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MEHJOO CASE OVERTURNED ON APPEAL

The Mehjoo case judgment (**EWHC 1500**), on the alleged professional negligence of a tax adviser, was the subject of much discussion in the tax profession during 2013. That judgment was overturned by the Court of Appeal on 26 March 2014 (**EWCA Civ 358**).

Whilst it is early days for analysis, or any decision as to whether it may be appealed again, initial observations on the judgment are as follows:

1. Whilst the outcome does appear to be more in line with many tax professionals' original expectations, there is no room for complacency around duty of care. Engagement letter terms and client expectations still need to be carefully scoped and managed well; the latest version of ICAS' Professional Conduct in Relation to Taxation which can be found at: **http://icas.org.uk/home/technical-and-research/technical-information-and-guidance/tax/Professional_Guidance/** discusses this further.
2. This judgment is fact-specific on a number of particular circumstances, giving practical application of existing principles rather than establishing new principles. As such it is difficult to draw broad conclusions on its likely impact, beyond deterring any 'bandwaggoning' litigation following the original judgment.
3. The engagement, or retainer, letter terms and duty of care can be expanded by implied terms but on a more limited basis than the original judgment decided; whilst pointing out that advice on the income and capital gains tax implications of non-domicile would be expected to be given, that would be only if it was relevant to advice on routine tax planning (see below). It was not considered that the adviser in those circumstances should have considered the potential relevance to non-domicile status of the possibility of changing the location of shares too.
4. A distinction could be drawn between more routine tax advice or tax planning covered by general engagement terms, and the more "sophisticated" advice, often to do with a greater extent of financial re-engineering and transaction restructuring, rather than around mitigating tax on an unchanged course of action. In the Mehjoo case, greater evidence of an express request for advice in that area of "sophistication" was needed for the duty of care to have been extended to advice beyond routine planning.

Overall, this judgment is a more comfortable read than that from the earlier courts, not simply because it did not extend to extensive tax technical analysis of marketed tax avoidance schemes. However, we remain in a litigious environment and expectations of chartered accountants are high; it would be dangerous to reduce focus on quality and risk management matters as a result of this outcome.

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ICAS

CIS INITIATIVE – IMPROVEMENTS IN THE PIPELINE

Since September 2011 HM Revenue & Customs (HMRC) and various professional body representatives have been working through the Joint Initiative on HMRC Service Delivery to meet the recommendations made by the House of Commons Treasury Select Committee to work closely to improve the end-to-end experience of dealing with HMRC.

Part of its work has focused on ways to improve the Construction Industry Scheme (CIS) repayment process. Since April 2014, users can expect an improved experience when they request a CIS repayment, whereby:

- HMRC aims to process a company's CIS repayment claims received in writing/online within 25 working days (or fewer) from the date of receipt, where the information sent matches the information HMRC holds;
- Where there is a mis-match, HMRC will need to investigate the discrepancy with the agent/customer - the speed at which the full repayment can be processed will be determined in part by the agent/customer response;
- In these circumstances HMRC will make a part repayment of the amount matched/verified and will aim to do so in the above timeframe;
- HMRC will make a repayment or part payment via a BACS payment if the full bank details are included on the claim form.

Other aspects of improved service:

- HMRC may offset the company's CIS repayment against its Corporation Tax or VAT liabilities so long as:
  - o the CIS repayment covers the full amount of the Corporation Tax or VAT due;
  - o the company informs the relevant department for the collection of either Corporation Tax or VAT that they have sent a claim for repayment;
  - o if the company meets these two conditions, HMRC will stop the recovery of the Corporation Tax or VAT debt to allow for the repayment to be allocated against it.
- If the company meets these conditions, HMRC will stop the recovery of the Corporation Tax or VAT due to allow time to process the repayment claim.

Looking ahead, HMRC is aiming to:

- Publish revised Guidance around Real Time Information (RTI) in April 2014;
- Work with the professional bodies to improve the operation of CIS in 2014 and consult with them over the summer on options for further improvements.

ICAS tax department would welcome feedback on this initiative so that we can tell HMRC how this initiative is working or of instances where the system has improved. Please tell us your experiences at **tax@icas.org.uk**.

HMRC'S NEXT WAVE OF NUDGE LETTERS

HM Revenue & Customs (HMRC) is continuing with its 'nudge letters' which are risk-based and designed to prompt a change in a taxpayer's behaviour. To date, nudge letters have often been sent to taxpayers, regardless of whether they have an agent, and often without a copy being sent, or any forewarning, to the agent. Strong representations have been made against this and therefore it is to be welcomed that HMRC has given forewarning of their next series of letters. HMRC has announced that it will be using data received under the EU Savings Directive to contact its customers, encouraging those with undeclared income offshore to come forward now.

As outlined in the recently published "*No Safe Havens 2014*", which can be found at: **https://www.gov.uk/government/publications/no-safe-havens**. HMRC will be launching more taskforces throughout this year using information on offshore accounts.

Some of your clients may be sent letters about this information in the coming weeks. These are not enquiry notices but they do ask about offshore income and gains, so some of your clients may be in touch with you. Customers who need to reply to HMRC will have 30 days in which to do so.

HMRC has said that this will help inform its approach to bulk offshore data before we receive more information on offshore accounts under the Foreign Account Tax Compliance Act (FATCA) and similar automatic exchange of information agreements with the UK Crown Dependencies and Overseas Territories (and, once finalised, the Organisation for Economic Co-operation and Development Common Reporting Standard). Those who have already declared their income, and have nothing to hide, have nothing to worry about but anyone hiding undeclared income offshore must understand HMRC is closing in and should come forward now.

HMRC uses data from a variety of sources to help inform its compliance activity, including data from the Isle of Man, Jersey and Guernsey. Anyone who has something to declare and has an account in one of these jurisdictions should take a look at the offshore disclosure pages which can be found at: **www.hmrc.gov.uk/offshoredisclosure/** or contact the Offshore Disclosure Facility Helpdesk on 0300 123 1080.

PAYE INTEREST – HMRC ANNOUNCES NEW APPROACH

From April 2014 onwards, HM Revenue & Customs (HMRC) has changed how it charges interest on late payments of PAYE. HMRC now charges in-year, rather than annually, interest on all unpaid:

- PAYE tax, Class 1 National Insurance and Student Loan deductions including specified charges
- Construction Industry Scheme (CIS) charges
- In year late filing penalties – which start from October 2014
- In year late payment penalties – which will be charged automatically from April 2015

Table 1 details when interest will be charged from and the date it is charged to:

Current interest rates are available at: **www.hmrc.gov.uk/rates/interest.htm**.

Guidance on operating PAYE in real time can be found at: **www.hmrc.gov.uk/payerti/index.htm**.

Table 1

Charge	Interest charged from	Interest charged to
PAYE, Class 1 NI, Student loan deductions & CIS scheme	19 of relevant month/ quarter for cheque payments and 22 for all electronic payments	Date payment made in full
Earlier Year Update	19 April for all cheque payments and 22 April for all electronic payments	
Penalties	Relevant due date of the penalty charge	
Class 1A NIC charges	19 July for all cheque payments and 22 July for all electronic payments	
Class 1B NIC charges	19 October for all cheque payments and 22 October for all electronic payments	

HMRC OPENS NEW DEBT MANAGEMENT AND BANKING LINE

HM Revenue & Customs (HMRC) has opened a dedicated agent line for dealing with clients' debt management and banking issues, a move welcomed by ICAS. The helpline, which provides a priority service, can be accessed on 0300 200 3887 and is available from 8am to 8pm Monday to Friday. It is also open from 8am to 4pm on Saturdays and Sundays for debt management and banking issues related to self-assessment and tax credits.

We would like to hear any member's experiences in dealing with the new helpline at: **tax@icas.org.uk** so that we may feed this back to HMRC.

HMRC CAMPAIGNS AND TASKFORCES – AN UPDATE

Second incomes campaign

HM Revenue & Customs' (HMRC) latest campaign targets second incomes. The campaign is aimed at individuals who may earn additional income through activities such as:

- Consulting eg providing training;
- Organising parties and events;
- Providing services such as taxi driving, personal training or hairdressing;
- Making products and selling them;
- Buying and selling goods eg at market stalls or car boot sales.

Those wishing to make a disclosure under the scheme must first of all fill in a notification form, which is available at: **http://www.hmrc.gov.uk/forms/d01-second-ic.pdf**.

The next stage in the process is to complete a disclosure form, available from **http://www.hmrc.gov.uk/forms/d02-second-ic.pdf**.

Individuals have 4 months from acknowledgment from HMRC of receipt of the notification to submit their disclosure form and pay over any tax

that is due.

More information on the campaign can be found at: **https://www.gov.uk/secondincomes**.

