Bahamas Institute of Chartered Accountants

Guidance Note For "Certification" of Financial Information in Business Licence Application

Background

Pursuant to the Business Licence Regulations, 2010 (the Regulations), as amended, businesses with turnover of one hundred thousand dollars ($100,000) per annum or more are required to have financial results, submitted as part of their business licence applications, certified by "a person qualified in accounting and who has no interest in the business".

The Bahamas Institute Chartered Accountants (BICA) has interpreted the person referred to in the Regulations to be a licensed member of BICA in good standing. Further, BICA considers it necessary to provide guidance regarding the certification process to ensure: consistency among practitioners; compliance with professional standards governing BICA; and compliance with Statements of Membership Obligations as a member of the International Federation of Accountants (IFAC) and the Institute of Chartered Accountants in the Caribbean (ICAC).

Technical Analyses

<u>Basis of preparation of financial information</u>

Pursuant to the Business Licence Act, 2010 (the Act), as amended, businesses are required to submit its turnover for the preceding calendar year as part of its business licence application for the current year, as business licence fees are based as a percentage of turnover. Turnover is defined in the Act as:

> *"….total revenues in money or money's worth accruing to a person for his own use and benefit from his business activities within The Bahamas during the preceding year or any part thereof or in such other accounting period as the Secretary may allow, including cash, credit sales and commissions without any deductions whatsoever."*

The Act does not provide sufficient details to be considered a comprehensive basis of accounting, as required by professional standards when performing any level of assurance. The terms "money" and "money's worth" can be interpreted as a cash basis of accounting, whereas "credit sales" can be interpreted as an accrual basis of accounting. However, pursuant to the Bahamas Institute of Chartered Accountants Act, 2015, the accounting principles generally accepted in the Commonwealth of The Bahamas (Bahamas) are International Financial Reporting Standards (IFRS).

The long term recommendation to the Ministry of Finance is to amend the Act to either adopt IFRS as the basis upon which turnover/revenue is to be recognised and reported, or to expand its details on the requirements for recognition of turnover/revenue. As an immediate solution to enable current business licence applications to be subject to assurance by independent practitioners is to document the accounting policies adopted by the respective business for revenue recognition and accounts receivable and provisions for doubtful accounts in the preparation of financial information for business licence purposes, and to have these policies appended to the business licence application. This would enable the Department of Inland Revenue to evaluate the accounting policies used and assess the appropriateness of such accounting policies for the purposes of business licence applications.

Further, the Act requires a business to pay business licence fees at a rate determined by reference to the consolidated turnover of group of businesses designated by the Department of Inland Revenue as having a parent/subsidiary relationship. The definition in the Act does not provide sufficient details to be considered a comprehensive basis of accounting for determining consolidation. The long term recommendation to the Ministry of Finance is to amend the Act to either adopt IFRS as the basis upon which consolidation is to be required, or to expand its details on the requirements for consolidation. As an immediate solution to enable current business licence applications to be subject to assurance by independent practitioners is to document the accounting policies adopted by the respective business for the purposes of consolidation in the preparation of financial information for business licence purposes, and to have these policies appended to the business licence application. This would enable the Department of Inland Revenue to evaluate the accounting policies used and assess the appropriateness of such accounting policies for the purposes of business licence applications.

See Appendix 1 for illustrative summary of accounting policies.

<u>Appropriate Assurance Standards</u>

In order for there to be consistency in the certification process, there must be an agreed assurance standard that should be adopted by all practitioners in performing the certification process. Further, there should be one (1) form of report by independent practitioners.

Based on the following factors, the most appropriate assurance standard is the International Standard of Review Engagements 2400 (Revised) *Engagements to Review Historical Financial Statements* (ISRE 2400 Revised):

- ISRE 2400 Revised is a limited assurance engagement, in which an independent practitioner expresses a conclusion that is designed to enhance the degree of confidence of intended users regarding the preparation of financial information in accordance with an applicable financial reporting framework. [ISRE 2400 Revised par. 6]

- Limited assurance is not at the level of an audit (reasonable assurance), however, the procedures in a limited assurance engagement are designed to enable the independent practitioner to identify matters that cause the independent practitioner to conclude that financial information is not prepared, in all material respects, in accordance with an applicable financial reporting framework. [ISRE 2400 Revised par. 14a.].

