directors of companies which are audit exempt are required to acknowledge, on the face of the balance sheet, their responsibilities for complying with the requirements of the Companies Act 2006 with respect to accounting records and the preparation of accounts in accordance with the provisions applicable to companies as well as the entitlement of the company to be exempt from audit.

Where the client signs the annual report in several places, such as is the case with a small company with more than one director, then it is good governance if the signatures are not all those of the same director/designated member.

Example balance sheet statements to be included in the financial statements regarding directors responsibilities and audit exemption for different entities can be found in Appendices 4, 5,6,7 and 8.

9. Planning

9.1 Introduction

It is important to plan all engagements. This will determine the overall objectives and determine how these will be achieved. The extent of planning required will depend upon the size and complexity of the client's business and the professional accountant's experience of the business.

9.2 Planning document

A basic planning document should be prepared, which documents the following:

- background information about the client (which could be documented on a permanent file);
- reporting regime for the financial statements being prepared;
- key issues to be considered such as what financial regime is to be adopted, whether an independent examination or audit is required and ethical considerations;
- records prepared by the client;

- the work that your practice needs to be undertaken;
- evidence that staff have been briefed, including a summary of the areas that have been discussed (unless the whole file is being prepared by the principal of the practice).

9.3 Background information about the client

Sufficient background information must be obtained about the client's business to ensure that the approach can be appropriately planned. This would include details of their business objectives, operations, premises, customers, suppliers, financing, key personnel, and accounting system.

This information could be recorded on the assignment plan for a very simple client or in a permanent file or permanent section of the current file which is rolled forward year on year.
Permanent information should comprise of:

- background information;
- a signed letter of engagement;
- any documents of a permanent nature, such as a completion statement for properties, significant lease agreements etc;
- statutory information such as the entity's constitutional documents; and
- a description of the accounting records (including internal controls).

Where the practice is not in frequent contact with the client, there should be communication with the client to ensure that there have been no developments which has a significant impact of the accountancy assignment or the anti-money laundering risk assessment relating to the client. Further information on anti-money laundering is available on the [IFA's website.]

9.4 Key issues to be considered

9.4.1 Reporting regime

The different reporting regimes for entities are discussed in section 5 of this guidance. It is imperative that the client understands the reporting regimes under which the accounts are being prepared and that, if a choice is available to the client regarding reporting regimes, this choice is discussed with them. If a choice of financial regime is available, the directors of the entity should make a decision regarding which financial reporting regime to adopt not the professional accountant.

9.4.2 Determining whether an audit or other form of assurance is required

IFA members are not able to undertake audit assignments. Whilst there is no reason why a member firm could not prepare the annual accounts and another practice of registered auditors could undertake the audit, the client may prefer to be serviced by only one firm of professional accountants.

If the client is very small, is not part of a group and has a standard Table A Companies Act 2006 memorandum and articles of association then it is relatively safe to assume that they are audit exempt, and answering a few simple questions on the Example Control Record in Appendix 1 should suffice.

If, however, there is any doubt then a detailed entitlement to audit exemption checklist should be obtained and completed.

The professional accountant should also consider whether other types of assurance are required such as an independent examination for a charity. Further information on independent examinations is available in the Charity Commission, OSCR and CRNI websites depending on the relevant jurisdiction of the charity.

9.4.3 Ethical considerations

During the course of the engagement, the professional accountant may become aware that information supplied by management is misleading, incorrect or incomplete. For example, incorrect information is provided, or there is inappropriate usage of the going concern basis (see section 11.3) or inadequate disclosures associated with the financial statements.

In such cases, the professional accountant should discuss the issues with the client in order to rectify the concerns. It is important to remember that the directors of a company have a legal obligation to maintain adequate accounting records and where information is missing, the directors are legally obliged to provide such information.

