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Guidance Bulletin for Practitioners

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Independence and the sole proprietor and small firm

The *CGA Code of Ethical Principles and Rules of Conduct* contains rules on independence.

These rules require a member to:

1. assess their level of independence with respect to all professional engagements,
2. comply with the *CGA-Canada Independence Standard* with respect to assurance and specified auditing procedures engagements, and
3. adhere to specific disclosure, communication, and documentation requirements surrounding independence.

Assurance and specified auditing procedures engagements and independence

The *CGA Independence Standard* deals with independence and assurance and specified auditing procedures engagements and is applicable to members and students engaged or employed in the practice of public accounting.

The Standard forms part of the *Code of Ethical Principles and Rules of Conduct* and is modeled after the International Federation of Accountants Code of Ethics, Part B – Section 8, “Independence for Assurance Engagements.” The Standard provides a framework that members must use to assess their level of independence. The process outlined in the framework involves identifying and evaluating threats and, where appropriate, ensuring safeguards are in place to counterbalance any threat to independence. If the threat is such that safeguards cannot reduce it to an acceptable level, the member must either eliminate the threat or decline the engagement. This process must be done formally at the start and end of each engagement with periodic reviews during the engagement.

Network firms are included in the Standard. A network firm is an entity under common control, ownership, or management within the firm, or any entity that a reasonable and informed third party, having knowledge of all relevant information, would reasonably conclude as being part of the firm nationally or internationally. Thus, firms with a national arrangement to use a common brand name or to share significant professional resources would be considered network firms.

The Standard includes prohibitions relating to assurance engagements, specified auditing procedures engagements, audit and review engagements, and audit engagements of listed entities when safeguards are not appropriate. Prohibitions are denoted in italics within section 4 of the Standard. Prohibitions extend beyond financial interests to activities such as the provision of valuation, information technology, internal audit, and non-assurance services such as preparing accounting records and financial statements.

It is the responsibility of the member to document the process and results of the independence assessment. At a minimum, documentation should include a description of the nature of the engagement contemplated, the process of review, identification of any interest, relationship or influence that might give rise to a threat, safeguards chosen and applied to reduce any threat identified, and why the member concluded that these safeguards are adequate. This documentation should be retained in the client engagement file and updated as the engagement progresses.

Compilation engagements and independence

The requirement to disclose the lack of independence when performing compilation engagements continues to exist. The member must disclose any lack of independence to the client in the Notice to Reader. The disclosure should be complete and direct. An example would be when a practitioner performs management functions such as preparing source documentation (such as journal entries or coding of invoices) without client approval or having custody of client assets. An example of the disclosure required would be: “We performed management functions for {client name}.”

Although the *CGA Independence Standard* applies to assurance and specified auditing procedures engagements, it is recommended that a member use the framework, examples, and prohibitions when assessing independence in all engagements undertaken. In particular, the member should avoid those activities identified as impairing independence in the far right column of the following table. These activities create a significant amount of risk and practitioners should exercise caution.

Independence issues in other professional engagements

In addition to the requirements outlined above, a member is still required to disclose any interest, influence, or relationship to the client (or employer) that has the effect or appearance of impairing independence. Examples of this are, where it is not normal business practice, receiving fees or commissions regarding the selling or recommending of a service or product and rendering advice to two or more clients in the same transaction (including any confidentiality issues that might arise).

Table of services and questions and answers on services provided to assurance clients

The following two sections — the table and FAQs — provide examples of common services and consider whether independence would be impaired. The provision of these examples does not relieve members of the need to assess each specific situation. Also, keep in mind that moving from independence impaired to

independence not impaired can often be accomplished by employing the two strongest safeguards, which are critical methodologies for a safe practice — seeking informed client approval and documentation.

The following information does not extend to audit engagements for listed entities.

Non-assurance service provided in conjunction with an assurance engagement	Independence not impaired	Independence impaired*
Preparing accounting records and financial statements	Preparing financial statements based on information in the trial balance.	Authorizing or approving transactions.
	Posting client approved entries to the trial balance.	Preparing source documents for the client.
	Recording of transactions when management has determined or approved the account classification, or posting client-coded transactions to the general ledger.	Determining or changing journal entries, account coding, or classification for any accounting record without client approval.
	Proposing standard, adjusting, or correcting journal entries that affect the financial statements provided the client reviews and understands the nature and the impact of the entries.	Making changes to source documents without client approval.
	Transmitting client-approved payroll or other disbursement information to a bank or other financial institution when the client has authorized the member to make the transmission and has arranged for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, the client must authorize the financial institution to process the information following transmission.	Signing or co-signing cheques, even if only in an emergency.
	Using client-provided and client-approved time records, generating unsigned cheques, or processing client's payroll.	Authorizing or approving disbursements for payroll or payroll taxes.
	Preparing government remittance forms for client approval and payment.	Signing government remittance forms on behalf of client management.
	Preparing cheques for client approval and signing.	Approving vendor invoices for payment.
		Controlling or having custody of a client's funds and making credit or banking decisions for the client.

