



## Access to working papers to successor auditors

Currently auditors do not provide access to their audit working papers to other parties, except in exceptional circumstances and only after hold harmless letters have been signed. From 6 April 2008, following a change in audit appointment, predecessor auditors will be required to provide access to relevant information where a successor auditor makes a request for such access. To bring this requirement, which arises out of the EU Statutory Audit Directive and also reflects one of the recommendations of the Audit Choice Market Participants Group, into UK law, the government is amending schedule 10 of the Companies Act 2006. It has given the Recognised Supervisory Bodies some discretion to consider what the most appropriate minimum requirement might be in relation to access to relevant information. The Professional Standards Directorate of the Institute has therefore drafted a new audit regulation and has sought to define relevant information.

There is no statutory compulsion on the successor auditor to require access, only for the predecessor auditor to provide access if the successor auditor requests it. This obligation is far reaching. Not only will it apply to all company audits, but it will also apply to non-company statutory audits (such as charities and pension schemes). It will apply to all companies within the UK (although, there will be differences in the application in the Republic of Ireland).

The requirement will apply to auditors' working papers (which have been compiled in accordance with auditing standards) in relation to the audited entity for which the auditor was engaged to carry out the statutory audit. Access will be restricted to the last completed audit of the predecessor auditor (where the audit report has been signed) and only one year's worth of papers and the subsequent interim review need to be made available. Access can only be requested after the auditor has been formally appointed as the successor auditor.

The Audit and Assurance Faculty has set up a working group to consider the practical implications of the regulation. A number of issues are being considered about the extent of application and a technical release is currently being drafted which will provide guidance to auditors on how to manage their duty of care when providing this access. It envisages putting in place a hold harmless framework, including the request of release letters from the successor auditor and an authorisation letter from the client. It is anticipated that this guidance will be available in March 2008 prior to the date when the requirement comes into force.

Sumita Shah | Manager, Audit and Assurance Faculty

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# 2007 year in review

The significant amount of change facing the audit profession in recent years has continued into 2007. While International Standards on Auditing (ISAs) are now into their second year of implementation in the UK, considerable work has been undertaken by the International Audit and Assurance Standards Board (IAASB) in 2007 to clarify and revise existing ISAs. There has been ongoing work with stakeholders on initiatives to improve audit quality and years of hard work prior to the launch of the consultation on the needs of audit exempt companies and the ICAEW Assurance Service is paying off with considerable interest shown from international organisations. The faculty is working to represent members' interests with regulators, while also providing members with timely and practical guidance.

## Audit Quality Forum

The faculty has had a busy year supporting the work of the *Audit Quality Forum*, the leading mechanism for open and constructive debate about transparency, accountability, reporting and confidence in independent audit. As well as convening debate between investors, auditors, business and regulatory bodies, the publication of the final two reports, *Auditor reporting* [R](#), and *Third parties* [R](#) generated considerable interest and brought the *Fundamentals* work programme to a close.

The earlier *Audit Quality Forum* work programmes have led to the *Evolution* work programme [R](#) which considers the changing environment in which auditors work, the reporting relationship between auditors and the audit committee and how the differing interests of stakeholders and their expectations of audit can be reconciled.

The faculty has supported the establishment of the *Evolution* programme, and convened its first event, a high profile debate on the impact of audit committees and plans to take forward further work into 2008. For further information on the work of the *Audit Quality Forum* please visit its website [R](#).

## Promoting Audit Quality

During the year, the faculty responded to the Financial Reporting Council (FRC) discussion paper *Promoting Audit Quality* and will continue to represent members' interests with the FRC through the *Audit Quality Forum Evolution* programme, which also aims to ensure confidence in auditing.

The faculty will follow up on specific issues now raised in the FRC report on responses to the *Promoting Audit Quality* consultation, liaising with other parts of the Institute, the FRC, Auditing Practices Board (APB) and other external bodies as appropriate.

## Assurance Services

The faculty continues to build on its expertise in the provision of external assurance services. The faculty added to its growing collection of assurance technical releases, with the publication of *Framework for assurance reports on third party operations* [R](#). This paper sets out a framework for performing assurance engagements on various aspects of business relations that are undertaken between organisations.

The faculty is focusing on promoting dialogue about assurance services among various stakeholders through the *re:Assurance* initiative. This includes: finding out where new services could strengthen markets and support economic confidence by making information flows more credible; asking how the *International Framework for Assurance Engagements* can be applied and developed; and answering demands for practical guidance to meet emerging market needs. To stimulate such dialogue on external assurance, the faculty has been working on a series of publications, entitled *Perspectives on Assurance* [R](#), focusing on specific audiences - practitioners, business and those with an interest in public policy.

Since the launch of the consultation on the needs of audit exempt companies, the faculty has been working hard to raise the profile of the consultation and the related product the ICAEW Assurance Service. The faculty has been consulting with users of Assurance Services to further refine the product through directly speaking to stakeholders including banks and lenders. The faculty plans to share its findings with the IAASB in its Strategy Consultation. To find out more about the ICAEW Assurance Service and join the debate please visit its website [R](#).