Let property campaign

HM Revenue & Customs' Let Property Campaign is under way and information so far indicates that this particular initiative may be recouping high levels of underpaid tax for the Treasury. One way that shows that HMRC is leaving no stone unturned is by going directly to the letting agents themselves and asking them to sign disclosures in relation to the landlords for whom they act. As well as owners of residential property, owners of overseas holiday homes who also let their properties are being targeted too. In these cases, HMRC is, for example, going direct to online lettings portals (of which there are many) to obtain details of the property owners. At present, those taxpayers who make a disclosure under the campaign have three months from the date of disclosure to pay any tax that is due.

More details of the Let Property Campaign can be found at: **https://www.gov.uk/let-property-campaign**.

HMRC TOOLKITS UPDATED

HMRC has published three updated agent toolkits which aim to reduce the level of errors in tax returns. The updated toolkits cover company losses, property rental income and directors' loan accounts.

A full list of toolkits can be accessed at: **www.hmrc.gov.uk/agents/prereturn-support-agents.htm**.

VAT TREATMENT OF TEMPORARY WORKERS – CLAIMS FOR OVERPAID OUTPUT TAX

Prior to 1 April 2009, HM Revenue & Customs (HMRC) allowed, by concession, that where employment businesses made a supply of temporary staff, VAT was only chargeable on the commission element of the fee charged to the client. Thus, the element of the fee that was essentially the salary and tax cost of the worker was free of VAT. This was a very valuable concession for partially exempt or non-VAT registered businesses. This concession was removed on 1 April 2009, with the effect that where an employment bureau provides staff as principal, VAT is chargeable in full on the whole amount payable for the supply. However, where an employment business merely introduces a worker to a client (thus acting in an agency capacity), VAT remained only chargeable on the introduction fee.

This distinction between supplies of services of arranging for the provision of temporary staff as principal or agent was tested in the First Tier Tribunal by **Reed Employment Limited (LON/2004/130)** with the result that the Tribunal found in favour of Reed (such that Reed was acting in an agency capacity only, predominantly because Reed didn't control the workers). This was held to be the case, despite the fact that Reed was paying the relevant workers and deducting employment taxes. What mattered was whether the relationship between the parties was, in reality, one of agent or principal. Thus Reed was only liable for output tax on the charge made for introducing workers to clients, under these contractual arrangements and was able to reclaim overpaid output tax on the salary and tax element of their fee.

HMRC have made it clear that the Reed decision does not set any precedent and is wholly limited to the facts of the particular case. This issue is therefore likely to be tested again through the Courts and it will be interesting to see how the decisions pan out. The case of **Hays Personnel (Lon/95/2610)** found that Hays was a principal and VAT was therefore due on the whole consideration received.

In the meantime, employment bureaux should consider reviewing the contracts that they have with their clients in order to determine whether in fact an agency relationship exists, rather than one of principal. In situations where the bureau has no control over the activity of the worker and in reality, all that has been provided is a service of introduction, it may be worth submitting a protective claim for overpaid output tax (going back four years). Such businesses may find their clients demanding repayment of VAT overcharged to them in such situations and therefore making a protective claim would be a prudent course of action.

VAT: CHANGES TO PLACE OF SUPPLY RULES AND THE VAT MINI ONE-STOP-SHOP (MOSS)

On 1 January 2015 the place of supply rules will change for business to consumer (B2C) supplies of broadcasting, telecommunications and e-services (BTE). The rules pertaining to supplies to business customers (B2B) are not affected. In addition to the changes to these rules, the VAT mini one-stop-shop will be effective.

Changes to the place of supply rules

The place of supply of BTE services is currently the place of belonging of the supplier; thus for suppliers belonging in the UK, UK VAT is charged on all such supplies provided to private individuals. From 1 January 2015, the place of supply will become the location of the consumer, effectively taxing these supplies where they are consumed. Thus such supplies made by a UK supplier to a private individual in France, become liable to French VAT. This is obviously significantly more administratively complicated. It will be necessary to determine the location of all private customers and potentially register for VAT in numerous EU member states. In order to minimize this administrative burden, the member states have agreed to cooperate and introduce the mini one-stop-shop.

HM Revenue & Customs (HMRC) have issued guidance to help affected businesses determine the place of belonging of consumers who are private individuals. An extract of their guidance is provided below:

"When providing BTE services in the circumstances below, you can presume that the location of the consumer is as follows:

- *if the service is provided through a telephone box, a telephone kiosk, a wi-fi hot spot, an internet café, a restaurant or a hotel lobby, the consumer location will be the place where the services are provided;*
- *if the service is supplied on board transport travelling between different countries in the EU (for example, by boat or train), the consumer location will be the place of departure for the journey;*
- *if the service is supplied through an individual consumer's telephone landline, the consumer location will be the place where the landline is located;*
- *if the service is supplied through a mobile phone, the consumer location will be the country code of the SIM card;*
- *if a broadcasting service is supplied through a decoder, the consumer location will be the postal address where the decoder is sent or installed."*

If none of these examples determines where a particular consumer belongs, HMRC will accept the business' decision as long as it is supported by evidence (such as the consumer's billing address or bank details).

VAT MOSS

The VAT Mini One-Stop-Shop online service (VAT MOSS) will allow businesses to register for VAT in any one member state only and still account for VAT, via one VAT return (with just one payment being made) at each of the relevant member states' rates based on the location of their non-business customers. For UK registration applications, this facility will be available from 1 January 2015. Applications for such VAT registrations may be made from October 2014.

For example, a business registering for the VAT MOSS online service in the UK will be able to account for all of the VAT due on B2C BTE sales in any member states by submitting one VAT MOSS return and any related payment to HMRC. HMRC will send an electronic copy of the appropriate part of this VAT return, and the related VAT payment, to each relevant member state's tax authority on behalf of the VAT registered entity. The VAT rate to be applied to each transaction will be that of each member state of the place of belonging of the consumer, at the time that the service was supplied.

Any supplier of BTE services located outside the EU may register in any EU member state in which the business has a fixed establishment. Other suppliers without a EU fixed establishment should use the 'Non-Union' VAT MOSS online service.

The introduction of the VAT MOSS relieves the need from having to become VAT registered in more than one member state within the EU and should significantly reduce the administrative burden of the affected businesses.

ICAS MENTORING

The Business Start-up Mentoring Pilot Programme is now being launched. Join the pilot programme now by emailing a CV or your LinkedIn page to: **accountingandauditing@icas.org.uk**, ideally with a short statement of why you want to be a mentor. More information can be found at: **http://icas.org.uk/Technical-Knowledge/Private-Sector/Guidance/Guide-to-starting-a-business/**.

TAX CASES

Susan Bradley v HMRC (UK FTT [2013] TC 02560)

Point at issue: Whether the appellant had "resided" at a specific property prior to its sale and therefore whether she was eligible for principal private residence (PPR) relief.

Background: Mrs Bradley was married to Mr Bradley. Until August 2007 they lived together at 118 Ashley Road, which was owned jointly by them. Mrs Bradley also owned 124 Exning Road, which was a semi-detached house, and 68 Weston Way, a small flat. Both properties were normally let to tenants.

In August 2007 Mrs Bradley left Ashley Road to live in the flat at Weston Way, due to marital problems. She was also suffering from depression at the time. On moving to Weston Way, she did not change the address on her bank account or utilities but did register for council tax, claiming single occupier relief.

In April 2008, Mrs Bradley moved from Weston Way to Exning Road when the tenancy at Exning Road ended. At this time, Mrs Bradley began some cosmetic updating of Exning Road, having already instructed her solicitors to put it up for sale on the 20 March 2008. It should be noted that Mrs Bradley did not expect the property to sell quickly as the market was particularly weak.

During this time, it was Mrs Bradley's intention that she would separate permanently from her husband with a view to obtaining a divorce. She spoke to a solicitor at this time, however no formal steps were taken. She still had a joint account with her husband, with whom she remained on civil terms. She did not seek any financial support from him during this period.

In the autumn of 2008 Mrs Bradley became reconciled with her husband and she moved back in with him to Ashley Road in November 2008. Exning Road was subsequently sold in January 2009. Mrs Bradley had claimed PPR relief in her tax return for the year ended 5 April 2009, but this was disallowed by HM Revenue & Customs (HMRC). Mrs Bradley appealed HMRC's decision.

Argument: Section 222 (6) of Taxation of Chargeable Gains Act (TCGA) 1992 states that in the case of an individual living with his or her spouse, there can only be one residence or main residence for both, as long as they are living together. In these circumstances, the Bradleys would only be treated as "not living together" if their separation was expected to be permanent. Mrs Bradley argued successfully that, when she left Ashley Road in August 2007, the intention was for this separation to be permanent, expecting as she did to eventually divorce her husband.

The next issue is whether or not Exning Road became Mrs Bradley's only or main residence. It is not enough for her to live at Exning Road, she must also demonstrate a degree of permanence.