- All businesses subject to certification under the Regulations are required to be registered for value added tax (VAT) purposes. Accordingly, businesses will be providing regular information on turnover/revenue against which the Department of Inland Revenue can compare turnover/revenue reported in business licence applications. Under VAT legislation, registrants will be subject to periodic audits by the Department of Inland Revenue. Therefore, limited assurance on financial information included in business licence applications should be sufficient.

- The procedures required under ISRE 2400 Revised consist primarily of inquiry of management of businesses and analytical procedures. However, when the independent practitioners believes that financial information has not been prepared, in all material respects, in accordance with an applicable financial reporting framework, ISRE 2400 Revised requires the independent practitioner to perform additional procedures necessary in his/her professional judgment to conclude that the information has been prepared, in all material respects, in accordance with an applicable financial reporting framework.

- The cost of an ISRE 2400 Revised engagement, limited to revenue and receivables, is significantly less than an audit under International Standards on Auditing (ISA) and an attestation engagement under International Standard on Attestation Engagements 3000 *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* (ISAE 3000). Given that the Department of Inland Revenue will be performing VAT audits of registrants, the required level of assurance under the certification should be evaluated along with the costs to businesses.

- Limited assurance was agreed between BICA and the Secretary of Revenue under the predecessor legislation, Business Licence Act, 1980. At the time, the professional standard was ISA 910, which has been replaced by ISRE 2400 Revised. Businesses subject to certification in the past are familiar with the requirements under limited assurance engagements. ISRE 2400 Revised has expanded the guidance on the requirements for limited assurance engagements, and therefore has strengthened the quality of engagements performed under this standard.

Certification Procedures

- ISRE 2400 Revised (attached for ease of reference), requires the following procedures, among others:

  ISRE 2400
  (Revised).pdf

  - Compliance with relevant ethical requirements [par. 27].

  - Acceptance and continuance consideration of client relationships [par. 29], which includes preconditions – one of which being management's acknowledgement of responsibility for preparation of financial information in accordance with an applicable financial reporting framework.

  - Agreeing terms of engagement, in an engagement contract [par. 36 and Appendix 1].

    - Determining appropriate materiality thresholds [par. 43 and A70].

    - Obtaining an understanding of the business and its environment and applicable financial reporting framework. This includes understanding, inter alia, operations, ownership and governance structure and accounting systems and accounting records. [par. 45 – 46 and A75 – A78].

    - Specific inquiries of management [par. 48 and A84 – A87].

    - Analytical procedures [par. 49 and A89 – A91], which range from simple comparisons to performing complex analyses using statistical techniques. Analytical procedures require development of independent expectations to compare with results recorded in accounting records, and can include trend analysis, ratio analysis or expectation based on independent sources of information.

    - Additional procedures when the independent practitioner becomes aware that financial information may be materially misstated [par. 57].

    - Request written representations from management [par. 61 and A100 – A102].

    - Form a conclusion [par. 72].

- Following the formation of a conclusion, the independent practitioner should prepare an independent practitioners' report, in the form attached in Appendix 1 to this guidance note].

    - Appendix 2 is an illustration of an unmodified conclusion. Practitioners should assess whether to use the singular form of practitioner of plural form of practitioners' based on the firm's policies.

    - In the event of a failure to form an unmodified conclusion, considerations of modified conclusions contained in ISRE 2400 Revised par. 75 – 81 and Appendix 2.

    - A restriction of use paragraph should be added, as the report is limited to financial information contained in the business licence application and appended thereto.

- The business licence application, using Form A as prescribed by the Secretary of Revenue, should be completed, printed and signed by the independent practitioner, and appended to the independent practitioner's report, along with a summary of significant accounting policies used by management in the preparation of financial information contained in the business licence application.

- The independent practitioner's report, signed business licence application and summary of significant accounting policies should all be scanned and appended to the online business licence portal.