Non-assurance service provided in conjunction with an assurance engagement	Independence not impaired	Independence impaired*
Provision of investment advisory or management services	<p>Reviewing how investment account managers are managing a client's portfolio, such as determining if account managers are:</p> <ol style="list-style-type: none"> 1. following the client's investment policy guidelines, 2. meeting the client's investment objectives, and 3. conforming to the client's stated investment styles. 	<p>Having possession of client-purchased securities.</p>
	<p>Recommending to the client the allocation of funds to invest in various asset classes, depending upon the client's desired rate of return, risk tolerance, and so on.</p>	<p>Making investment decisions on behalf of client management or otherwise having discretionary authority over a client's investments.</p>
	<p>Performing recordkeeping and reporting of client's portfolio balances including the provision of a comparative analysis of the client's investments to third-party benchmarks.</p>	<p>Executing transactions to buy or sell client's investments.</p>
	<p>Transmitting a client's investment selection to a broker-dealer or equivalent provided the client has authorized the broker-dealer or equivalent to execute the transaction.</p>	<p>Acting in the capacity of broker-dealer or equivalent in the execution of investment transactions.</p>
Provision of IT systems services	<p>Installing an off-the-shelf accounting package.</p>	<p>Designing, developing, and implementing a client's financial information system.</p>
	<p>Training or instructing client employees on an information and control system.</p>	<p>Operating a client's IT system, including hardware and software, as well as the data used or generated by the system.</p>
	<p>Designing, developing, installing, or integrating a client's information system that is unrelated to the client's financial statements or accounting records.</p>	<p>Supervising a client's staff in the day-to-day operation of their information system.</p>
	<p>Assisting in the setup of a client's chart of accounts and financial statement format with respect to the client's financial information system.</p>	<p>Performing significant modifications to the source code underlying a client's existing financial information system.</p>
Provision of human resource services	<p>Reviewing the professional qualifications of applicants.</p>	<p>Searching for or seeking out prospective candidates for management, executive, or director positions.</p>

Non-assurance service provided in conjunction with an assurance engagement	Independence not impaired	Independence impaired*
	Advising on the suitability of candidates for a position, provided the criteria for doing so is established by the client and that all management-related decisions, including who to hire, are retained by the client.	Engaging in psychological testing, or other formal testing or evaluation programs for staff of a client.
		Performing reference checks of prospective candidates for an executive or director position.
	Assisting in the preparation of a short-list of candidates for interview, provided the criteria for doing so is established by the client and that all management-related decisions, including who to hire, are retained by the client.	Acting as mediator or negotiator on behalf of a client with respect to employees or future employees regarding any condition of employment, including position, status or title, compensation or fringe benefits.
		Recommending or advising a client to hire a specific candidate for a specific position.
Provision of dispute resolution services	Providing advice in dispute resolution services provided members of the assurance team are not involved in the service and the client makes the ultimate decision.	Providing dispute resolution services when the amounts involved are material in relation to the financial statements.
Provision of valuation services	<p>Providing valuation services that involve the valuation of matters not material to the financial statements and not involving a significant degree of subjectivity provided the following safeguards are in place:</p> <ol style="list-style-type: none"> 1. a colleague who is not a member of the assurance team reviews the work or otherwise advises as necessary, 2. the client understands and approves the underlying assumptions of the valuation and the methodology to be used, 3. the client acknowledges their responsibility for the results of the work, and 4. staff involved in the provision of the services do not participate in the assurance engagement. 	Providing of valuation services that involve the valuation of matters material to the financial statements and a significant degree of subjectivity.

* These activities create a significant amount of risk and practitioners should exercise caution.

Frequently asked questions

Providing non-assurance services to assurance clients

1. **I record journal entries while performing monthly bookkeeping services *without* obtaining client approval. Is this allowed?**

No. In order for you to maintain your independence the client must review and approve the journal entries. You must also be satisfied that management understands the nature of the proposed entries and the impact the entries (will) have on the financial statements.

2. **During the course of providing monthly bookkeeping services, I receive invoices from the client, indicating approval for payment and identifying the appropriate general ledger accounts in which to record the transaction. I prepare the client's cheques for payment of those invoices, record the transactions in the client's general ledger system, and return the cheques to the client for approval and signature. I do not have signing authority on the client's chequing account. Is this allowed?**

Yes, because management determined and approved the appropriate account classifications, approved the invoices for payment, and reviewed and signed the prepared cheques. You should also ensure that the government remittance forms are signed by the client.