The First Tier Tribunal (FTT) referred to **Goodwin v Curtis (70TC478)** which is the leading case on the meaning of residence. The taxpayer in this case moved into the property in question as a stop-gap measure whilst they looked for alternative accommodation. Schiemann LJ said in his judgement "*in order to qualify for the Relief a taxpayer must provide some evidence that his continuity in the property showed some degree of permanence, some degree of continuity or some expectation of continuity*".

The crucial point here relates to Mrs Bradley's act of putting Exning Road up for sale in March 2008, before she had actually moved into it in April 2008, and it is this order of events which seemed to have scuppered her chances of getting PPR relief.

Decision: The FTT rejected Mrs Bradley's appeal, finding that she never intended to live permanently at Exning Road and that it was only ever going to be a temporary place for her to stay.

Commentary: This is an interesting case and shows how easy it is to fall foul of the PPR rules. As ever, it is a question of degree and had Mrs Bradley waited some time before marketing the property for sale, the outcome could have been different. The fact that she had the property on the market before she even moved in was clearly a major factor for the appeal being refused.

Contrast this with the outcome of the case of **David Morgan v HMRC (2013 UK FTT 181 TC02596)**. Mr Morgan was purchasing a property where he intended to live when he and his fiancée were married. He sold his own flat and moved in with his fiancée's family, but unfortunately, two weeks before the purchase, the relationship ended. He went to live with his parents and carried on with the purchase of the property where he moved to for two weeks, specifically to prepare it for renting. The property was let and eventually sold.

On the face of the information, one would expect that Morgan would not be able to obtain PPR. However, the tribunal decided that Morgan had lived in the property for two weeks before making serious enquiries about letting and this was enough for the property to qualify as a residence. PPR was made available.

Full details of the Bradley case can be found at: **www.bailii.org/cgi-bin/markup.cgi?doc=/uk/cases/UKFTT/TC/2013/TC02560.html&query=bradley+and+v+and+hmrc&method=boolean**.

HMRC v Raymond Brown (2014 UK FTT 302 TC03439)

Point at issue: Whether the discovery assessments to tax levied on a bookmaker for under-declared profits were correct and the penalties imposed proportionate.

Background: Raymond Brown (Mr Brown) was an on-course bookmaker

and had been so since 1994. Mr Brown operated at racecourses, attending daily race meetings on approximately 240-250 days a year (during 2005/6) and at Portsmouth Greyhound track, typically attending 120 evening meetings. He would normally carry large amounts of cash, which was needed in case he had to pay out race winnings. Mr Brown did his own bookkeeping, providing his accountant, Mr Hancock with annual summaries of his bookmaking activities so that he could prepare his tax return.

HMRC raised discovery assessments against his tax returns for the years 2002/3, 2003/4, 2004/5 and 2007/8 and closure notices making amendments to his 2004/5 and 2006/7 self-assessment tax returns. On 19 November 2010, HMRC issued penalty determinations on Mr Brown under s95 Taxes Management Act (TMA) 1970 for "*negligently delivering to an officer of HMRC incorrect returns*".

The amounts that are in dispute and the penalties (at 50%) are as follows:

Accounting year	Disputed amount £	Penalty £
2002/3	57,843	28,921
2003/4	43,819	21,909
2004/5	48,735	24,368
2005/6	50,380	25,190
2006/7	60,518	30,259
2007/8	62,562	31,281

HMRC's penalty system is based on a maximum abatement of 20% of the penalty for disclosure, 40% for co-operation and 40% for "seriousness", which is based on the size of the omissions and the seriousness of the "offence".

Fundamental to this case is that Mr Brown did not distinguish between cash held for private purposes and for business purposes, nor did he have a system for recording how much cash he was holding at a point in time. His accountant, Mr Hancock, did not perform a cash reconciliation as part of his working papers for the client. This practice was unchanged until 2001/2, when an enquiry was undertaken by HMRC. At the conclusion of this enquiry a statement of assets was prepared, which showed that, at 21 February 2005, Mr Brown held £77,000 in cash.

Mr Brown's 2005/6 tax return was filed on 27 June 2006 and his 2006/7 return was filed on 28 January 2008. HMRC opened enquiries into both returns (on 19 October 2007 and 11 July 2008 respectively).

Records relating to the 2005/6 return were made available to HMRC and a meeting held between Mr Brown, Mr Hancock and Mrs Stevens, of HMRC, on 11 July 2008. Discovery assessments were raised for 1996/7 to 2004/5 inclusive and 2007/8 with an amendment to the 2005/6 return on the basis of unexplained deposits totalling £139,414 made by Mr Brown into various bank accounts. Mr Brown appealed against these assessments on 16 September 2008. The assessments for 1996/7 to 2001/2 were withdrawn by HMRC, the focus turning to the latter periods.

Although the parties did attempt to come to an agreement on the assessments raised, through HMRC's alternative dispute resolution service, this did not prove possible. A statutory review was carried out by HMRC which upheld the assessments and amendments stated in the closure notices. Mr Brown was informed of this by letter in November 2011 and appealed on 21 December 2011.

Argument: The argument put forward by Mr Brown was that his father had provided him with the funds which they were querying, as loans to buy further pitches at racecourses. An ex-bookmaker, his father explained that he habitually held large amounts of cash and often lent money to his children but did not expect to get it back as "they will get it anyway". HMRC contended that this money was in fact profits and did not come from Mr Brown Senior as was suggested.

Mr Brown also put it to the court that, based on the margins on which he operated, of 5% or 6%, this level of profit would necessitate a turnover in the region of £4m once expenses were taken into account, which to him was wholly unrealistic.

HMRC made further information requirements to Mr Hancock, in relation to Mr Brown's affairs. This necessitated him looking more closely into these arrangements than he had previously and uncovered a number of errors in relation to previous tax returns:

- The year to 31 March 2006 understated income from greyhound races by £8,517
- This return also omitted foreign income of some £2,300 and bank interest of £566
- An adjustment of approximately £6,000 was required to correct an understatement of his business profits for the 2007/8 tax year

This information does provide some backup to HMRC's contention that Mr Brown's returns were systematically incorrect.

Decision: The tribunal agreed that, based on the information provided, Mr Brown's underlying business records were not reliable and that arithmetic mistakes were made. Further, that arithmetic mistakes were made which resulted in a loss of tax. The primary task, therefore, is to find the correct amount of tax that must be paid. Given that there had been no material change in the way the Mr Brown had operated over the years, the tribunal agreed with HMRC's approach to continuity when making assessments and amendments to his returns.

A key point made in the summing up was that "although Mr Brown's evidence appeared to be credible, and we do not doubt its sincerity or honesty, it was

not supported or corroborated by any independent or documentary evidence". HMRC's assessments in relation to unpaid tax were therefore upheld.

As regards the penalties, the tribunal saw things differently from HMRC, believing that the abatement for cooperation should be increased from 20% to 30% in light of Mr Brown attending a meeting with HMRC and the additional accounting work performed by Mr Hancock. The result being that the total abatement of penalties was increased from 50% to 60%. In relation to the disputed amounts, HMRC and Mr Brown will be in negotiations as regards the level of capital injections provided by his father, with the penalties being adjusted accordingly.

Discussion: This is an interesting case and must mirror the situation that a lot of cash businesses with poor records find themselves in when HMRC come knocking. There are three learning points here:

1. The co-operation and willingness to engage with HMRC has clearly had a positive effect and should always be encouraged whenever clients find themselves being investigated.
2. The failure to perform a cash reconciliation was a major oversight by the accountant. Although this may not have been easy due to the client's chaotic record-keeping and attitude to personal vs business cash, having a system in place from the beginning that made these large amounts of money traceable would have had a substantial impact on the investigation and the level of tax and penalties levied by HMRC.
3. The case is relevant to HMRC investigations where HMRC refuse to accept any form of explanation for cash bankings. The taxpayer in this case was eventually able to provide capital statements and testimony from witnesses to demonstrate that the cash receipts were capital injected into the business by his father. HMRC had not accepted this explanation until evidence was provided.

The judgement in this case is based on legislation contained within S95 and S102 of TMA 1970, legislation which has since been repealed (from years beginning on 1 April 2009 onwards). The updated legislation, contained in Finance Act 2007, mentions reference to "prompted" and "unprompted" disclosures. Details of the mitigation available under Finance Act 2007 can be found at Section 55.

TAX QUERY

Query: *Have you any guidance in relation to the suggested approach to dealing with clients who are, or could be, at high risk of being caught under IR35? In particular, is there any guidance from ICAS on the ethical considerations for dealing with clients who would be considered high risk, particularly if the client does not wish to apply a deemed payment and on determining the point at which there are money laundering considerations/decisions being required as to whether to continue to act for the client.*

It is an issue that some clients and potential clients may have friends and colleagues who use other firms of 'accountants' who may be less concerned with complying with professional obligations.

Any guidance or advice would be much appreciated.