## International standards on auditing (ISAs)

While the auditing profession in the UK and Ireland is now familiar with ISAs (UK and Ireland), the faculty has been busy working with the ISA Implementation Sub-group to represent member interests in drafting responses to the many exposure drafts on clarified and revised ISAs issued as part of the IAASB's 'clarity project' [R](#). Now that the development phase of the clarity project is coming to an end, the faculty and Sub-group are turning their attention once again to implementation issues and we are seeking early engagement with regulators and training providers. A forum was held at Chartered Accountants' Hall in the autumn to provide practitioners, training providers and regulators with the opportunity to share experiences from the original implementation of ISAs in the UK and Ireland and to consider issues going forward for the implementation of clarified and revised ISAs. The faculty will continue to represent members' interests to the European Commission (EC), IAASB and APB and will communicate proposed changes to members through *Audit & Beyond*, the faculty roadshow and website.

## Statutory Audit Directive

The Statutory Audit Directive, finalised in mid 2006, is the single biggest European Union (EU) legislative initiative to impact on the audit profession. Most of the measures required by the Directive are already in place in the UK or will be brought in at the same time as the new Companies Act provisions on 1 April 2008. The faculty has this year responded to two Government consultations on UK implementation of the Directive [R](#). The faculty is keeping members abreast of developments through *Audit & Beyond* and will continue to work closely with the Department of Business Enterprise and Regulatory Reform (BERR) on implementation measures.

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## A framework for assurance reports on third party operations

A new technical release on providing assurance reports on business relationships is enclosed with this month's *Audit & Beyond*. Jo Iwasaki discusses some of the essential points.

As reported in October 2007 *Audit & Beyond*, the Audit and Assurance Faculty was due to publish a new technical release on providing assurance reports on external business relationships. This technical release is now enclosed with this issue. The technical release provides high level guidance for practitioners who provide assurance reports on certain aspects of business relationships, such as compliance with the contractual terms, the control and management of outsourced business processing, and whether the agreed level of business performance was achieved.

It is not always practicable for specific aspects of business relationships to have guidance as the nature of business relationships today and interests of the involved parties can vary widely: the latter can range from protecting the business reputation to paying a correct, and not overstated, fee for an outsourced service.

This means that, when using the guidance in practice, practitioners will still need to do some thinking, including:

- How can I measure/assess the subject matter?

- Should the period of measurement/assessment be specific points in time or cover a period of time?

These are matters that will need to be agreed with the client and then set out in the engagement letter.

Practitioners should also be aware of the viewpoint of those who ultimately benefit from the business relationship. The client may want to ensure that they are not paying a fee for an inadequate level of performance for outsourced operations (i.e. the client = the user organisation). But there are cases where the client is a general service provider, for instance, a company that provides a royalty accounting service for its customers and wants to demonstrate that its performance is trustworthy (whether the practitioner's assurance report will be shared with the company's customers is a separate matter). In this context, it is important that practitioners consider the viewpoint

of the customers who have assigned the royalty accounting task to this client so that practitioners can determine the criteria, materiality and the extent of evidence gathering. If such a viewpoint is missing, practitioners may end up performing an internal audit task for the sake of the client's management. This may be an obvious point in an audit where shareholders are the users, but may not always be so in non-audit assurance services.

The point can be a fine one and in some cases the management concerns are very similar to those of its customers. However, the importance of differentiating the views of the two is crucial. This is because, at the end, considerations such as materiality and the extent of evidence gathered would affect the assurance conclusion.

**Jo Iwasaki** | *Manager, Audit and Assurance Faculty*

## 2007 year in review - cont'd from page 2

### Audit exemption threshold

During the year there has been regulatory activity at both European and national fronts in relation to audit exemption. The faculty has been working with other Institute staff and committees to respond to the UK Government consultation on amendments to the accounting directives. Following its consultation, BERR has indicated that it will raise the audit exemption thresholds to a turnover of £6.5 million and balance sheet total of £3.26 million. It is expected that the regulations will take effect for financial years starting on or after 6 April 2008.

In July 2007, the European Commission issued a series of proposals aimed at "Simplifying the business environment for companies" in the areas of company law, accounting and audit **R**. The key points in the ICAEW's response, which the faculty contributed to, are set out on pages 8-9.

### Supporting members

The faculty's response to over 25 consultations this year provides an indication of the substantial activity by regulators in the audit field. The faculty recognises the

need for our members to receive accurate and timely updates and guidance on regulatory changes and other developments impacting on the audit and assurance profession to assist in the delivery of quality service. In 2007, in line with the Institute's re-branding, the faculty made some changes to the design of its publications to improve their accessibility. The changes have been reflected in the faculty's *Audit & Beyond* newsletter, quarterly *Technical Update*, *CPD Planner* and *Tech at a Glance* and will be used for future publications.

The faculty's roadshow has proven to be a popular means for members to learn about changes to the audit environment. In 2007 there were 16 roadshows held across England and Wales attracting over 1,200 delegates.

### Going forward

Looking ahead into 2008, audit quality, the faculty's *re:Assurance* initiative and ISA implementation will feature high on our agenda.

