



## PROFESSIONAL OVERSIGHT BOARD

### REVIEW OF HOW ACCOUNTANTS SUPPORT THE NEEDS OF SMALL AND MEDIUM-SIZED COMPANIES AND THEIR STAKEHOLDERS

UPDATE - DECEMBER 2007

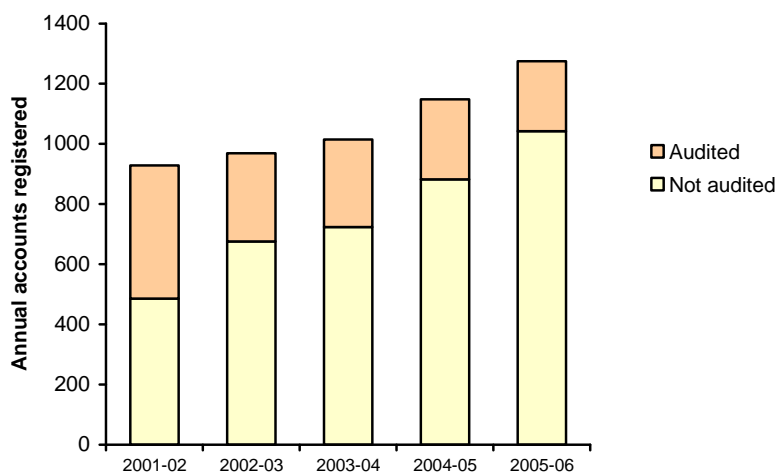
#### Introduction

The Financial Reporting Council (FRC) aims to strengthen confidence in corporate reporting and governance. One way in which the Professional Oversight Board (POB), an operating body of the FRC, contributes to this aim is by seeking to increase the extent to which clients of professionally qualified accountants can rely on them to act with integrity and competence.

In March 2006, the POB published the findings of its review of how professional accountants work with small companies and medium-sized companies and their stakeholders. The POB decided to undertake the review having considered the overall importance of this sector and the significant changes made in recent years to the financial accounting and reporting arrangements for these companies, including the significant take-up of audit exemptions (see diagram below). The review focused on the extent to which directors of small companies and users of their accounts rely on professionally qualified accountants to act with integrity and competence.

The review was based on research including surveys of the views of 600 companies and 1,250 accountants and other business advisers. The POB met with around 25 small professional accountancy practices nominated by the bodies, as well as members of the AAT, IFA, and the Institute of Certified Bookkeepers, and general business advisers. In addition 350 sets of accounts of small and medium-sized companies filed at Companies House were reviewed by the POB together with the professional accountancy bodies.

#### Annual accounts registered at Companies House by type, 2001-02 to 2005-06



Source: Department of Trade and Industry, Companies in 2005-06. Excludes dormant companies.

## Progress in implementing the recommendations

### *Clarifying the role of professional accountants to users of unaudited accounts*

The Review found that individuals and companies who are considering doing, or are already doing, business with small companies whose accounts are not audited are often unclear over the role of professional accountants in the preparation of these accounts.

Very few sets of accounts on the public record include a report describing the involvement of the accountant. Although the professional accountancy bodies provide guidelines to their members on a 'compilation' service and the use of a 'compilation report', the guidelines vary between the bodies. Much of the content of these reports is in the form of negative statements which describe the limitations of the work undertaken. Furthermore, some bodies have recommended that the reports are not attached to the accounts sent to Companies House.

To help users of non-audited accounts, the POB recommended that the bodies should work together to provide a clear explanation of the extent and relevance of the involvement of professional accountants in the preparation of accounts. The POB suggested that this should be achieved through a cross-profession report for non-audited accounts that includes a very broad description of the scope of engagement of the professional accountant together with a positive description of the accountant's professional obligations.

Under their codes of ethics, professional accountants are required not to be associated with accounts where they believe the information to contain a materially false or misleading statement or statements or information furnished recklessly. They are also required to maintain their professional knowledge and skill at the level required to ensure that clients receive competent professional service. These powerful statements, the POB noted, could be more clearly communicated to help ensure they are recognised by directors and users of their accounts.

The use of the cross-profession report for non-audited accounts would need to be supported by new and more secure arrangements for reporting the involvement of professional accountants when accounts are filed electronically at Companies House.