If the matters cannot be resolved with the client and the professional accountant believes that the financial statements are misleading, then the professional accountant should consider withdrawing from this engagement and should not permit their name to be associated with the financial statements. In such circumstances, the professional accountant should explain to their client the reasons for withdrawing from the engagement unless if doing so would breach regulatory and legal requirements, for example, 'tipping off' under the Money Laundering Regulations.

Further guidance is available in section 4 of the IFA's Code of Ethics.

9.4.4 Receipt and custody of a clients' accounting records

Many clients' accounting records maybe accessed online via accounting and bookkepping software packages or alternatively clients may send in an electronic copy of accounting records. However, clients might also send in either backing documents or their entire accounting records in manual format. In these circumstances it is vital that a comprehensive list is made at the time of receipt of all documents received, not only to identify any omissions, but also so there is documentary evidenced of what documents are held and need to be returned to the client by the professional accountant.

It goes without saying that during the time of the assignment these documents must be kept safe, their location should always be documented, and they should be returned to the client promptly once the assignment has been finalised.

9.4.5 Materiality

On accountancy assignments, materiality should be calculated to ensure that the professional accountant is not associated with misleading accounts by virtue of them containing material errors. Materiality is a useful concept since it helps to:

- direct the work being undertaken, thus ensuring, for example, that time is not wasted calculating trivial prepayments or accruals; and
- justify the approach being adopted, for example, where FRS 102 is being followed often deferred tax is not calculated since it is 'not material'. Having a calculation to support this professional judgement is helpful.

On smaller assignments, a 'ball park' materiality figure could be used, such as £250, £500 or £1,000 on the basis that the client would not care about a figure below this amount.

For larger clients, material should be based on a single financial criterion. This approach is consistent with the calculation of materiality for an audit assignment. It is usual to calculate materiality for an investment company, including property investment companies based on gross assets, a trading company based on profit (or loss) and a charity or a cost centre organisation on expenditure. Turnover might be used as an alternative for a trading company if year on year the profit figure was very volatile.

The table below gives indicative percentages that could be used for the purposes of calculating materiality:

Gross assets	**2%**
Turnover	**1%**
Expenditure	**1%**
Profit or loss	**10%**

If profit is chosen then practitioners may determine whether profit before or after tax is used to calculate materiality, or whether it would be more meaningful to use earnings before interest, taxes, depreciation, and amortization (EBITDA). Irrespective of which figure is chosen, generally, exceptional items should be excluded from calculation, and the figure should always be reviewed to ensure that it appears to be reasonable.

Cumulative errors and unprovided items (like potentially deferred tax) should not individually or in aggregate exceed 75% of materiality. It is normal on most accountancy assignments for all errors to be corrected unless they are clearly trifling.

10. Documentation

The professional accountant should document the work that has been undertaken to demonstrate that the engagement was conducted in accordance with the terms of the engagement and professional obligations. The extent of documentation will vary between clients depending on the nature of the engagement, key issues that arose during the engagement and the complexity of the client's business, risks, accounting procedures and accounting records.

As part of the documentation, it is vital to have lead schedules in the working papers agree to the trial balance and draft accounts. More complex clients will need to have detailed work programmes and working papers, whereas for other clients the work undertaken could be adequately summarised in the planning section of the file.

Irrespective of whether an professional accountant uses an off the shelf procedures manual produced by one of the training consortia, or whether they create their own system for documenting assignments to produce the year end accounts (which might integrate the forms and procedure incorporated into this guidance document), the annual accounts file for the client should contain the following key information:

- A copy of the **signed** accounts presented to the client.
- A copy of the accounts filed at Companies House (if applicable).
- Evidence of the control process.
- A financial disclosure checklist, if considered necessary.
- Evidence of planning:

  - lead schedules, which agree to the supporting schedules and the accounts;
  - summaries of the work undertaken; and
  - a trial balance and journal adjustments which reconcile between any figures produced by the client and those included in the final version of the annual accounts.

Appendix 2 gives an example format for an index that could be used to provide structure to a year end accounts file.