Conclusion

The Guidance Note provides guidance on using the appropriate professional standards to perform a certification, the normal financial reporting framework to be used by businesses and the reporting logistics for independent practitioners.

The form and content of the independent practitioner's report takes the form of preparation of financial information in accordance with a comprehensive financial reporting framework and not of compliance with a contract, which is on the basis that the Act does not provide sufficient details to report on compliance with the revenue recognition requirements of the Act. The appending of accounting policies enables the use of the form and content of an engagement to review financial information prepared in accordance with a comprehensive financial reporting framework.

Changes to the form and content of the independent practitioner's report, the procedures required to be performed and the logistics of filing will be updated in accordance with any changes in the ISRE standard applicable to review engagements of historical financial statements.

Appendix 1 – Illustrative Summary of Significant Accounting Policies

The principal accounting policies adopted in the preparation of the [consolidated] financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

(a) Basis of preparation

The [consolidated] financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) [or International Financial Reporting Standards for Small and Medium-Sized Enterprises (IFRS for SMEs)], and under the historical cost convention. The preparation of financial statements in accordance with IFRS [or IFRS for SMEs] requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the accounting policies of [Company's full legal name] (the Company). Estimates and assumptions made by management affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the [consolidated] financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the [consolidated] financial statements, are disclosed in Notes (b) and (c).

New standards, amendments and interpretations adopted by the Company

Standards and amendments and interpretations to published standards that became effective for the Company's financial year beginning on 1 January 2015 were either not relevant or not significant to the Company's operations and accordingly did not have a material impact on the Company's accounting policies or [consolidated] financial statements.

New standards, amendments and interpretations not yet adopted by the Company

With the exception of IFRS 9 *Financial Instruments* (IFRS 9) and IFRS 15 *Revenue from Contracts with Customers* (IFRS 15), the application of new standards and amendments and interpretations to existing standards that have been published but are not yet effective are not expected to have a material impact on the Company's accounting policies or [consolidated] financial statements in the financial period of initial application.

IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities, and replaces the guidance in IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through profit or loss and fair value through other comprehensive income. The determination is made at initial recognition, and the basis of classification depends on the Company's business model for managing its financial assets and the contractual cash flow characteristics of the financial asset. In addition, IFRS 9 will require the impairment of financial assets to be calculated using an expected credit loss model that replaces the incurred loss impairment model required by IAS 39. For financial liabilities, there were no changes to classification and measurement, except for the recognition of changes in own credit risk in other comprehensive income for financial liabilities designated at fair value through profit or loss. The Company has not yet assessed the full impact of adopting IFRS 9, which is effective for financial periods beginning on or after 1 January 2018.

IFRS 15 deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with its customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard is effective for annual periods beginning on or after 1 January 2018, and replaces IAS 18 *Revenue* and IAS 11 *Construction Contracts* and related interpretations. The Company has not yet assessed the full impact of adopting IFRS 15.

[(b) Principles of consolidation

Subsidiaries are all entities over which the Company has control. The Company controls an entity when the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are deconsolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting polices of subsidiaries are changed where necessary to ensure consistency with the policies adopted by the Company.

Pursuant to Section 8(2) of the Business Licence Act, 2010, as amended (the Act), the Company consolidates the following group companies for the purposes of determining the Business Licence fee rate:

- ABC Subsidiary Limited
- DEF Subsidiary Limited
- GHI Subsidiary Limited

OR

Pursuant to Section 8(2) of the Business Licence Act, 2010, as amended (the Act), the Company is designated as a group company of JKL Parent Limited for the purposes of determining the Business Licence fee rate.]

(b) Revenue recognition

Sales are measured at the fair value of the consideration received or receivable, and represents amounts receivable for goods supplied, stated net of returns, rebates and discounts. The Company recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity, and when specific criteria have been met for each of the Company's activities, as described below.