The bodies, through the Consultative Committee of Accountancy Bodies (CCAB), set up a working group to consider a cross-profession report for non-audited accounts. However, in consulting their members, the bodies found concerns and uncertainty over the benefits that such a report would deliver to them or their clients. The POB will accept invitations to participate in further discussions with the bodies and practitioners to explore these issues and, in association with other parts of the FRC, could, if helpful to the bodies, provide more direct guidance.

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*The POB considers that further work is needed to explain the extent and relevance of the involvement of professional accountants in non-audited accounts. The profession should not be over-cautious in explaining the effort taken by its members as a matter of course to provide competent professional services and to ensure that accounts are of high quality.*

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The CCAB has also met several times with Companies House and reports a good level of agreement on the key areas needing development. However, since the POB report was published, electronic filing of accounts has been introduced in a way that shows no evidence of the involvement of accountants. This compares to paper filing where the name of the accountant is often provided.

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*The POB considers that the CCAB should continue to work with Companies House to find a way of disclosing clearly on the public record the involvement of professional accountants in the preparation of unaudited accounts, including those filed electronically.*

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In September 2006, the ICAEW launched a consultation exercise to explore the financial information requirements and assurance needs of businesses that fall below the statutory audit threshold. Alongside this, the ICAEW launched a new assurance service that chartered accountants can offer clients who would like an independent report on their annual accounts.

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*The POB notes that it is yet to be established whether there is a need for an assurance service in the 'gap' between professional accountants' standard accounts preparation services and audit. Improved clarity over the role of professional accountants in the preparation of non-audited accounts is necessary before this can be fully explored.*

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*Ensuring that there is substance behind the description of the role of professional accountants*

The Review found that a sizeable minority of accounts filed on paper at Companies House, including those prepared with the involvement of professional accountants, included technical issues, errors or other evidence of a lack of care in preparation. The POB recommended that the bodies should take steps (including those they had proposed) to help improve the quality of financial accounts which have the involvement of their members. The bodies were asked to report formally to POB on the effectiveness of these steps in April 2007.

The bodies have taken steps, including publicising the problems, providing guidance to their members and assessing the quality of accounts during quality control visits. Bodies reported that more time is needed before they can measure the effectiveness of these steps.

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*To help ensure that there is substance behind the explanation of the role of professional accountants, the POB considers that the professional bodies should continue their work to improve the quality of accounts prepared with their members' input. The POB would expect them to be able to measure the effectiveness of the measures by Spring 2008.*

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*Helping directors of small companies to assess their need for support from professional accountants*

The Review found that some directors of small companies were unclear over the options available to them for their financial reporting and how they can obtain help with it.

Following the introduction of audit exemption, directors of most small companies were now free to choose different types of accountancy advisers. Some directors did not know whether their advisers were professional accountants or why this might be important. This may reflect a shortage of suitably qualified bookkeepers, which can result in professional accountants carrying out routine record-keeping work for their clients.

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*The POB appreciates the work of the professional bodies in implementing the recommendations made in this Review. However, as set out in this project update, in our view further work is needed to help ensure that professional accountants are able to continue to meet the needs of directors of small companies and users of their accounts with integrity and competence.*

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Some company directors were filing abbreviated accounts at Companies House without a full understanding of the commercial implications of this choice. Many directors were also unclear whether they are filing audited or unaudited accounts. Some appeared not to be aware that certain user groups, particularly credit managers, may look for an audit and may be more cautious in the absence of it.

Some directors appeared not to appreciate the value of good financial information. These directors do not look for support in understanding or interpreting financial information, often see accounting merely as a regulatory burden and may not have good financial information to inform their decision making.

The POB recommended that the professional bodies work together to explain the role of professional accountants to directors of small companies. The POB also recommended that the bodies should also explain to directors their options in respect of filing abbreviated or full accounts, having the accounts audited, and using accounting information to achieve good financial management.

The bodies drew attention to their publications and other initiatives which provide these explanations to directors of small companies. One suggested that general information campaigns of a scale necessary to increase awareness amongst company directors are beyond the combined budgets of the accountancy bodies. Several bodies suggested that statutory recognition of the term "accountant" would help directors to better understand the role of professional accountants.

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*The POB considers that the bodies should work collectively rather than individually to more effectively provide information to help directors of small companies assess their need for support from professional accountants.*

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