During the course of the engagement, accounting queries should be collated and points summarised for inclusion in the letters of representation or the management letter where these are to be issued. Professional accountants may not consider it appropriate to have letters of representation for smaller low risk clients (see section 11.6).

11. Process and procedures

11.1 Knowledge of the business

The professional accountant should have:

- a general knowledge of the business and its operations of the entity;
- an understanding of the accounting principles, standards and legal and regulatory requirements relating to accounts preparation for the entity and the sector in which the entity operates; and
- an understating of the form and content of the accounts that is appropriate to the entity.

11.2 Procedures

The procedures undertaken by the professional accountant will vary by the complexity of the client and the risk of material misstatement assessed by the professional accountant.

The procedures suggested below are significantly less than would be expected in an audit or assurance engagement. However, they do provide some comfort to the professional accountant that the information that has been provided is accurate and complete.

At a minimum, the professional accountant would normally undertake the following procedures to ensure that the material entries in the accounts are accurate and complete:

- check opening balances with the previous year end accounts;
- confirm significant fixed asset additions and disposals by looking at supporting documentation;
- calculate or re-calculate the gain/loss on fixed assets;
- reconcile key control accounts such as debtors, creditors, and PAYE to the general ledger;
- check the bank reconciliation;
- test stock and WIP;
- check or perform a VAT reconciliation (if the entity is VAT registered);
- cut off procedures to ensure that debtors and creditors are correctly recorded in the correct period.

Overall analytical procedures must be performed on the accounts to ensure that they appear reasonable and are consistent with your knowledge of the business. The focus should be on the overall view given by the accounts and should not be overly concerned with calculating ratios. It is **vital** that this is done, as professional accountants must not be associated with misleading accounts (see sections 4 and 12.4).

As part of this overall analytical review, the professional accountant should consider material misstatements and follow up on unexplained variances with management. If the professional accountant becomes aware of material misstatements, amendments to the accounts should be discussed and agreed with management.

Amendments to the accounts may include adjustment of the figures and reclassification of items in the accounts via journal adjustments. In addition, there may be disclosure amendments that are needed to be made the accounts.

It is important that journal adjustments, amendments to disclosures and unadjusted errors are discussed fully with management as it is not appropriate for a professional accountant to make management decisions. However, some clients will need more guidance and support than others when discussing the accounts being presented to them. Providing guidance and support to the client is acceptable as long as the professional accountant does not make management decisions.

If clients refuse to make amendments to the accounts and the professional accountant considers the accounts to be misleading, they should consider withdrawing from the engagement.

Where there are departures from financial reporting standards which do not make the accounts misleading, provided the appropriate disclosures are made in the accounts, the professional accountant should include an explanatory paragraph in their accountant's report to highlight this departure.

11.3 Going concern

In the UK accounts are produced under either the going concern basis or, where the entity is not a going concern, the break-up basis. It is the responsibility of directors to assess the entity's ability to continue as a going concern.

Under the going concern basis, accounts are prepared on the assumption that an entity is a going concern and will continue its operations for the foreseeable future, unless management either intends to liquidate the entity or cease operations, or has no realistic alternative but to do so. Thus, an entity that is planning to cease trade and become dormant, even if there are no issues regarding their solvency, is deemed not to be a going concern.

All entities must actively consider their going concern status. It is not part of the professional accountant's role to actively search for indicators of potential going concern problems. However, if it becomes clear during the process of preparing the accounts, that the entity does have a going concern issue, then the professional accountant would be expected to bring this to the client's attention and ensure that they are aware of their responsibilities.

Consideration also needs to be given as to whether a Suspicious Activity Report needs to be made to the National Crime Agency (NCA). Fraudulent (illegal) trading is a criminal offence and thus reportable (immediately that the practitioner suspects that it is occurring), whereas wrongful trading is a civil matter and is thus not reportable. The main difference between the two is intent. Business operators who take part in fraudulent trading have a clear intent to deceive and defraud their creditors and customers (as opposed to naivety or over-optimism).