The Company bases its estimates of returns on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Sales of goods – wholesale

The Company sells a range of products on a wholesale basis. Sales of goods are recognised when the Company has delivered products to the buyer and there is no unfulfilled obligation that could affect the buyer's acceptance of the products. Delivery does not occur until the products have been shipped to the specified location, the risks of obsolescence and loss have been transferred to the buyer, and either the buyer has accepted the products in accordance with the sales contract, the acceptance provisions have lapsed or the Company has objective evidence that all criteria for acceptance have been satisfied. Sales are recorded based on the price specified in the sales contracts, net of the discounts and returns.

Sales of goods – retail

The Company operates a retail outlet for selling products. Sales of goods are recognised when the Company sells a product to the customer. Retail sales are usually in cash or by credit card.

Service revenue

Fees for professional services are recognised by reference to the stage of completion of the specific engagement. Therefore, fees include amounts billed to clients, as adjusted for work-in-progress; increased for work-in-progress as of the end of the year and decreased for work-in-progress as of the beginning of the year. Work-in-progress is determined by reference to the costs of providing the professional services (salaries, overheads etc.), plus profit margins and less provision for expected losses.

Costs incurred that are to be recovered from clients are recognised on the accrual basis, and actual recoveries are recognised against expenses when billed.

Interest income

Interest income is recognised using the effective interest method.

Other

Other income is recognised on an accrual basis.

(c) Trade receivables

Trade receivables are amounts due from customers for merchandise sold or services provided in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business, if longer), they are classified as current assets; if not, they are presented as non-current assets.

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment.

The Company evaluates at each balance sheet date whether there is objective evidence that a trade receivable or group of trade receivables is impaired. A trade receivable or group of trade receivables is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event (or events) has an impact on the estimated future cash flows of the trade receivable or group of trade receivables that can be reliably estimated.

If there is objective evidence that an impairment loss on trade receivables has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the original effective interest rate of the respective trade receivables. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the [consolidated] statement of comprehensive income.

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the [consolidated] statement of comprehensive income. When a trade receivable is uncollectible, it is written off against the related allowance account. Recoveries of accounts previously written off are recognised directly in the [consolidated] statement of comprehensive income.

Appendix 1 – Form and Content of Independent Practitioner's Report

INDEPENDENT PRACTITIONERS' REVIEW REPORT

TO THE SECRETARY FOR REVENUE

THE MINISTRY OF FINANCE

NASSAU, BAHAMAS

We have reviewed the financial information of [Company's full legal name] (the Company) set forth in the accompanying Business Licence Application in respect of the year [insert applicable year], which comprise [turnover/gross premium] for the year ended [insert date] of $[insert amount], and summary of significant accounting policies.

Management's Responsibility for the Financial Information

Management is responsible for the preparation and fair presentation of this financial information in accordance with the provisions of the Business Licence Act, 2010 and related regulations, as amended, and for such internal control as management determines is necessary to enable the preparation of financial information that is free from material misstatement, whether due to fraud or error.

Practitioners' Responsibility

Our responsibility is to express a conclusion on the accompanying financial information. We conducted our review in accordance with International Standard on Review Engagements 2400 (ISRE 2400). ISRE 2400 requires us to conclude whether anything has come to our attention that causes us to believe that the financial information is not prepared in all material respects in accordance with the provisions of the Business Licence Act, 2010 and related regulations, as amended. This Standard also requires us to comply with relevant ethical requirements.

A review of financial information in accordance with ISRE 2400 is a limited assurance engagement. The practitioners perform procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluate the evidence obtained.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing. Accordingly, we do not express an audit opinion on this financial information.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the financial information set forth in the accompanying Business Licence Application does not present fairly, in all material respects, the [turnover/gross premium] of [Company's full legal name] for the year ended [insert date] in accordance with the provisions of the Business Licence Act, 2010 and related regulations, as amended.

Independence

We are independent of [Company's full legal name] in accordance with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

Restriction of Use

This report is intended solely for the Secretary of Revenue and should not be distributed to or used by parties other than the Secretary of Revenue; it relates only to the financial information specified above and does not extend to the financial statements of [Company's full legal name], taken as a whole.

Chartered Accountants
Nassau, Bahamas

[insert date]

[Signing Partner's Name], Bahamas Institute of Chartered Accountants Licence # [insert]