Answer: IR 35 is recognised as a difficult compliance area, as noted by the House of Lords Committee on Personal Service Companies which reported recently. The report can be found at: **www.parliament.uk/business/committees/committees-a-z/lords-select/personal-service-companies/news/personal-service-companies-report-published/**.

The report specifically discusses the scenario you describe and it recognises in chapter 4 that many contractors are quite prepared to take a risk that HM Revenue & Customs (HMRC) will not investigate their affairs. It also discusses the Business Entity Tests. The report includes the following:

122. We conclude that many individuals simply take a risk that Her Majesty's Revenue and Customs will not look into their employment status, an attitude that is fostered by the decreasing number of compliance investigations.

123. We recommend that the Contract Review Service be publicised to greater effect, that Her Majesty's Revenue and Customs investigate ways to encourage individuals to use the service and that they look into ways to bolster confidence in its independence and impartiality. (Recommendation 8)

133. We accept that the guidance will never be able to give absolute certainty to taxpayers of their status in relation to IR35 but we agree that the current guidance is far from satisfactory.

134. We recommend that Her Majesty's Revenue and Customs undertake a full consultation on how the Business Entity Tests could work better to provide greater certainty for taxpayers. (Recommendation 9)

In order to address the 'high risk' clients, a distinction needs to be drawn between:

a) those at high risk of being investigated by HMRC, and
b) those at high risk of being within the IR 35 regime.

In both cases, but particularly with those who are at high risk of being within the IR35 regime, each contract needs to be analysed on a contract by contract basis, and with this, analysis needs to be documented as to the reasons why a particular decision was reached.

Should a client not wish to follow the CA's advice, the guidance in 'Professional Conduct in Relation to Taxation' (PCRT) should be applied and this can be found at: ***http://icas.org.uk/Technical-Knowledge/Tax/Professional-Guidance/***.

In particular, chapter 3 notes the responsibilities of both the taxpayer and the agent.

Chapter 3.2 states:

'The taxpayer has primary responsibility to submit correct and complete returns to the best of his knowledge and belief. The return may include reasonable estimates where necessary. It follows that the final decision as to whether to disclose any issue is that of the client.'

Chapter 3.5 includes the following

'....A member must not be associated with the presentation of facts he knows or believes to be incorrect or misleading....'

Chapter 3.7 notes:

'Where the client is reluctant to follow the member's advice then the guidance at Chapter 5 should be followed....'

Chapter 5 discusses irregularities and there is a flow chart to assist the member in his thought processes, but note in particular chapter 5.4:

'A member must act and be seen to act correctly from the outset. A member should keep sufficient appropriate records of discussions and advice. When dealing with irregularities the member's objectives are:

- *To give the client appropriate advice;*
- *If necessary, so long as he continues to act for the client, to seek to persuade the client to behave correctly; and*
- *To ensure that he does nothing to assist a client to plan or commit any offence or to conceal any offence which has been committed, as to do so would be an unlawful act.*

At all stages it may be helpful to discuss the client's situation with a colleague or an independent third party (having due regard to client confidentiality).'

Chapter 5.5 notes that:

'Once aware of a possible irregularity, a member must bear in mind the legislation on money laundering and the obligations and duties which this places upon him (see CCAB guidance ***www.ccab.org.uk/PDFs/CCAB%20guidance%202008-8-26.pdf*** *[see page 99 onwards within this document regarding tax]). He should also consider whether the irregularity could give rise to a circumstance requiring notification to his professional indemnity insurers.'*

HMRC also has a useful guidance document available at: **www.hmrc.gov.uk/ir35/guidance.pdf** which lists IR35 business entity tests including example scenarios.

STRATEGIC REPORT – NEW REPORTING REGULATIONS

For financial years ending on or after 30 September 2013, all UK companies that do not meet the Companies Act 2006 definition of Small are required to prepare a new strategic report as part of their annual report. This change has been introduced by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013.

The strategic report replaces the business review and will be presented as a separate section of the annual report, outside of the directors' report. It should contain a fair and balanced analysis, consistent with the size and complexity of the business, of:

- The development and performance of the company's business during the financial year;
- The position of the company at the end of the year; and
- A description of the principal risks and uncertainties facing the company.

The report should analyse the company's performance and position using financial and, where appropriate, non-financial key performance indicators (KPIs), including information regarding environmental and employee matters. However, medium-sized companies are not required to provide non-financial KPIs.

The strategic report may also contain matters otherwise required to be disclosed in the directors' report if they are considered to be of strategic importance to the company, and should also, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.

There are additional requirements for quoted companies such as disclosure of the company's strategy and business model, and information on gender diversity.

The Financial Reporting Council (FRC) has issued an Exposure Draft of Guidance on the Strategic Report which is expected to be finalised shortly. This has been written primarily with quoted companies in mind, however, other companies may also find it useful in determining how to structure their strategic report.

The Financial Reporting Council's (FRC) latest Audit and Assurance Bulletin highlights recent changes to auditors' responsibilities which will have a significant impact in 2014. The Bulletin notes that auditors have the same statutory reporting responsibility for the

new Strategic Report as they have for the existing Directors' Report.

The FRC exposure draft is available to download from: **www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Exposure-Draft-Guidance-on-the-Strategic-Report-File.pdf**.

The strategic report regulations are available from: **www.legislation.gov.uk/uksi/2013/1970/contents/made**.

UK GAAP is dead, long live UK GAAP

ICAS, in conjunction with the FRC, will be hosting a breakfast event in Edinburgh focusing on the end of UK GAAP and the introduction of FRS102.

The event, on 20 June 2014, will host a range of speakers from the FRC, HMRC and accountancy firms Chiene + Tait and Mazars. More information is available at: **http://icas.org.uk/Events/UKGAAPIsDead-LongLiveUKGAAP/**.

FRSSE (2008/2015) UPDATED FOR MICRO-ENTITIES

In November 2013, The Small Companies (Micro-Entities' Accounts) Regulations 2013 (SI 2013/3008) (the Micro-Entities' Accounts Regulations) were made to implement the provisions of the EU Directive on the annual accounts of certain types of companies as regards micro-entities in UK law. The Micro-Entities' Accounts Regulations, and these corresponding amendments to the FRSSE, only apply to eligible companies incorporated under the Companies Act 2006 and may not be applied by any other entity applying the FRSSE. The Regulations became effective in respect of financial years ending on or after 30 September 2013 for companies filing their accounts on or after 1 December 2013. To be eligible to apply the micro accounts provisions, an entity must satisfy at least two out of the following three parameters:

- Turnover not more than £632,000
- Balance sheet total (gross assets) not more than £316,000
- Average number of employees during the year not more than 10

The Regulations permit micro-entities to take certain exemptions relating to the preparation of their financial statements, meaning that without amendments to the Financial Reporting Standard for Smaller Entities (effective April 2008) and the Financial Reporting Standard for Smaller Entities (effective January 2015) (FRSSE) a micro-entity would not be able to comply with the FRSSE whilst taking advantage of the available exemptions. However, this does not restrict a micro-entity's ability to take advantage of the new legal exemptions from their effective date but rather the accounting standards to be followed. Therefore, the Financial Reporting Council have amended both FRSSE's (2008 & 2015) to allow those micro-entities taking advantage of the exemptions available in law to continue to prepare financial statements in compliance with the FRSSE.

Consistent with the Micro-Entities' Accounts Regulations these amendments to both FRSSE's relate mainly to the presentation and disclosure in the financial statements of micro-entities. However, in addition the Micro-Entities' Accounts Regulations simplify the measurement bases available for fixed assets and certain current assets, with the effect that micro-entities applying the micro-entities regime may no longer revalue any fixed assets, including investment property or measure any current asset investments at current cost; as a result any previous revaluations would need to be reversed. Other than in relation to these simplifications in the measurement options available, the amendments do not affect the recognition or measurement of amounts included in the financial statements of micro-entities.

To take advantage of the legal exemptions, a micro-entity must meet certain qualifying conditions based on size, and must not be excluded from being treated as a micro-entity. Companies excluded from being treated as micro-entities include those excluded from the small companies regime, charities, those voluntarily preparing group accounts and those included in group accounts.

When the remainder of the new EU Accounting Directive is implemented in the UK and the Republic of Ireland it will make significant changes to the small companies regime, although further changes to the micro-entities regime are not expected. In response, the FRC is reviewing the FRSSE, and expects to issue revised accounting requirements for small entities, which will be effective from the same date as the legal changes. As part of this, the FRC is also considering how to present the requirements for micro-entities in the most user-friendly way. Therefore these amendments represent an interim solution.

PRACTICE NOTE 14: THE AUDIT OF HOUSING ASSOCIATIONS IN THE UNITED KINGDOM

Background

Practice Note 14 (Revised January 2014): The audit of housing associations in the United Kingdom was issued by the Financial Reporting Council (FRC) in January 2014. The latest revision acknowledges that these organisations' business models and risk profiles have changed significantly since the last version issued in 2006, due to limitations on bank funding and changes to the legislative and welfare systems. In addition, the introduction of clarified International Standards on Auditing (ISAs) in 2010 rendered much of the previous version out of date and it was subsequently withdrawn in 2012.