It is worth noting that as it is more difficult in the UK to get a prosecution where a trader is accused of fraudulent trading, that it is common for an action to be taken against them on the grounds of wrongful trading irrespective of whether they have been involved in wrongful or fraudulent trading. The fact that an action is being taken against your clients on the grounds of wrongful trading does not negate your duty to report if you suspect that fraudulent trading has actually occurred.

Where statutory accounts are produced under the small entity regime, the professional accountant must ensure that adequate disclosures regarding going concern are made in the accounts, they should also draw the readers' attention to these disclosures by having an additional paragraph in the accountant's report or an appropriate cross reference (see section 12.5).

Where statutory accounts are produced under the micro-entity regime there is no requirement to make any disclosures regarding an entity's going concern status unless the entity has actually entered into the process of being wound up. Options include encouraging the entity to make appropriate going concern disclosures, including an overview in the accountant's report or alternatively not issuing an accountant's report.

If the professional accountant does not agree with the directors' going concern assessment, they should discuss the matter with the directors to amend the accounts accordingly. If such amendments are not made, and the professional accountant considers the accounts to be misleading, they should withdraw from the engagement (see section 4 and12.4).

11.4 Subsequent events (post balance sheet events)

Any material events arising after the balance sheet date may need to be either disclosed or accounted for in the accounts. If they reflect conditions which were in place at the balance sheet date they should be accounted for (these are known as adjusting post balance sheet events). If they relate to conditions that arose post balance sheet, they should be disclosed (these are known as non-adjusting post balance sheet events).

Where the balance sheet is not heading up as a balance sheet, then the term post balance sheet should be avoided, and replaced with the term 'after the reporting date'.

Where accounts are prepared under FRS 102 then non-adjusting post balance sheet events must be disclosed, as a note to the accounts. Where, micro accounts are prepared for a company or LLP, then disclosure is not necessary, but can be given. Where an event was very significant then ideally it should be disclosed in the accounts of sole trader, trust or partnerships.

11.5 Review of the accounts

Where accounts are produced using accounts production software it is vital that the latest version of the software is being utilised and that the software package is still supported and that practitioners receive regular updates.

Often software packages produce exception reports, highlighting deficiencies or anomalies, these reports must be actioned.

Regarding statutory accounts, even where micro accounts are produced, disclosure errors are still common, therefore, it is recommended that a disclosure checklist is completed ideally annually on every assignment, but at the very least every three years. Alternatively, where the practitioner does not subscribe to a technical support package that provides disclosure checklists, the accounts could be compared to the disclosure requirements in FRS 102 Section 1A or FRS 105 by taking copies of the relevant pages of the applicable standard, and annotating them.

Model and proforma accounts are also available which might also provide a useful tool for reviewing the quality of accounts being produced.

Appendix 3 contains a form that can be used to review the overall quality of accounts produced.

11.6 Management representations

During the preparation of the accounts, reliance is placed by the professional accountant on the accuracy and completeness of information and reliability of estimates, judgements and explanations from directors and management. Therefore, the professional accountant should consider obtaining written management representations which confirms their responsibility for the accuracy and reliability of the financial information supplied. The management representation would normally cover points such as:

- responsibilities;
- accuracy and completeness of information provided to the professional accountant;
- matters involving subjective judgements, e.g. stock valuations or going concern; and
- confirmation of any explanations provided to the professional accountant.

Obtaining a letter of representation from management it not a legal or regulatory requirement but it is considered to be best practice. However, for low risk and clients below a certain threshold, the professional accountant may feel comfortable not to obtain a letter of representation.

Letters of representation should:

- be printed on the client's formal letterhead (this is a legal requirement);
- be dated. Where an accountant's report is to be appended to the annual report, the letter of representation should be dated on or slightly before the date of the accountant's report; and
- be tailored to the client engagement and of a high professional standard. It should be remembered that besides the accounts, on most accounts production engagements, it is the only other documentation of the professional accountant's work that the client sees and therefore it needs to be of a high professional standard.