After over six years spent developing the faculty into the leading voice on audit and assurance services, we say goodbye to Deborah Chaplin who is moving to a new role as Director of Faculties at the ICAEW. She has handed over the reins to new faculty Head, Henry Irving, who will lead the faculty into 2008.

**Michael Gallagher** | *Operations Manager, Audit and Assurance Faculty*

# The audit of charities in the United Kingdom

This article summarises some of the main points arising from the proposed revision of Auditing Practices Board (APB) Practice Note 11, *The audit of charities in the United Kingdom*.

Practice Note 11 was last revised in April 2002. There have been major changes since then, necessitating a further update:

- Implementation of ISAs (UK and Ireland) for audits of accounting periods starting on or after 15 December 2004. The APB published guidance for auditors on the application of ISAs to the audits of charities, in Bulletin 2005/1, *Audit Risk and Fraud - Supplementary Guidance for Auditors of Charities*, but this covered only the so-called 'risk' ISAs, as an interim measure. There are nearly 30 more ISAs to be taken into account
- Companies Act changes. Some of these have led to changes in reporting requirements for company charities rather than different auditing procedures, but the 2006 requirement for directors' statements about the provision of information to auditors has important implications for communications between auditors and those charged with governance
- Changes in the regulation of charities in Scotland and Northern Ireland. The Charities and Trustee Investment (Scotland) Act 2005 (the Scottish Act) established the Office of the Scottish Charities Regulator (OSCR) and legislation is being developed for a Northern Ireland Charity Commission
- Charities Act 2006 applicable to charities in England and Wales (E&W). The main change is the 'migration' of provisions for the audit of small company charities from the Companies Act to charities legislation, so that the audit exemption report for such charities will be replaced by independent examination (for which the threshold will now be income over £10,000)
- Whistleblowing provisions. Reporting requirements will change with the alignment of Companies Act and Charities Act provisions, and with the creation of the new charity regulators in Scotland and Northern Ireland

The APB expected to be able to publish a consultation draft of the revised Practice Note in October 2007, but the extent and complexity of the regulatory changes delayed completion of the draft until much later in the year, with publication now expected in Spring 2008. The implementation of accounting and auditing provisions of the 2006 Charities Act has itself been put back due to pressures on parliamentary time, which has made the production of definitive guidance very difficult.

The main changes to the Practice Note are expected to be:

- The section comparing Independent Examination with audit has been removed, because Independent Examination does not constitute an audit and is the subject of separate guidance issued by the Charity Commission
- Withdrawal of the guidance on Statement of Standards for Reporting Accountants
- The inclusion of material on Charitable Incorporated Organisations - mainly the reporting considerations

Overall, the guidance in the revised PN will be much condensed, though the format, of an introduction setting out the particular features of charities followed by the application of each ISA in the context of charities, will be the same. There will also be an appendix with updated example audit reports.

The changes to the whistleblowing requirements for auditors of company charities and non company charities are particularly important but are also particularly complex and so have proved difficult to cover in the revised guidance.

Under current legislation the auditors of non company charities registered in E&W or in Scotland have a statutory duty to report matters of material significance to the Charity Commission or OSCR respectively. The auditors of company charities in E&W have a right, but not a duty, to report under the Companies Act 1985 to the Charity Commission. Under the Scottish Act, on the other hand, auditors of a company charity have a duty to report to OSCR. And the auditors of company charities in E&W will have a duty to report when the provisions of the Charities Act 2006 relating to accounts and audit are fully implemented.

**Mary-Lou Wedderburn |**

*Consultant, Audit and Assurance Faculty*



# Understanding IT Risk: an opportunity for internal auditors to close the gap

With technology featuring more prominently on UK board agendas a recent Internal Audit Lecture gave delegates an opportunity to consider the implications of IT risk and whether or not internal audit has the capacity and credibility to provide technology assurance to the board. Antony Ruddenklau and Peter Westberg of PricewaterhouseCoopers and authors of *IT Risks - Closing the Gap*, discussed key messages emerging from their research.

Technology continues to rapidly change pace and is increasingly embedded across business functions. Over the past year PwC, with the Institute of Internal Auditors, surveyed senior management (including Chief Financial Officers and Chief Information Officers) and Heads of Internal Audit to gather information on perceptions of IT risk and current assurance. Follow up interviews were then held to help identify any gaps that exist between different parts of an organisation.

## Findings

Some of the survey findings included that:

- 74 percent of organisations have technology related risks higher on the board agenda
- 60 percent of boards consider internal auditors are able to discuss IT risks effectively
- 74 percent of Internal Audit Heads would like to provide more assurance over IT risk at a strategic level

Responses from the two groups surveyed (senior management and Heads of Internal Audit) differed, notably in the areas of the board's understanding of IT risks and its capacity to respond to these. In terms of IT risk management, the survey found that 68 percent of Internal Audit Heads believe the board does not understand the IT risks they face, with the proportion of senior managers also of this view lower at 40 percent. A recent KPMG survey of audit committees tends to support the Head of Internal Audit views, with only 30 percent feeling boards have an understanding of IT risk.