As a result, the revised Practice Note is significantly different from the earlier version and includes greater detail on the extent of interaction between auditors and the four regulators in each of the individual UK jurisdictions of England, Scotland, Wales and Northern Ireland.

Extent of interaction between Auditor and Regulator

Within each of the four United Kingdom nations there is a separate Housing Association Regulator as listed below:

- The Housing and Communities Agency, England;
- The Scottish Housing Regulator;
- The Welsh Government's Housing Division; and
- The Department for Social Development's Housing Division, Northern Ireland.

The Practice Note, and the accompanying Appendices 1 to 4, provide specific guidance in relation to the auditor's duty to report to the regulator for each jurisdiction and the nature and extent of information that the Housing Association needs to submit to the Regulator in each jurisdiction.

The Welfare Reform Act 2012 (Consequential Amendments) Regulations 2013

The Welfare Reform Act received Royal Assent on 8th March 2012. The Act introduces a new Universal Credit which will eventually replace most existing benefits and limits the total amount of benefit a person can claim. It also introduces a new size criteria or 'bedroom tax' in the social rented sector. The welfare reforms impact on the way tenants receive benefit, in many cases, removing the option of having benefits paid direct to landlords.

Risk profile

There is greater emphasis placed on the need for the auditor to acquire a detailed understanding of the sector and the specific risks faced by Housing Associations.

i) Business risks

Changes to the welfare system, most notably the Welfare Reform Act, see box below, and the introduction of Universal Credit, may have a significant impact on the revenues and liquidity of a Housing Association. This may result in:

- an increase in rent arrears as the welfare credit will now be paid directly to the tenant as opposed to the landlord;
- a greater percentage of bad debts for the same reasons as noted above;
- a fall in Housing Association revenues as the effects of the so called 'bedroom tax' on under-occupancy start to take effect; and
- diversification into new markets, for example social care and support, subjecting the association to greater external scrutiny and a higher risk of loss of reputation due to the provision of care and support to more vulnerable individuals.

ii) Going concern risks

- Many associations have seen the amount of grant funding available fall combined with a decrease in the amount of bank funding to which the sector has access as a result of the economic crisis. This might have an impact on an association's ability to continue as a going concern.
- The funding pressures have caused some associations to attempt to diversify their activities by operating in new areas which present their own specific risks. For example, diversification into the rental of investment property in the private market is now subject to much tighter legislation over the standard of these properties so that landlords face increasing repair and property maintenance costs. As referred to in (i) above, diversification into the social care sector and potential loss of reputation might also impact upon an association's ability to continue as a going concern,
- A number of Housing Associations may be members of multi-employer defined benefit pension schemes. Following a number of years of low market growth and a fall in government bonds, pension schemes have found themselves increasingly underfunded. Under the new accounting requirements of *Financial Reporting Standard (FRS) 102 'The Financial Reporting Standard* applicable in the UK and ROI', where a Housing Association has entered into a recovery plan to make good a past deficit by making additional contributions, this commitment should be recognised as a liability. Therefore, in the first

year of application, there will be a prior year adjustment to reflect this liability and a resulting negative effect on the balance sheet. This may also affect an association's bank covenants and, as a result, its ability to continue as a going concern. Furthermore, as well as the regular contributions to the schemes, the recovery plan will require additional contributions to reduce this past funding deficit representing an additional financial burden for Housing Associations.

Changes to the accounting framework

Housing Associations are required to prepare their financial statements in accordance with the *Statement of Recommended Practice (SORP): Accounting by registered social housing providers*. The current version of this SORP is being updated following the issue of FRS 102 and is expected to be published in 2014, effective for accounting periods commencing on or after 1 January 2015.

- One of the key accounting changes arising from the introduction of FRS 102 which is likely to have a direct effect on Housing Associations is the classification of financial instruments. If a Housing Association has financial instruments, unless they can be classified as basic, they will be designated as complex and therefore will need to be restated at fair value each year end, with the movement recorded in the profit and loss account. Therefore, greater consideration will need to be given to the classification of financial instruments between those that are complex and those that are basic, but it should be noted that basic financial instruments do not include interest rate swaps which may result in a change of accounting treatment for many associations.
- There may be additional implications for the treatment and amortisation of grants as these are no longer permitted to be netted off against the cost of the fixed asset.
- Also, FRS 102 removes the option of a "planned internal subsidy", where the value of a social unit is lower than the depreciated cost, to avoid recognising an impairment provision on the asset. As a result, some Housing Associations may find themselves having to perform an impairment review and recognise an impairment provision.

Practice Note 14 can be downloaded at: **https://frc.org.uk/Our-Work/Codes-Standards/Audit-and-assurance/Standards-and-guidance/Standards-and-guidance-for-auditors/Practice-notes.aspx**.

Appendix II of the FRC's Impact Assessment guidance includes a case study that specifically addresses a Registered provider of Social Housing. **https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Impact-Assessment-FRS-100,-FRS-101-and-FRS-102.pdf**.

TWO SORPS FOR THE CHARITY SECTOR

The Charity Commission (CC) and Office for the Scottish Charity Regulator (OSCR) have announced that the charity sector is to have two Statements of Recommended Practice (SORPs) for periods commencing on or after 1 January 2015. The two new Charities SORPs will be based on the FRSSE and FRS102.

Charities preparing true and fair accounts which are not eligible to use the FRSSE must prepare their accounts in accordance with FRS102 and must apply the FRS 102-based SORP from next January.

Further details on the two SORPs will follow once these are published. Publication is expected during the summer and ICAS will keep you informed of further developments.

Eligibility to use the FRSSE - Reminder

A charitable company or non-company charity generally qualifies to be treated as small and can apply the FRSSE in relation to a financial year if the qualifying conditions are met in the current financial year and the preceding financial year. The threshold in the Companies Act 2006 (section 382) for qualification as a small company can be interpreted as any company charity or non-company charity which is not otherwise excluded from the regime (section 384), and meets two out of the following three conditions:

- annual gross income not exceeding £6,500,000
- balance sheet total (ie gross assets) not exceeding £3,260,000 and
- average number of employees not exceeding 50

For accounting periods which are shorter or longer than twelve months the gross income condition should be adjusted in proportion to the accounting period.

FRC THEMATIC INSPECTION REVIEW: AUDITOR'S IDENTIFICATION OF FRAUD RISKS AND AUDITOR'S CONSIDERATION OF LAWS AND REGULATIONS

In January, the Financial Reporting Council (FRC) published the principal findings of the second thematic inspection review undertaken by its Audit Quality Review (AQR) team during 2013. The two themes for this review were:

(i) the auditor's identification of and response to fraud risks; and

(ii) the auditor's consideration of laws and regulations.

These thematic reviews supplement the FRC's annual programme of audit inspections of individual firms and specifically focus on firms' policies and procedures in respect of a specific aspect of auditing, and their application in practice. These reviews are narrower in scope, and enable an aspect of auditing to be examined in greater depth, and to allow comparisons between firms with a view to identifying both good practice and areas of common weakness.

The findings and recommendations identify some specific areas in which auditors should review and improve their performance with a view to better fulfilling their professional responsibilities. Whilst the focus of the review was the six largest audit firms, some of the points identified are likely to have wider applicability across the auditing profession.

Good practice observations

Fraud

- Requiring specific audit procedures to be performed for listed entities, including reviewing analysts' reports, to identify fraud risk factors.
- Using forensic specialists in fraud risk discussions and in running computer assisted audit techniques (CAATs) for journal testing.
- Using CAATs on all audits to test journal entries, with exceptions expected to be rare.
- In relation to the risk of management override of controls, requiring completion of a final conclusions document summarising the results of all audit procedures performed and reaching an overall conclusion.
- Requiring audit teams to review the results of audit work performed for all accounting estimates in one place to assess whether there are any indications of management bias.

Laws and regulations

- Using a proforma document identifying the applicable laws and regulations; how they might affect the financial statements; and assessing the design and implementation of relevant controls.
- Providing appropriate training and guidance to audit teams on how they should respond to the UK Bribery Act in conducting audits.