Below is a summary of the proforma letters of representation which are appended to these guidance notes:

Appendix 9	**Micro company – single director**
Appendix 10	**Micro company – multiple directors**
Appendix 11	**Micro LLP**
Appendix 12	**Small company – single director**
Appendix 13	**Small company – multiple directors**
Appendix 14	**Small LLP**
Appendix 15	**Partnership**
Appendix 16	**Sole trader**
Appendix 17	**Trust**
Appendix 18	**Charitable company – accrual accounting**
Appendix 19	**Charitable trust/Charitable incorporated organisation (CIO) – accrual accounting**

NB: No proforma wording has been provided for any type of charity which adopts receipts and payments accounting.

11.7 'Management' letter/post assignment letter

Whilst usually more associated with an audit assignment at the finalisation stage or just after the engagement has concluded, a professional accountant may wish to issue a 'management' letter. This is not mandatory and will probably not be necessary on most accounts production engagements. However, on some engagements it might be useful to help to protect the accountancy practice or 'add value' to the engagement.

Areas that could be covered would include:

- weaknesses in the client's accounting systems, including internal controls;

- improvements that could be made to the client's financial statements which are not material enough to warrant a modification to the accountant's report but are still worthy of note;
- non-compliance with business rules and regulations;
- general developments that will affect all clients; and
- specific developments relevant to the client in question or the specific sector in which they operate.

11.8 The need to make a report to the National Crime Agency (NCA)

During the production of the year end accounts, a practitioner may come across issues that need to be reported to the NCA. These reports are known as Suspicious Activity Reports or SARs for short. There is no requirement to actively seek reportable issues, but if they are evident from reviewing the client accounting records or from discussion with the client then they need to be acted upon.

Your client does not need to be perpetrator of the crime they could be the victim of the crime; both circumstances are reportable.

Remember where your client is the victim of a crime no report needs to be made to the NCA if: the perpetrator of the crime cannot be identified, **and** no information is available as to the location of the criminal proceeds **and** you have no other information that would be of use to the authorities.

Potentially reportable issues are noted below, this is not meant to be exhaustive:

- Client suffering from fraud by a director, employee, customer, supplier; or third party.
- Illegal trading .
- Intentionally failure to pay the national minimum wage.
- Intentionally employing somebody who does not have the right to work in the UK.
- VAT errors in the favour of the client which are not correct.
- Intentionally retaining an overpayment from a customer.
- Corporation tax fraud; etc.

11.9 Supervision

It is usual for accountancy engagements to be controlled by the director, partner, or principal of the practice. However, this might not always be the case. In such situations, the person who has overall responsibility for the engagement should have adequate knowledge, skills, seniority, and experience to ensure that the engagement is undertaken to a professional standard.

Where the file is not entirely prepared by the person who supervises the engagement, then the file should be subject to review and this should be appropriately evidenced throughout the file.

Whilst not specifically documented, all working papers should be subject to self-review. The preparer of the working papers should take a critical look at the work that they have prepared to make sure that it is clearly documented, adequately cross referenced and most importantly makes sense.

All working papers, except those prepared by the person with overall responsibility and control of the engagement, should be reviewed by a more senior person working on the assignment. This supervisory review should be evidenced on each working paper containing the initials of the reviewer and the date of their review.

The person with overall responsibility for the engagement should review any working papers not already reviewed, review in detail the accounts, and make a judgement on any critical issues identified during the assignment.

11.10 Points forward for next year

It useful to collate information that will aid the completion of next year's engagement. This might include:

- Changes that should be made to this year's approach to facilitate a more efficient engagement being undertaken next year, for example, not wasting time on calculating immaterial prepayments.
- Documenting significant developments that are occurring in the client's business, such as the adoption of a new accounting system, the purchase of a building and changes in its business operations.