Interviews with Assurance Directors provided some further comments on the capacity of boards to understand technology risk, including:

- It is hard for 'technologists' (i.e. technology managers) to communicate risks to boards
- Boards often lose sight of the delivery of projects
- Boards are not aware of new technological developments and associated risks
- Boards do not spend adequate time understanding IT related risk

## Defining and identifying IT risk priorities

The survey split technology risk into 11 areas, of which 250 survey respondents identified their highest priorities as:

- IT project risk (e.g. failure to deliver benefits or within budget)
- IT resilience and continuity
- IT governance risk (lack of alignment between IT and the business) and then three risks relating to data
- Data security and privacy
- Business systems risk (e.g. poor change control over an ERP system)
- Data quality risk

## A detailed or strategic approach?

Based on the 11 risk areas, survey respondents were asked which of the following approaches were used: a strategic/governance level; processes and procedural level; or a detailed level to help develop a picture of the focus of an IT internal audit approach to technology risk.

The highest priority (project risk) was given a medium focus rating at all three levels (between 20-40 percent of respondents feeling that they manage the risk). If project risks are considered to be the highest risk, but only 20-40 percent of respondents are addressing the risk at any level, there is either an unaddressed risk, or perhaps risk is being assured by other means? IT governance risk was the only one of the 11 risks considered to be managed at the strategic level, by over 40 percent of respondents. This lack of strategic focus provides an opportunity for the internal audit discipline to play a strategic bridging role providing assurance by aligning risk management; IT security; compliance; and management and looking at technology risks across these areas.

## Target operating model

Based on ideas and findings from their research, Antony and Peter suggest a target operating model should consider the following aspects. Language should incorporate business risk, not just technical controls. In terms of

resourcing, a networked model that incorporates specialists from across the business or externally, rather than one that is solely sourced from within Internal Audit will help deliver the depth and flexibility required. A more dynamic approach adapting the audit work plan to incorporate the IT elements in business change, rather than a static yearly approach, is necessary. Consideration might be also given to the effectiveness of the integration of IT risk across a business - all IT risk stakeholders (compliance, security, fraud and so on) should all identify, measure and manage IT risk in a consistent manner rather than providing differing versions of the truth. Ideally this will lead to an assurance model that facilitates a more combined, less disaggregated approach to technology risk. It will also help the Board and audit committee discharge their responsibilities far more effectively.

To conclude, delegates were asked to consider the following questions concerning what the board needs to understand, manage and challenge IT risk.

1. What is the current level of real engagement with existing providers of IT assurance and is this engagement effective, joined up and adding value?
2. Does IT audit activity support the strategic needs of the business and is this audit activity communicated within a business context?
3. Does the board need to be challenged around their roles, responsibilities and composition to help them fulfil their obligations around IT risk?

**Michael Gallagher** | Operations Manager, Audit and Assurance Faculty

# The ICAEW Assurance Service: practitioners' experiences

This article reviews the faculty's work on gaining an understanding of the practitioners' relevant experiences in relation to the audit-exemption threshold rise and the ICAEW Assurance Service.

This faculty launched the consultation on the needs of audit-exempt companies in August 2006. At that time, the faculty made clear its intention to seek the views of its members about their experience of the audit-exemption threshold rise and the ICAEW Assurance Service, as well as technical and practical feedback on the technical release AAF 03/06 the *ICAEW Assurance Service on unaudited financial statements* **R**. AAF 03/06 was initially issued as an interim technical release, so that at the end of the consultation period, feedback can be incorporated.

The faculty has since spoken to a number of practitioners to collate their views and experiences through formal and informal presentations, one-to-one interviews, group discussions/roundtables, and written questionnaires. We are also looking at statistical information on what is happening in practice, such as the number of registered auditors, as reported by the Institute to the Professional Oversight Board and then to the Secretary of State for Business, Enterprise, and Regulatory Reform.

The faculty is also speaking to overseas professional bodies which have gone through similar experiences of audit-exemption and the introduction of new service(s) to understand what they went through, and how they managed the process.

This is a long process, and the faculty will continue to work to collect evidence. For instance, along with the faculty's roadshow, we organised two round table sessions: one in Durham and one in Manchester. We are extremely grateful for the valuable input from members through the sessions and reflect, where we can, on what we do. As these sessions gave us great opportunities to speak to our members, we are planning to hold a few more sessions over the next six months. If you are interested in taking part in such sessions, details will appear on the website **R** under 'News and Views'.

We are half-way through the consultation and will continue to gather views of stakeholders including our members. We will take actions where we can. For instance, we noted that sometimes members are wondering how some of the practitioners are marketing the new service. We asked Michelle Fisher, a practitioner in North London, to share her experience with us.

## Case study



Michelle Fisher of Sobell Rhodes and chair of the working party that developed the ICAEW Assurance Service talks about one of her clients.

"But surely you could do something a little less than an audit, Michelle?" That was my client Leon's question to me in early 2004 when the audit exemption threshold had been raised, as the company for which he acted as financial director no longer required an audit.

