

Behind the Counter

The Accounting Engagement

A small business would need to hire an accountant for the following reasons:

- 1) To fill out the T2124 for the Canada Revenue Agency if the business is a sole proprietorship
- 2) To fill out the T2 corporate return for the Canada Revenue Agency and produce the associated financial statements
- 3) To audit or review financial statements required for a bank loan or purchase/sale of a company
- 4) To communicate with the Canada Revenue Agency on its behalf with respect to tax questions.

Currently a sole proprietorship's financial information is usually only the income statement and is filed with their personal return because since they are the only owner, they are taxed on any net income that they have made at their personal tax rates. This is a quick and dirty statement. It is usually the least expensive type of arrangement for a small business, but it does nothing to help plan for the future or manage your business or identify trends in your business. Also, the accuracy of the information is only based on the accuracy of the information compiled by the client and based on how well the client keeps accounting records.

I have several clients that arrive at tax time with an entire year's worth of receipts, expect the receipts to be organized for the tax return and then analyzed to help save them taxes. A task like that is sort of like trying to change 4 tires in under 10 min, it can be done, but it isn't pretty and they may not all be balanced. I continue to suggest that perhaps we could receive these items on a quarterly or semi-annual basis when we may have some time to really look at the data and make some really profound suggestions.

Alternatively, if the sole proprietorship is larger, meaning that staff are employed, there are many transactions and many customers and suppliers, many accounting firms are performing a compilation engagement, or what is called a 'Notice To Reader' engagement. This is the same engagement that is required by incorporated companies for the purposes of putting together the Corporate tax return. It is the generation of the Balance Sheet and Income statement and in most cases the use of generally accepted accounting principles. By using generally accepted accounting principles from period to period, when we go to analyze financial data we can be assured that the same assumptions or methodology was used from period to period which would make the numbers comparable. The data or methods used by the client do not necessarily need to conform to generally accepted accounting principles so note disclosure is not required, but the information cannot be false or misleading. If there is any question about the correctness of the data during the engagement, the accountant has a duty to

investigate and amend the information, or to resign from the engagement. The accountants report on the first page of these financials is called a 'Notice to Reader' and it serves to warn the users of these financial statements that the information contained in the statements is limited and should not be relied upon for 'informed' decision making. The paragraph also states that the information has not been audited or reviewed for completeness or accuracy.

The next level up in an accounting engagement that is required by most lending institutions is a review engagement. This is the review of financial information provided by the client through statistical analysis, enquiry and external confirmation with the desired result being that the financial statements are believable or plausible. The financial statements need to have been prepared in accordance with generally accepted accounting principles, however, they have not been audited, so 'Unaudited' must appear on every page of the financial statements. The accountant's report attached to the review engagement provides what is called 'negative assurance' in that it states that nothing has come to the accountant's attention that would indicate that the financial statements are materially misstated.

Finally, an audit engagement requires an auditor's report which is the opinion of an auditor. This is the highest level of engagement that an accountant can perform. This type of engagement is said to provide 'reasonable assurance' that the financial statements are fairly presented. It does not guarantee absolute assurance because the only way that could be achieved would be to completely re-post all the entries and redo all the work previously done by the company to see if the results are the same and that would be very costly. The audit process usually consists of using a test basis to examine the accounting records, study and evaluation of the company's internal controls, enquiry of staff and external customers and suppliers, observation of the existence and use of assets and the use of statistical analysis and comparison to industry standards. The BC Corporations Act legally requires each company to have an audit, but will allow companies that do not have shares that are traded on the public market to waive the audit requirement if all the shareholders agree in writing. Most small audits can take up to 65 hours of work and can be extremely expensive. Most not-for-profit entities that receive funding from the government require audits.

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