12. Accountant's report

12.1 Requirement and purpose

The professional accountant should normally attach a report to the accounts which they have prepared to add credibility to the accounts and clarify the professional accountant's role in the preparation of the accounts.

While there is no statutory requirement for an accountant report, the IFA strongly recommends that where the professional accountant's name is associated with the accounts the professional accountant should issue a formal accountant's report explaining the nature of the engagement. This report should also be included in the accounts filed at Companies House or other authorities such as the Charities Commission.

Where an accountant's report is not included, it is best practice for the professional accountant's name not to appear anywhere in the accounts.

12.2 Reporting on an accounts preparation engagement

Whilst most accountancy production software packages include inbuilt accountant's reports it is usually possible to upload other 'templates', so it should possible for a practitioner to use the IFA's proforma accountant's reports included in this guidance.

However, a professional accountant can choose to use whatever accountant's report they feel is most suitable for their practice. If a professional accountant chooses to modify the report issued by another accountancy body, such as the ICAEW, ACCA or ICAS, then the professional accountant must ensure that nothing alludes to them being a member of that body, if they are not.

Whilst inherently an accountant's report for a company will differ to that produced for a sole trader for example, the accountant's report has similar wording:

(a) A title – identifying the persons to whom the report is addressed (in the case of a company this would be the directors).

(b) A statement that, the professional accountants have prepared the accounts as set out on pages xx to xx from the entity's accounting records and from information and explanations supplied by the client. The report may refer to the specific primary statements and notes to the accounts rather than the page numbers.

(c) A statement that the professional accountants are subject to the ethical and professional requirements of the IFA which can be found at: www.ifa.org.uk/media/1185019/IFA-Code-of-Ethics-effective-March-2020.pdf

(d) A statement that the report is made to management in accordance with the terms of the engagement.

(e) A statement that, to the fullest extent permitted by law, no responsibility will be accepted for the work or the report to anyone other than management as a body. For companies, the responsibility will be to the company and its Board of Directors as a body.

(f) For companies, a statement that management have acknowledged their responsibility for maintaining adequate accounting records and for the preparation of accounts which show a true and fair view of the company's assets, liabilities, financial position and profit [/loss]. Statements of a similar nature may be applicable for other types of entity.

(g) A statement that the professional accountants have not carried out an audit of the accounts, 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 accounts.

(h) The name, signature and address of the professional accountants and any appropriate designation (but not 'registered auditor').

(i) The date of the report.

Whilst it is recommended that statements (d), (e), (f) and (g) above are included in the report issued to management, this is ultimately a risk management decision for each professional accountant.

The accountant's report should be signed in the name of the practice and not in the name of an individual principal of the practice, and it should be signed and dated after the directors have approved and signed the accounts (see section 8 of this document). The address of the practice should also be given, either in full, or alternatively in sufficient detail to identify the practice e.g. 'Maidstone, Kent'.

The IFA's proformas have been designed to make them appropriate for clients, so for example there are two company versions, one for where there is a sole director (which makes no reference to a board of directors) and one for a company that has a board of directors.

It is important that where there are square brackets in the proforma accountant's report that they are suitably tailored. For example, '*in accordance with the terms of our [letter of] engagement'*, if there is no formal letter of engagement in place then '[letter of]' should be deleted.

The Appendices to this guidance contain the following:

Appendix 20	**Limited Company (Multiple Directors)**
Appendix 21	**Limited Company (Sole Director)**
Appendix 22	**Limited Liability Partnership**
Appendix 23	**Partnership**
Appendix 24	**Sole Trader**
Appendix 25	**Trust**
Appendix 26	**Charitable Company**
Appendix 27	**Charitable Incorporated Organisation / Trust Based Charity**

Please note that no proforma wording has been provided in these guidelines for any type of charity which adopts receipts and payments accounting.

12.3 Where accounts are subject to an independent examination or audit

If a set of accounts are going to be subject to an independent examination (or other assurance service) or an audit, then there is little point including an accountant's report.