I explained that was impossible because at that time there was no readily available product in the market. Then, a company not required to have its accounts audited could opt for a voluntary statutory audit or a compilation report. There was no interim level of reporting for a company, previously audited, that relied on the credibility an audit offered, but wished to reduce red tape and the associated professional costs.

The introduction of AAF 03/06 made Leon's company an obvious candidate for an Assurance Engagement.

The company's turnover is approximately £2 million and there are three shareholders, only one of whom is involved in the

management of the company. Leon oversees the company's finances aided by two accounts staff. Being in a "creative" industry, the managing director is not interested in understanding the detail of the numbers, but wants peace of mind over the bigger picture.

As the two non-working shareholders and the bank would be scrutinising the company's accounts, an Assurance Report gave sufficient comfort to the managing director that his accounts team had done a good job and that his management accounts, provided on a monthly basis throughout the year, were providing a trustworthy snapshot of his business's performance.

Our client was highly satisfied with the Assurance Service. It struck a balance between providing sufficient credibility on the accounts presented to the shareholders and being cost effective.

Many clients of Sobell Rhodes are opting for an Assurance Engagement. These clients are a mixture between those previously being audited and not, but it is of particular interest to fast-growing companies or those with external shareholders.

All our new business proposals for SMEs include the offer of an Assurance Engagement and we find that this gives us a competitive edge as we demonstrate the breadth of services we provide and our willingness to adapt to the changing environment.

Would you like to share your experience of offering the Service with the faculty? Please contact [tracy.gray@icaew.com](mailto:tracy.gray@icaew.com).

# Faculty welcomes its new public sector audit committee chair

Mike Suffield, a Director at the National Audit Office takes over from Janet Eilbeck as Chair of the faculty's Public Sector Audit Committee. In this article he reflects on Janet's work for the Committee, and sets out his strategy for the Committee going forward.

Member presence in the public sector world is significant and growing. It is important that the Institute is able to influence developments in the sector. On the audit and assurance front, this role is led by the Public Sector Audit Committee of the Institute's Audit and Assurance Faculty, which inputs to the development of Institute policy on issues relevant to members working in or having an interest in the sector. The Committee is currently made up of practitioners from firms, national audit agencies and internal audit agencies.

Firstly, I would like to extend my gratitude to Janet on behalf of the faculty and the Institute. Janet has held the reins for the last ten years. She started up the Committee in 1997 at the instigation of the faculty's Technical and Practical Auditing Committee. With a career spanning more than 25 years in the public sector and with her extensive knowledge, she was instrumental in setting up the original strategy and leading the way in the work that the Institute carries out in this area. One achievement has been the publication of the faculty's Public Sector Handy Layout Guide, which brought together introductory information on all of the strands of the UK public sector into a single document for members. This is now being updated as a result of changes in government structures.

A little background on me as I pick up the reins from Janet: I am a Director at the National Audit Office with responsibility for the financial audit of the Foreign & Commonwealth Office and the Department for International Development, and have sat on the Public Sector Audit Committee for over 5 years. My aim as Chair is to build on Janet's work and strengthen the Institute's voice across the sector. A crucial feature of this will be to make sure that the different strands of

Institute activity in the public sector are well co-ordinated. To that end, I have already met with Andrew Hind, Chair of the Institute's Public Sector Advisory Board, to discuss how our respective groups might work together.

Recently we reviewed our strategy to align with that of the Institute. It has the following key elements:

- **To raise the image of the Institute's public sector role within the wider profession** - through working pro-actively with stakeholders (e.g. APB, Government Departments, national audit agencies) on developing public sector assurance policy issues, and through contributing to the ICAEW's development of joint working with CIPFA. On this latter point, there may be times when it makes sense to join forces with CIPFA in contributing to policy or technical debates in the public sector, whilst retaining a distinctive ICAEW view where necessary. This is something which the Committee will explore over the coming months as the two Institutes flesh out their ideas on joint working
- **To influence the wider public sector audit and assurance debate** - through making timely and effective contributions to consultation papers and working groups, and developing relationships with others shaping the debate

- **To support the Institute's members** - through developing and distributing relevant information and working with other Institute groups with a remit in the public sector to enhance the reputation of the Institute

We are a group of volunteers, who meet quarterly but also deal with issues as they arise between meetings, working, of course, around the day job. We are also well supported by Sumita Shah from the faculty secretariat. To help us in planning our work to take our strategy forward in 2008, I would be very interested to hear from members working in the public sector audit and assurance field, or, indeed, on "the receiving end" of audit and assurance activities, who feel they might be able to contribute to the work of the Committee.

#### Current Membership:

Mike Suffield, (Chair), National Audit Office  
 Adrian Brook, Moore Stephens  
 Chris Butler, HM Treasury  
 Paul Dillon-Robinson, South Coast Audit  
 John Chastney, Mazars  
 Mike Haworth-Maden, Audit Commission  
 Lynn Hine, PricewaterhouseCoopers LLP  
 Nigel Johnson, Deloitte LLP  
 Mike Usher, Wales Audit Office

**Mike Suffield** | Director, National Audit Office

# ICAEW responds to EC Communication on a simplified business environment for companies

In the September issue of *Audit & Beyond* we explained that the European Commission had issued a consultation paper **R** which put forward a series of proposals designed to simplify the business environment for EU companies in the areas of company law, accounting and auditing. The Institute has responded to this consultation **R** and this article explains the key points made.