Overview of findings

- All firms' methodologies require audit teams to perform the risk assessment and audit procedures required by auditing standards for fraud and laws and regulations. The matters raised in the report mostly relate to audit teams' application of these requirements in practice. There was no identification of any significant deficiencies which would indicate that an inappropriate audit opinion may have been issued. They did, however, identify a number of areas where auditors should improve the quality and effectiveness of the audit procedures performed.
- Although practice is not uniform across all firms and audits, the FRC believes there is a lack of focus on identifying the specific risks in relation to fraud and non-compliance with laws and regulations and that there are a number of specific areas requiring improvement. These improvements would better position auditors to detect possible material misstatements due to fraud and non-compliance with laws and regulations.
- The consideration of fraud risks and relevant laws and regulations, and the performance of related audit procedures, tends to be viewed as a compliance exercise rather than as an important and integral part of the audit. Improvements are needed to better focus attention on how these may affect the financial statements. The FRC saw evidence of a presumption by audit teams that issues in these areas were unlikely to occur at the entity they were auditing, which suggests a lack of appropriate professional scepticism.
- More frequent and up to date training would assist audit teams in identifying potential risks in relation to fraud and laws and regulations and in designing appropriate audit procedures to address these risks.

Key messages for audit firms – Fraud risks

- Auditors should increase their focus on identifying fraud risk factors in both planning and conducting the audit. In achieving this:
    - o Auditors should ensure that fraud risk discussions amongst the audit team are led by the engagement partner and are more focused on identifying fraud risk factors as well as the risks of material misstatement in the financial statements due to fraud. For the larger, more complex entities, including forensic specialists in

these discussions would improve the identification of potential fraud risks.
  - o Auditors should improve their assessment of fraud risk factors and fraud risks by having more meaningful discussions with management, including internal audit and those outside the finance function. These discussions should focus more on fraud risks rather than any frauds already identified.
- Fraud risk factors may become apparent as the audit progresses. These fraud risk factors should be reassessed at the end of the audit and a conclusion reached as to whether fraud risks have been reduced to an acceptable level.
- Assessment of fraud risks and the audit procedures which are intended to address them should be more tailored to the entity. For example:
  - o Auditors should ensure that, in identifying the risk of management override of controls as a significant risk, they also assess the level of risk specific to the audited entity taking into consideration all of the fraud risk factors present.
- As fraud risks should always be considered to be significant risks, auditors should evaluate the design and implementation of the entity's internal controls to detect and prevent fraud, where such risks are identified.
- Auditors should ensure that journal testing is responsive to the fraud risks identified. More use of computer assisted audit techniques (CAATs) may improve the quality of audit work in this area.
- Auditors should exercise greater professional scepticism in identifying and addressing the fraud risks that are specific to the audited entity.
- Auditors should ensure that final analytical review procedures are not limited to comparing line items in the current year income statement and balance sheet to the prior year figures. Use of other ratio analysis and inclusion of the cash flow statement in the analysis may improve the quality of work in this area.
- Auditors should draw an overall conclusion relating to the risks of material misstatement due to fraud after considering all relevant audit evidence obtained during the audit.
- More frequent and up to date training is likely to be beneficial in improving audit quality in this area.

Key messages for audit firms - Laws and regulations

- Auditors should improve their identification and assessment of the laws and regulations affecting the audited entity, with a clearer identification of those that may have a direct or indirect impact on the financial statements, including considering the UK Bribery Act 2010.
- Auditors' discussions with management should include management responsible for compliance matters and should place more emphasis on identifying the relevant laws and regulations that may have a direct impact on the financial statements and whether the entity is in compliance with them.
- Auditors should evaluate the design and implementation of the entity's internal controls to monitor compliance with laws and regulations.
- Auditors should exercise greater professional scepticism throughout the audit in relation to possible breaches of laws and regulations that may have a material impact on the financial statements.
- More regular and up to date training is likely to be beneficial in improving audit quality in this area, particularly in relation to the auditor's response to the UK Bribery Act 2010.

The report can be viewed at: **https://frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-Fraud-Risks-and-Laws.pdf**.

Calling Eligible Firms - Register for the FREE online General Practice Procedures Manual (GPPM)

The General Practice Procedures Manual (GPPM), your "one-stop shop for practice procedures" is now available online and eligible firms are invited to register so that they may access the updated manual FREE of charge. Eligible firms are those where at least 50% of principals are members of ICAS.

To register we would encourage firms to visit the GPPM page at: **http://icas.org.uk/ca/practice-hub/** (login required).

More information on the GPPM can be found at: **http://icas.org.uk/GeneralPracticeProceduresManual/**.

REVIEW ENGAGEMENTS – THE TECHNICAL ISSUES

This article forms the first in a series of pieces which looks at different types of engagement and how engagement choice is impacted by the needs of clients and end users. The focus of this piece is on the technical issues associated with review engagements.

The updated International Standard on Review Engagements (ISRE) 2400, issued recently, has reignited the debate on whether practitioners should be offering a review of financial statements as an alternative to the audit to their clients who, although entitled to audit exemption, have elected not to take advantage of this option.

The revised standard, running to 85 pages (including application notes) has been updated to provide a clearer understanding of what a review engagement involves and provide additional guidance for practitioners when carrying out such an assignment.

Gone are the references to negative assurance in a new definition of Limited assurance (see box below), to be replaced by the phrases '*a meaningful level of assurance*' and '*likely to enhance users*' confidence about the financial statements.

> **Limited assurance**
>
> 'The level of assurance obtained where engagement risk is reduced to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for expressing a conclusion in accordance with this ISRE. The combination of the nature, timing and extent of evidence gathering procedures is at least sufficient for the practitioner to obtain a meaningful level of assurance. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the financial statements.'

However, if the assurance obtained continues to be limited in nature, just how much confidence in the financial statements are users getting from the revised ISRE 2400? And is it the assurance they are looking for?

At ICAS, we have always resisted the pressure to develop guidance and promote review engagements to our members. There are still some strong arguments in favour of us resisting a move in this direction. Nonetheless, we believe that it is important to reassess whether we should reconsider our position and develop and promote guidance for members on the application of this standard. Furthermore, the potential increase to the turnover and balance sheet audit thresholds to approximately £10m and £5m respectively, will mean that more organisations will have the ability to drop out of the statutory audit regime and perhaps this is an opportunity for us to reconsider the type and nature of engagement that will provide lenders, customers, employees and other stakeholders with the required level of comfort.

In the past, our reasons against adopting ISRE 2400 were based on a number of specific arguments, and we believe that these remain relevant and pertinent to the revised standard. These arguments are summarised below:

Lack of clarity in definition of limited assurance and associated terminology:

The previous version of ISRE 2400, and the IAASB assurance framework, defined limited assurance as a negative expression of opinion along the lines of "*nothing has come to our attention that causes us to believe that the financial statements do not present a true and fair view*". The use of the word '*negative*' in relation to this type of assurance gave the impression that the related assurance was of little value to users.

The revised definition drops the word '*negative*' and instead refers to a '*meaningful*' level of assurance. Interpreting and applying the use of the word '*meaningful*' is likely to be a subjective exercise and the only further clarification of the definition of 'meaningful' in this respect provided in the standard is that it is likely to 'enhance users' confidence about the financial statements'. Once again, this statement is very subjective and not the focus of any of the definitions elsewhere in the assurance framework. Therefore we question whether the revised standard clarifies the extent of assurance being obtained and, as a result, provides the level of comfort that users of financial statements and other stakeholders are seeking.

Requirement to comply with International Standard on Quality Control (ISQC) 1:

Paragraph 4 of the revised ISRE 2400 requires that '*The provisions of this ISRE regarding quality control at the level of individual review engagements are premised on the basis that the firm is subject to ISQC 1 or requirements that are at least as demanding.*' ICAS has always opposed the imposition of these requirements as this would create an onerous burden for many of our small practitioners and put them at a competitive disadvantage when compared to unregulated practitioners who are not obliged to adhere to such rigorous standards in relation to engagement quality control. Since there has been no proposed proportionality in the application of ISRE 2400, all practitioners adopting this standard will be required to comply fully with the requirements of ISQC 1 and its onerous quality control conditions.

Alternative service already provided:

Many jurisdictions already provide guidance for practitioners on

engagements which are subject to less rigorous procedures than those associated with the statutory audit and ICAS has its own in the Framework for the Preparation of Accounts. This guidance is currently used by many of our small and medium-sized practitioners when preparing accounts for an entity.

So what does ISRE 2400 provide us with that the Framework for the Preparation of Accounts does not?