12.4 Situation where it is unethical to issue an accountant's report your own accounts or those of a related party

It is not ethically acceptable for an accountant's report to be attached to the accounts of your own practice, any other connected entity, or any entity where a principal, or senior manager of your practice is director/designated member, the company secretary or a person with significant control (PSC).

Incorrectly prepared accounts

Professional accountants should not be associated with incorrectly prepared (misleading) accounts; this includes filing them at Companies House or lodging them with the tax authorities.

If the professional accountant becomes aware of any material non-compliance with accounting standards, a SORP or the Companies Act 2006, then they should seek to get these matters regularised. If this is not possible, they should then refer to the matter in a note to the accounts and draw attention to the issues in the accountant's report. See section 12.2.

If the client refuses to allow such disclosure in both the accounts and the accountant's report, then the professional accountant should disassociate themselves from the accounts by not issuing any report and ensuring the firm's name is in no way associated with the accounts. In such cases, a letter should be sent to the client, enclosing the accounts, and explaining clearly why the professional accountant considers the accounts to be incorrectly prepared. The client must be made aware that they cannot represent to any third party that the firm has produced the accounts, as this may create unwarranted assurance and put the firm's reputation at risk. The firm should not act for the client going forward unless they felt reasonably certain that the situation will not arise in future accounting periods.

12.5 Modified accountant's reports

There will be circumstances where the professional accountant wishes to draw attention to an issue that they have identified, or to focus the reader's attention on a specific disclosure or disclosures in the annual accounts.

In these circumstances an additional paragraph or paragraphs should be added to the accountant's report, the most logical place would be as a final paragraph or paragraphs.

There should be a suitable heading such as 'Non-Compliance with FRS 102 Regarding the Amortisation of Goodwill' or 'Going Concern'.

The paragraph should state 'We draw your attention to…'. If information is given in the notes to the accounts and this is in the view of the practitioner adequate, then the practitioner might simply want to state the note number. However, ideally, it would be better to have a summary of the issue.

Where there is no disclosure or incomplete disclosure then a fuller discussion of the issue is needed.

Incorrectly prepared accounts

As noted above, it might be necessary to modify an accountant's report where either disclosure is inadequate or an accounting treatment adopted by the client is not in accordance with the financial reporting regime that they have adopted.

Where the latter is the case, if not disclosed in the accounts, the professional accountant should note what the specific requirement of the Standard is, including noting a paragraph reference(s), as to what treatment the client has adopted, and how this has impacted on the figures in the current, and the comparative information. In simple terms anybody reading the accounts should be aware of how the figures would have been presented if the 'correct' accounting treatment had been followed.

Potentially illegal (unlawful) dividends

Dividends are unlawful when insufficient accumulated profits exist within the company to cover the amounts paid. Rules regarding the payment of dividends are laid down in the Companies Act 2006 which states, 'a dividend or distribution to shareholders may only be made out of profits available for the purpose.'

Only the court can actually determine whether a dividend is illegal (unlawful), however, where it appears that a potentially illegal dividend has occurred, then this should be mentioned in the accountant's report, and also ideally disclosed in the accounts.

NB: Where the shareholders knew the dividend was potentially unlawful (as would be the case if they were directors) then the transaction should be treated as a debtor, if however, shareholders are 'remote' from the company then the potentially illegal dividend is not legally recoverable and should be continued to be shown as a dividend.

Going concern

Where disclosure is made of a material uncertainty regarding the going concern status of the client, or where there is no material uncertainty but reference has been made in the accounts to an issues that might make the reader of the accounts believe such an issue existed, then the accountant's reports should either reiterate these disclosures or contain an appropriate cross reference to the note(s) in the body of the accounts.

Where no such disclosures are made either due to there being no requirement to do so, the client refusing to make appropriate disclosures, then either the accountant's report should be modified, or no report should be given.

Further guidance is included in section 11.3.