## Key measures under consideration by the Commission

- Repealing certain Company law Directives that address mainly domestic situations or removing certain information obligations in the Company law Directives
- The introduction of a category of micro entity which could be excluded from the requirements of the accounting directives
- Amending the SME thresholds transition periods. This would see a move from the current two year period to a one year period for those companies ceasing to exceed the thresholds and a five year period for companies exceeding the thresholds
- The procedure for amending the thresholds should be simplified by leaving it to the European Commission (rather than the European Council).
- Relief from publication requirements for small company accounts
- Extension of exemptions for companies which do not have a wide range of external users of the accounts, such as medium-sized companies where managers are the owners and for unlimited companies
- Exemption for certain SME subsidiaries from preparing audited accounts
- Changes to accounting for deferred taxes
- A reduction in disclosure requirements for accounts

## Company law Directives

The Institute believes that absolute harmonisation across Member States is not achievable as a legislative or political proposition and that the current EU company law system does not achieve the benefits of complete harmonisation yet is imposing costs. It supports the repeal of any EU regulation that addresses mainly domestic rather than cross-border issues.

The response emphasises that simplifying the capital maintenance and distributions regime is the most important issue in the company law arena for the ICAEW, given the complexity of operating the current system in an IFRS environment. Member States should be permitted to implement an optional alternative solvency-based regime, under which distributions would be determined by reference to the effect of distributions on company solvency and the need to preserve the company as a going concern.

This change could be by way of repeal of the relevant Second Company law Directive provisions or by way of radical reform, enabling Member States to introduce a solvency-based regime as an optional alternative. If the current provisions are replaced at EU level it is important that the new provisions are high level principles, requiring Member States to implement the measures they think fit taking into consideration the interests of creditors but giving significant flexibility to Member States to determine the appropriate type and level of regulation.

## Introduction of micro entities

The Institute suggests that there is a case for exploring whether Member States should be able to exempt very small entities from the full rigours of the accounting directives, though the economic and legal ramifications of such a change are, however, likely to be complex. For example, the existing rules on distributions would need to be amended for micro entities.

It comments that following any changes in EU law, national jurisdictions would then need to consider the minimum reporting requirements appropriate for such entities to satisfy the information needs of national authorities.

The response recommends that further research be undertaken by the Commission in terms of defining the thresholds for this category of company and account should be taken of any existing definitions of very small entities in other areas of EU law.

## Thresholds for SMEs

We do not believe that there is a compelling case for changes to the current transition periods. We are not aware of any concerns that have arisen with the application of the existing rules. A five year transition period is too long for those companies exceeding the threshold and a one year period for those companies ceasing to exceed the thresholds may be open to abuse.

In principle, the Institute supports the simplification of legislative procedures to allow for swift decision-making in light of economic trends but this should not undermine in any way the process of consultation and impact assessment needed before any new measures in this area are adopted.

## Relief from publication requirements for small companies

The Institute is not convinced of the arguments put forward by the

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## Clarified ISA implementation date and IAASB's Strategic Plan



The IAASB has announced the implementation date for clarified ISAs and it is also consulting on its strategic plan going forward after finalising the clarity project.

IAASB has announced the implementation date for clarified ISAs which is for audits of financial statements for periods beginning on or after December 15, 2009, which effectively means for 2010 interim and final Audits. **R** The UK auditing standard setter, APB has yet to decide when and how it will implement these ISAs in the UK. It seems likely that the larger firms, through their membership of the Forum of Firms, will be obliged to follow IAASB's timetable, however, the issue is complicated to the extent that

the EC has yet to announce an implementation date for ISAs in Europe and it may not adopt the full suite of ISAs as promulgated by IAASB. The faculty will of course be pressing for an early UK announcement in order that plans can be made by practitioners for the changeover well in advance. It is envisaged that the awareness-raising work of the Institute's ISA Implementation group will move centre stage as this issue develops. Roadshows and publications will follow at the appropriate point when we have a firm implementation date.

IAASB's strategy consultation **R**, which closed at the end of November, proposed a two-year moratorium in its standard setting activities in order to give sufficient time for clarified ISAs to bed down and a subsequent focus on serving the world's capital markets, implementation of ISAs and SMEs. There are some interesting projects

proposed, among them a project on the professional accountant's involvement in carbon trading schemes which have grown in number in recent years, on other environmental matters and on XBRL. Just as important are projects on implementation of ISAs and SMEs. IAASB is proposing to develop a method to assess effectiveness of implementation for example and a project on prospectuses. IAASB cannot perform all of these projects and is consulting on which should be a priority. The Institute did comment on the previous consultation in this area and any comments on this round should be sent as soon as possible to [kbagshaw@icaew.com](mailto:kbagshaw@icaew.com). The work of this standard setter has a direct influence on UK standard-setting.