ISRE 2400 Versus Framework for the Preparation of Accounts

Content element	Practitioner's responsibilities under ISRE 2400	Chartered accountant's responsibilities under the Framework for the Preparation of Accounts
Terms of engagement	To be agreed with management prior to undertaking the engagement and normally in written form (paras 36 and 37)	Agreement in letter form. No duty to assess estimates and judgements made by directors (App1 para 3.1)
General principles	Integrity Objectivity Professional competence and due care Confidentiality Professional behaviour Independence (para A15)	Integrity Objectivity ** Professional competence and due care Confidentiality Professional behaviour (para 11) **Independence is viewed as a subset of objectivity
Scope	Primarily inquiry and analytical procedures to obtain sufficient appropriate evidence as the basis for a conclusion on the financial statements as a whole (para 7)	Accounts preparation exercise, including analytical review, to ensure that the accounts are consistent with their knowledge of the business in the form of best practice guidance for chartered accountants (paragraphs 3 and 6)
Understanding of the entity	Shall include sector and external factors; nature of the entity. ie operations, governance, investment policy, structure, strategy, accounting system and accounting policies (paras 45 and 46)	General knowledge of the business and operations should be acquired. General understanding of the nature of transactions, accounting records to be obtained. Comparison of accounts with practitioner's expectations based on this understanding (paras 20, 21 and 27)
Consideration of materiality	The practitioner is required to determine materiality for the financial statements as a whole and revise as appropriate (paras 43 and 44)	Silent but per paragraph 26, the chartered accountant should ensure that the accounts are free from material misstatement. Therefore, although no formal process is referred to for the determination of materiality, there is a duty for the chartered accountant to consider materiality in relation to the financial statements (para 26)
Process	Primarily inquiry and analytical procedures to obtain sufficient appropriate evidence (para 7) Shall include: management estimates; identification of related parties and related party transactions; significant, unusual or complex transactions or events; existence or suspicion of fraud or non-compliance with laws and regulations; events subsequent to the balance sheet date; management's going concern assessment; obligations and commitments; non-monetary transactions; adequacy of the accounting system output (para 48)	Knowledge of the business and operations; familiarity with the industry specific accounting policies and practices; understanding of the accounting systems; assessment of estimates and judgements; vouching transactions and unusual items; cut-off procedures; analytical review and variance analysis; completion of disclosure checklist (paras 20 to 28)

ISRE 2400 Versus Framework for the Preparation of Accounts Continued

Content element	Practitioner's responsibilities under ISRE 2400	Chartered accountant's responsibilities under the Framework for the Preparation of Accounts
Professional scepticism and judgment	Obligation to be aware that material misstatement may exist and for exercising professional judgement (paras 22 and 23)	Silent on professional scepticism. Reference to assessment of management's judgement (para 22) however, this is inconsistent with para 3.1 of the engagement letter in Appendix 1.
Reliance on the work of others	The practitioner shall review the work of others for adequacy for his/her purposes (para 55)	Silent
Going concern	Management's responsibility to assess the entity's ability to continue as a going concern and the practitioner shall review and evaluate that assessment (paras 53 and 54)	Management's/directors' responsibility to prepare accounts on a going concern basis. No responsibility on the part of the practitioner (para 38)
Subsequent events	Practitioner responsibility to ensure that events occurring between the date of the financial statements and the signing date are appropriately reflected in the financial statements (para 58)	Silent – but to meet the 'true and fair' requirement, FRS 21, Events after the balance sheet date, applies
Report	Shall include: title; addressee; nature of engagement; management's responsibilities; limitations of review engagement; conclusion; obligation to comply with ethical requirements; date; signature and location of practitioner (para 86)	Shall include title; statement of compliance with ethical and professional requirements of ICAS; statement confirming management's responsibilities; statement that no audit has been undertaken; name signature and address of the chartered accountant (para 43)
Quality control	Firm's quality control procedures at least as demanding as ISQC 1 (para 4)	Silent - but subject to the ICAS monitoring regime

Conclusion

Clearly, there are areas listed above where the Framework for the Preparation of Accounts is potentially less explicit on the responsibility of the Chartered Accountant and it might appear that users are provided with no or very little comfort, for example subsequent events; going concern and independence.

However, the ICAS Code of Ethics requires that chartered accountants should not be associated with accounts which they consider to be misleading and thereby sets a benchmark in terms of reliability that which any accounts preparation or review engagement should reach. Therefore, we consider the procedures detailed in the Framework for the Preparation of Accounts sufficient comfort to users and stakeholders over the reliability of the information in the financial statements and see no need for further procedures as proposed in ISRE 2400.

We would be interested to hear your views on this subject and, if you have any feedback, please send this to **accountingandauditing@icas.org.uk**.

The follow-up piece, focusing on agreed-upon procedures, will be in a future edition of Technical Bulletin.

ACCOUNTING AND AUDITING QUERIES

Query: *I am the financial controller at a large private company. The directors are considering acquiring a five year licence to use patented technology from 1 January 2015 which is used in the process of manufacturing drilling machines. The directors are seeking my advice as to how the transaction will be accounted for if they decide to acquire this patented technology for their company. The transaction would involve the payment of an upfront fee on delivery of £20,000, followed by a second instalment of £25,500 due within one year of the delivery date. The deal is also to be the subject of annual royalty fees amounting to 12.5% of machines sold each year. The directors have estimated the following expected sales of machines as follows:*

Year	***Sales of machines***
1	*£400,000*
2	*£408,000*
3	*£432,000*
4	*£467,000*
5	*£480,000*

The directors specifically want to know whether an intangible asset will be recognised and if so, at what value it would be stated in the accounts. The company currently adopts UK GAAP and it is intended that it will use Financial Reporting Standard (FRS 102) for accounting periods commencing on or after 1 January 2015.

Answer: The company is acquiring an intangible asset that will result in the generation of future revenues for the company. Based on the data provided the amount which should be capitalised is the upfront payment of £20,000 plus the net present value of the second instalment paid 12 months after. The royalty fees in question are not included as these do not present a present obligation of the company but rather will be expensed as incurred. The intangible asset recognised would of course be amortised over the 5 year period.

Query: *I am the financial director of a large private company. I have heard that the introduction of FRS 102 will mean that the company will need to accrue holiday pay for those employees who have not used all of their holiday entitlement at the company's year-end. Is this correct?*

Answer: FRS 102 specifically requires that short-term employee benefits, which includes paid annual leave, should be recognised as an expense in the year in which the service is rendered and the associated liability recognised. Where an employee is unable to carry forward any unused holidays then there is no associated liability at the year-end. However, where employees can carry forward such entitlement then FRS 102 requires that the expected additional cost of accumulating compensated absences be recognised. This should be done based on the amount that the entity expects to have to pay to settle the liability which should not be discounted as it relates to a short-term liability. Companies therefore have to assess the additional cost they expect to pay based on the cumulative unused entitlement at the year end. They must take into account the likelihood that certain employees will lose their entitlement e.g. if a company does not recompense those employees who leave the organisation with unused holiday entitlement and/or any unused entitlement which cannot be carried forward for more than one year.

ICAS PRACTICE MONITORING – A REPLACEMENT FOR QUALITY REVIEW

As of 1 April 2014, ICAS has been operating a new monitoring approach called Practice Monitoring, which has replaced Quality Review. The aim of this change is to keep the valued aspects of Quality Review but reduce the disruption to firms.

The approach will be risk-based and those firms who have a good compliance history and no significant changes to their practice will be visited less often, thereby reducing their regulatory burden. Smaller firms may be offered the chance to have their visit conducted via a telephone discussion or offsite via a desk top review, if it suits them better. Visits will also take less time, with the average visit now taking half a day.

Firms who are authorised for audit work will be able to choose to have their Practice Monitoring visit alongside their Audit Monitoring visit if they wish.

For more information, watch the video, "What to expect on a Practice Monitoring visit", which can be viewed at: **http://icas.org.uk/ca/practice-hub/**.

Full information on the new Practice Monitoring regime can be found at: **http://icas.org.uk/regulation-and-ethics/practice-monitoring/**.

BUSINESS START-UP GUIDE LAUNCHED

ICAS, in partnership with the Scottish Chamber of Commerce, has launched its business start-up guide, which aims to provide concise information for anybody setting up their own business. The guide, named "*Starting a Business*" covers:

- Sources of advice and mentoring
- Preparing a business plan
- Identifying appropriate funding
- Tips on starting your own business
- Where you can find sources of further guidance

In addition to addressing issues such as strategy and marketing, the guide also covers topics such as tax relief applicable to start ups including:

- The Seed Enterprise Investment Scheme
- Research and Development relief
- Grants

The guide also provides a useful list of online resources and where to get help from industry bodies, government and other sources.

The guide to starting up a business can be accessed at: **http://icas.org.uk/starting-a-business/**.

CHARITIES AND THE DATA PROTECTION ACT (1998)

The Data Protection Act (1998) applies to all organisations in the UK regardless of their status. The public sector is the only sector where there is a legal obligation to report data breach incidents to the Information Commissioner's Office (ICO). The ICO does, however, publish quarterly reports of notified breaches across all sectors. As can be seen from the table below, the charity sector is currently in 4th place with 34 reported breaches over a 9 month period.

Data Breaches April–December 2013

	Sector	No of Incidents
1	General business	65
2	Solicitors/ barristers	51
3	Housing	36
4	Charities	34
5	Financial advisers	22

Although the legislation changed in April 2010, allowing the ICO to levy fines of up to £500,000 no Monetary Penalty Notices (MPNs) had been issued to charities until February 2013 when the Nursing & Midwifery Council was fined £150,000. February 2014 saw the British Pregnancy Advice Service (BPAS) fined £200,000.