3. **During the course of providing monthly bookkeeping services, I discuss with the client the need to record recurring journal entries (for example, amortization expense) each month in the general ledger. The client approves the recurring journal entries and makes any necessary decisions (for example, useful lives of the assets). I then record these entries in the client's general ledger each month. Is this allowed?**

Yes, because steps have been taken to ensure that the client understands the general nature of the journal entries and the impact they have on its financial statements.

4. **A client records all disbursements in its chequebook and identifies the type of expense (for example, telephone or rent) on the chequebook stubs. During the course of providing monthly bookkeeping services, I assign the general ledger account number based on the type of expense indicated by the client and record these payments in the client's accounting system. Is this allowed?**

Yes, independence is not impaired because you are not classifying the transactions.

5. **During the course of the audit or review engagement, I propose adjustments to the financial statements. Examples of these entries include the current tax accrual and future tax assets or liabilities and the amount of amortization necessary for the current year. The client reviews these entries, understands the impact on its financial statements, and records the adjustments identified. Is this allowed?**

Yes, proposing entries is a normal part of audit and review engagements, and the client understands the general nature of the entries and the impact they have on its financial statements.

6. I prepare a bank reconciliation of my client's bank account in connection with monthly bookkeeping services. The client reviews and approves the bank reconciliation. Is this allowed?

Yes, because the client reviews and approves the bank reconciliation and understands the services performed sufficiently to oversee them.

7. I assist a client in understanding the nature of adjusting entries and their impact on the financial statements. Is this allowed?

Yes. If a client needs assistance in understanding the nature of the entries and their impact on the financial statements, you should explain the accounting principle(s) that give rise to the adjustment(s), as well as the impact of the adjustments on the financial statements.

8. I operate a client's local area network (LAN) system. Is this allowed?

No. Operating a client's LAN is considered a management function that would impair your independence. Having the responsibility to operate such a system for the client, even with client oversight, is not deemed to provide a sufficient safeguard to independence. While it is acknowledged that the actual operating processes of a LAN could be mechanical in nature, it is still felt that such operation is a management function, and thus must be avoided.

9. I perform network maintenance (for example, updating virus protection, applying updates and patches, or configuring user settings consistent with management's requests) on a client's local area network (LAN) system. Is this allowed?

Yes. Performing network maintenance is not "operating" the LAN provided a competent client employee is making all decisions and approving all activities.

10. I assist a client in procuring and securing Internet access. Is this allowed?

Yes, provided a competent client employee makes all decisions as to the Internet provider and services provided.

11. I assist in the performance of a client's internal audit activities. Is this allowed?

Yes, provided the client is responsible for internal audit activities and acknowledges in writing its responsibility for establishing, maintaining, and monitoring the internal control system. The client must evaluate and determine which of your recommendations are implemented and designate a competent employee (preferably in senior management) to be responsible.

12. I provide taxation services to an assurance client. Is this allowed?

Yes. Taxation services including compliance, planning, provision of formal taxation opinions, and assistance in tax disputes generally will not impair independence.

When representing clients with Canada Revenue Agency, or any third party, it is important that the member avoids the promotion of the client's position at the expense of the member's own objectivity and professional judgment as this would be considered an advocacy threat. Examples of safeguards to use in this instance would be to use a staff member that is not a member of the assurance team, ensure that the client makes informed decisions, and document.

13. The total fees generated by a single assurance client represent a large portion of my total fees. Is this allowed?

Yes, however the dependence on that client and your concern about losing the client may create a self-interest threat to independence. Safeguards available that may reduce the threat to an acceptable level include:

- discussing the extent and nature of fees with members of the audit committee, or in the absence of an audit committee, those charged with governance;
- taking steps to reduce dependency on the client;
- performing external quality control reviews; and
- consulting with a third party such as a professional colleague or the member advisor of your provincial Association.

14. I provide advice or assistance to a client in arranging financing. Is this allowed?

Yes, because you are not making a management decision on behalf of your client.

15. I provide resumes that were dropped off at my office to my client for a specific position. In doing so I called the candidate to ask them if they would consent to this. The client hires one of the candidates. Is this allowed?

If the client makes the decision as to who to hire and it is a non-management position, this would normally be allowed. If it is management position independence would be compromised. Safeguards such as client consultation, consent, decision-making, and documentation are critical.

16. Must I rotate my lead engagement partner of an audit of a long-standing client?

It is inevitable that this situation creates a familiarity threat. Rotation is suggested but not mandated unless the client is a listed entity. If rotation is not possible, it is critical that this file be either reviewed by a professional colleague that was not involved in the audit or reviewed during regular practice reviews by the Association. Again, thorough documentation of informed client consent is key.