**Katherine Bagshaw** | *Manager, Auditing Standards, Audit and Assurance Faculty*

### ICAEW responds to EC Communication on a simplified business environment for companies - cont'd from page 8

Commission for exempting small companies from the requirement to publish their accounts. The additional costs involved in publishing accounts are negligible, if the company is already preparing and distributing its accounts.

The response notes that the benefits of small companies producing statutory accounts in the first place are poorly understood and that some economies appear to function efficiently without such requirement and suggests that this issue merits further consideration.

#### Wider use of small company exemptions

We are not persuaded that there is a sound case for extending the exemptions available to small companies to medium-sized companies which are managed by their owners. Medium-sized companies are not insignificant in size and may have a number of stakeholders interested in their accounts. If they are no longer required to prepare audited accounts, or for that matter, file any accounts at all, it might be far more costly for these other stakeholders to obtain the information they need.

In terms of unlimited companies, we agree, in principle, that the proposed exemptions could be made available to such companies.

#### Consolidation

We see some merits in proposals to exempt certain SME subsidiaries from the requirement for an audit so long as the group auditor has the right to require an audit if he/she considers it necessary. However, there are some concerns with such proposals such as whether this might be open to abuse i.e. companies might deliberately form groups of companies to avoid the need to have certain aspects of their operations audited. There are also potential implications for other users of the accounts who might lose the ability to access audited financial information about the subsidiary. The response also expresses concern about how you might assess the robustness of the guarantee given by parent companies.

#### Accounting for deferred taxes

The Fourth Directive does not require that deferred tax be provided for, only that it should be

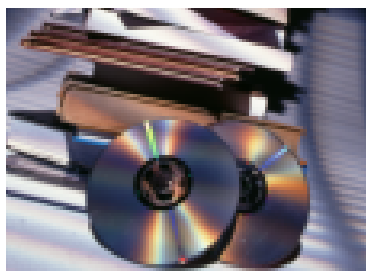
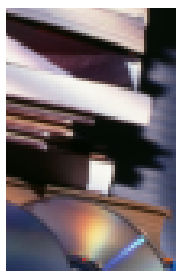
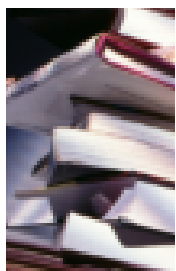
disclosed. The requirement to provide for deferred tax is in accounting standards. Accordingly, we do not believe there would be any substantial cost savings by abolishing the disclosure requirement in the directive.

#### Disclosures

The Institute recommends that a full list of the disclosures currently required by the directives should be circulated to relevant user groups to identify those that are useful and how the information might be used. Those that are not useful and used should be removed.

**Louise Sharp** | *Manager, Audit Practice Issues, Audit and Assurance Faculty*

# Training Providers' Forum



As the timeline for the conclusion of the project to clarify International Standards on Auditing (ISAs) approaches, the Institute was pleased to host a Consultative Committee of Accountancy Bodies' (CCAB) event which brought together training providers and regulators to discuss the practicalities of implementing clarified ISAs.

Since ISAs were introduced to the UK and Ireland, for the audit of financial statements beginning on or after 15 December 2004, replacing the previous Statements of Auditing Standards (SASs), considerable work has been undertaken by the International Auditing and Assurance Standards Board (IAASB) on its 'clarity project' and important revisions. Implementation of the resulting clarified, and in some cases revised, ISAs will require considerable planning on the part of the profession in the UK and Ireland.

The Training Providers' Forum held in Chartered Accountants' Hall in October provided the opportunity to talk about auditing standards, an increasingly important issue for practitioners and their clients as we move towards the new regime of clarified ISAs with their new requirements.

The intention of this event was to facilitate two-way communication between training providers and regulators, considering how training providers have approached the first time application of ISAs and any messages arising from this for the regulators.

Speakers gave practitioner, regulator and inspector perspectives, with Martyn Jones, Chair of the ISA Implementation Sub-group, Jon Grant, Executive

Director of the Auditing Practices Board, Sha Ali Khan, Head of Practice Monitoring at the ACCA and Lesley Jones and Trevor Smith of the Quality Assurance Department at the Institute.

## ISA implementation issues

In this overview of the auditing environment in the UK, the Forum heard about the:

- Effect on ISAs of changes in the economy
- Increasing scrutiny of the profession by regulators
- Increasing pace of change for the auditing profession, especially with ongoing revisions to ISAs, ethics and the Companies Act
- Increasing litigation risks facing the profession

Against this background, some of the possible issues that could impact ISA implementation, include:

- Increased independent, national and international regulation
- People recruitment
- Learning and development
- Training and retention
- External issues

Delegates were asked to consider these along with any other issues they might have to work towards possible solutions.