Over the last 4 years the ICO has issued over 50 MPNs to a wide variety of organisations but only 2 have been as a direct result of cyber-crime, BPAS being one of those organisations and the Sony Corporation being the other one.

The BPAS incident is interesting because as well as being an example of the cyber-crime threats that all businesses are increasingly facing, it also demonstrates the importance of understanding what goes on in the supply chain.

Cyber-crime

The BPAS web site used a web form that enquirers could fill in with their details to request a call back for advice.

Most web design software supports the function of creating a "contact" form and it is straightforward to do. The forms can be quite sophisticated in appearance with drop down boxes and radio buttons, but can also include free text that the enquirer fills in. The web site can store the information in a number of ways, but the quickest and easiest way is in either a Comma delimited (CSV) or plain text file. The file extension would be either .csv or .txt, which makes them quite easy to find if you are scanning a web site.

The web site usually does two things once a "form" is completed, it:

a) sends the information to a recipient within the organisation; and
b) saves the details in a file.

In the case of the BPAS web site, this file had grown over a number of years and contained the details of over 9,900 individuals.

BPAS is the largest provider of abortion services in the UK and the web site clearly describes the services offered such as contraceptive advice, abortion, counselling, STI screening, sterilisation, vasectomy and treatment for erectile dysfunction. Therefore, the individuals who submitted their details for a call back were more than likely to require advice in relation to one or more of these services provided by BPAS.

The attacker targeted BPAS because he disagreed with abortion and wanted to cause trouble. He had not expected to find the contact details but once in possession of the data publicly expressed his intention to publish it all.

BPAS did not design the website, neither did it host or maintain it, so it might seem a little unfair that it receives a MPN for £200,000. In law, however, it is the data controller and the responsibility rests with the organisation, not its suppliers.

The Supply Chain

In 2007, BPAS instructed an IT company to develop the website for them which was initially designed to have an online 'appointment booking service' so that users could book an appointment to receive a call back. This feature was not fully implemented, mainly due to

concerns over the security of the data. In the absence of any further specification, BPAS mistakenly assumed that the scaled down content management system (CMS) function would only generate an email when users completed the 'call back web form' which would be sent to the secure email server with no call back data being retained on the website.

In 2008 BPAS decided to instruct another IT company to host their website. BPAS was not aware that it was processing the call back data, and as a consequence BPAS did not ensure that administrative passwords were stored securely or that stated standards of communication confidentiality were met. BPAS also failed to carry out appropriate security testing on the website which would have alerted them to the vulnerabilities that were present and did not ensure that the underlying software supporting the website was kept up to date. BPAS did not have a written contract with either company that complied with the requirements of the Act.

Conclusions

Most accountants will have at least one charity as a client. Most of these will be quite small, often looked after on a pro-bono or merely cost recovery basis. The fact that the sector is reporting so many incidents is worrying but understandable given the large number of volunteers active in this sector. Whilst there have been only two MPNs issued to date, there have been many Undertakings issued, often to quite small charities. (An Undertaking is an agreement with the ICO to take specified measures to correct identified weaknesses.)

The technical issues raised in the supply chain are not unique to charities. Even if you do not have a charity as a client the chances are that you will have clients using technology this way. You may even have a client using this sort of web form to collect credit card details as part of a simple e-commerce site.

The reality is that whilst most businesses will be vaguely aware of the DPA and the ICO they tend to think it does not matter to them. Your typical accountant's average client will not be in the public sector, neither will they be charities. There is a tendency to think that all of this information security stuff is irrelevant to your firm and your clients.

Nothing could be further from the truth. When you look at the detail of what goes wrong the majority of incidents are either staff or supplier related.

MONEY LAUNDERING UPDATE

Hillgrove PR case

The recent tax fraud case involving Richard Hillgrove, a PR Consultant with several high profile clients, is of significant relevance to accountants. His company, Hillgrove Public Relations Limited, had avoided paying VAT totalling £52,000 and PAYE totalling £43,000. The money was spent on luxury items such as flowers and hotels. Hillgrove also owed taxes from a Limited Liability Partnership, RJH Management, a business he had operated with his wife.

One of the main pieces of prosecution evidence on which the case hinged was a suspicious activity report (SAR) submitted by his former accountant. This SAR was picked up by HM Revenue & Customs (HMRC), who were already investigating Hillgrove.

What is unusual about this case is that the contents of the SAR were actually directed to be disclosed in court by the judge, since one of the defences put forward by Hillgrove was that HMRC and his former accountants were involved in some sort of collusion to bring about his downfall. Michelle Bishop, partner at Bishop Fleming, was involved in Hillgrove's affairs from November 2010 to January 2012. She was summoned as a witness and asked in detail about her firm's relationship with Mr Hillgrove and the basis of her SAR.

There are two points here:

1. The disclosure of the contents of the SAR and subsequent cross examination of the submitter will prove as something of a warning to accountants to make sure that they get the procedural side of things correct when they find themselves in a situation where they need to report to the National Crime Agency.
2. Hillgrove was a headstrong and potentially morally dubious individual. Accountants who become involved with clients of this type should not forget their ethical duties and also their duties under the Proceeds of Crime Act 2002.

It is not yet clear whether Hillgrove will appeal the court ruling but if he does we will of course keep you informed of this and any further ramifications which may impact practitioners.

Anti-money laundering and combating the financing of terrorism – jurisdictions and deficiencies

Iran and the Democratic People's Republic of Korea remain on the Financial Action Task Force's (FATF) most urgent list, requiring significant overhaul to address substantial terrorist financing and money laundering risks which exist in these jurisdictions.

In the next category of severity are jurisdictions with strategic Anti Money Laundering deficiencies that have not made sufficient progress in addressing the deficiencies or have not committed to an action plan developed with the

FATF to address the deficiencies. These are Algeria, Ecuador, Ethiopia, Indonesia, Myanmar, Pakistan, Syria, Turkey and Yemen.

Afghanistan and Cambodia have been singled out as two jurisdictions with plans in place, but which are failing to make satisfactory progress in implementing these plans.

Full details are available on the FATF website at: **http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/documents/public-statement-feb-2014.html**.

MONEY LAUNDERING QUERY

Query: *I have just finished the audit of a client and during the course of auditing expenses discovered that a member of staff had been making fraudulent expense claims, mainly in relation to fudged mileage and subsistence claims. The claims had been going on for over a year and the client became aware of the situation and the employee was sacked. The client did not press criminal charges on the understanding that the former employee pay back the amount which was obtained fraudulently. This amount has now almost been completely repaid.*

We are unclear as to whether this is a reportable offence because the amount is being repaid? Do we need to make a suspicious activity report in this situation?

Answer: The key matter here is to decide whether or not the ex-employee's behaviour falls under the definition of money laundering. Money laundering is defined in section 2.1 of the CCAB guidance as "*including all forms of handling or possessing criminal property, including possessing the proceeds of one's own crime, and facilitating any handling or possession of criminal property*".

In this situation, the individual has obtained a benefit from their criminal conduct in the form of the criminal property that they have possessed. Although the money was repaid and they lost their job, they have still had a benefit from it based on the fact that it was effectively an interest-free loan during the period when it was taken to when it was repaid.

Therefore, the employee's actions still constitute a money laundering offence and we would therefore suggest that a suspicious activity report needs to be lodged with the National Crime Agency.

The CCAB guidance can be accessed at: **http://www.ccab.org.uk/PDFs/070612%20CCAB%20Guidance%20Clean.pdf**.

SUSTAINABILITY SURVEY HIGHLIGHTS NEED FOR MORE GUIDANCE

Although the Mandatory Carbon Reporting requirements currently only apply to UK quoted entities, there is evidence of these requirements cascading down the supply chains of these listed entities to the Small and Medium-sized Entities (SMEs) with which they engage.

As a result, many smaller organisations have found that they are obliged to measure and quantify their carbon emissions.

The ICAS Sustainability Committee undertook a members' survey in September 2013 to ascertain the extent of members' awareness of sustainability issues and to identify any additional guidance and further training that would help them fulfil these new reporting responsibilities.

Two thirds of the respondents agreed that sustainability is an accounting issue despite few of them having had much, if any, recent exposure to sustainability-related activities in their working lives.

One of the questions in the survey asked for an assessment, in terms of importance, of those topics where training would be of greatest value. The areas of Mandatory Carbon Reporting and Environmental Tax Incentives were highlighted as the most important areas for further training.

A lack of awareness of certain bodies and organisations that specialise in this subject was also highlighted in the survey responses and this feedback will be used to populate the Sustainability area of the ICAS website to provide greater insight to members seeking guidance and direction.

Suggestions and ideas from some of the comments received will also be used to populate the Sustainability area of the website with more useful and practical guidance and information.

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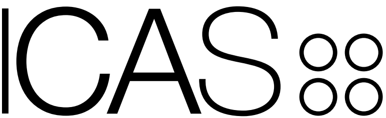

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