## Audit Quality

The Forum learned about the regulators' interest in audit quality. An outline of key findings and recommendations from the APB *Promoting Audit Quality* consultation was discussed **R**. These included:

- The importance of the drivers of audit quality
- Concerns exist about transparency within the profession
- Audit committees who could do more to evaluate audit effectiveness under their 'Combined Code' obligations; their activity should be reported clearly in the annual report
- Issues relating to the quality of detailed audit work, given the UK model where much complex, detailed work is undertaken by junior staff. Opinions were split on this and a working party will look into it

The drivers of audit quality were broken into five categories:

- Culture within firms
- Skills and quality of people doing the work, including training; time allocated and supervision

*cont'd on page 11*

# Bulletin Board

## Faculty update

### Annual membership fees and subscriptions

Annual membership fees and subscriptions become due for renewal on 1 January. It is also time for members to make their annual CPD declaration and complete the members' profile. To help keep costs down and therefore membership fees, members are asked to settle their account and complete the profile promptly. The simplest way to pay is by direct debit. Alternatively, you can use our secure online payment facilities at [www.icaew.com/members](http://www.icaew.com/members). You can also make your CPD declaration and complete your profile online at the same address.

### Perspectives on assurance: Engaging practitioners

Included with this issue of *Audit & Beyond* is a copy of *Perspectives on assurance: Engaging practitioners*. As explained in the November issue of *Audit & Beyond*, this paper is part of a series aimed at stimulating dialogue on external assurance. The paper explains the key elements of the International Auditing and Assurance Standards Board's *International Framework for Assurance Engagements*, seeks feedback based on practical experience and aims to identify areas where there may be a need for further guidance for practitioners.

### China's Accounting Revolution - 16 January 2008

China now has the 4th largest GDP in the world, ahead of the UK, and boasts nearly 1500 listed companies with a market capitalisation of some three trillion US dollars. But until recently, Chinese accounting fell far short of international norms.

There is a roundtable on China's Accounting Revolution taking place at Chartered Accountants' Hall, Moorgate Place, London, EC2, on Wednesday 16 January 2008. The roundtable will be chaired by Andy Simmonds, Partner, Deloitte, and Chairman of the ICAEW Financial Reporting Committee.

The roundtable will commence at 9.30 am, and is expected to finish by 12.00pm. Registration starts at 8.30 am and breakfast will be served until 9.15 am. There is no charge for attendance at the roundtable but places are strictly limited.

Contact [lauren.bridgen@icaew.com](mailto:lauren.bridgen@icaew.com) for more information.

### Internal Audit Lecture series

Please note the Internal Audit Lecture Series will be held in Chartered Accountants' Hall, London on the following Mondays from 6.00 - 7.15pm in 2008, with topics and speakers to be announced:

- 4 February (TBC)
- 10 March
- 21 April
- 16 June
- 8 September
- 20 October
- 1 December

## Training Providers' Forum - cont'd from page 10

- Effectiveness of the audit process, ensuring that technical support is available when an audit team encounters difficulties
- The reliability and usefulness of audit reporting, acknowledging that various fora, such as the *Audit Quality Forum* **R**, are considering stakeholder views and the establishment of an APB working party to consider reporting and compliance with the Companies Act
- Factors outside the control of auditors, such as whether or not a company has good corporate governance and its relationship with the audit committee

### Monitoring visits feedback

The Forum also learned about the most common problems QAD has observed during its visits. The overall standard of audits remains high, and problems found during inspections arising from the transition from SASs to ISAs tend to be around documentation. Of all the standards, the greatest problem in practice has been with the main risk ISAs but some firms are also experiencing problems with the ISAs on fraud and communications with those charged with governance. Smaller firm awareness of the documentation

requirements of ISQC (UK and Ireland) 1 is also an issue.

### IAASB Developments

There is considerable interest and work underway on the harmonisation of auditing standards. International regulators are pushing for higher international standards and Europe is pushing for greater consistency. Audit inspectors are also looking at means to better co-ordinate their activities. Large firms have an interest in ensuring the quality of their work internationally.

The existing ISAs (UK and Ireland) were close to SASs but ISAs are going to change. Too much flexibility was believed to exist as a result of the use of the present tense in standards and one of the major changes brought about by the clarity project will be to clarify this language.

In terms of a timetable, the IAASB hopes to finalise and complete the clarity project in 2008 with an effective date for implementation being for audits of accounting periods commencing on or after 15 December 2009. Implementation in the UK may be related to implementation of the Statutory Audit Directive in Europe and the APB has yet to make a decision on UK implementation.

Delegates had the opportunity to discuss and consider issues relating to: recruitment; small and medium size entities and practitioners; areas of change; and the current audit environment. There was agreement that the event was most worthwhile in preparing training providers and practitioners for the implementation of clarified ISAs.

**Michael Gallagher** | Operations Manager, Audit and Assurance Faculty

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		ICAEW response to the consultation	<a href="http://www.icaew.com/index.cfm?route=125130">www.icaew.com/index.cfm?route=125130</a>
9	Clarified ISA implementation date and IAASB's Strategic Plan	Implementation date for clarified ISAs	<a href="http://www.ifac.org">www.ifac.org</a>
		IAASB's strategy consultation	<a href="http://www.ifac.org">www.ifac.org</a>
10	Training Providers' Forum	APB: <i>Promoting Audit Quality consultation</i> feedback	<a href="http://www.frc.org.uk/about/promotingauditquality.cfm">www.frc.org.uk/about/promotingauditquality.cfm</a>
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