

## Faculty Autumn Roadshow

Chris Cantwell attended the latest faculty roadshow *The quality of audit files - common problems and solutions* held in Luton and in this article reports on some of the issues covered by the speaker John Selwood.

### Background to the roadshow

John explained that the Institute's Quality Assurance Department (QAD) had helped in putting together the material for the roadshow and it was therefore based on real examples encountered by the QAD.

### General feedback from QAD visits

The good news is that the QAD feedback is generally positive but there are examples of firms doing more work or documenting more than they need to. Some of the feedback from firms suggests that a QAD visit is more challenging than it used to be given all the new requirements but the inspectors do provide constructive comments to firms grappling with these. However, the QAD are likely to expect firms to be further down the road now that we are beyond the first year of ISAs (UK and Ireland).

### Quality control requirements

There is sometimes a lack of documentation of quality control compliance in line with ISQC (UK and Ireland) 1, particularly for smaller firms. The faculty's guide on this standard can helpfully be referred to regarding these requirements which should be tailored to the size and circumstances of the firm. John did emphasise that a commitment to quality needs to be demonstrated by real behaviours and actions and gave the example of a larger firm that had all the right words in its policies but failed to live up to these words in practice.

### Audit documentation

The QAD commonly find problems with documenting the auditor's understanding of the entity. John reminded delegates about the Auditing Practices Board (APB) guidance on smaller entity audit documentation contained in Practice Note 26 and the rationale for the audit planning requirements in the ISAs (UK and Ireland). Auditors ought to think about what they are trying to achieve and narrative notes of the firm's understanding of the entity can sometimes provide better information than completing a checklist.


### Bank reports and stocktakes

John mentioned the revised Practice Note 16 on bank reports issued by the APB and the importance of bank reports to the audit. The practical difficulties with banks often experienced by firms do provide challenges to obtaining sufficient evidence relating to cash balances. With respect to stocktakes, ISA (UK and Ireland) 501 means that there is normally an expectation that auditors do attend these when stock is material to the accounts.

### Sample sizes and selection

The QAD sometimes find examples of firms unable to justify sample size and selection. Where the inherent risk is greater there is a greater need for a statistical method of determining sample size.

## In this issue...

02. ICAEW charity audit report examples updated
03. Member survey – a better understanding  
Jo Iwasaki summaries the feedback from our recent survey
04. IFAC's Small and Medium Practices Committee  
IFAC's SMPC is the voice of smaller firms at the international level and its work is becoming increasingly high profile
04. The ICAEW leads the debate over the non-audit assurance at European SME/SMP Congress  
Jo Iwasaki reports
05. American Accounting Association annual meeting  
Henry Irving reports from the recent AAA meeting
06. Limiting auditor liability in engagement contracts  
Tony Bromell reports
07. The accountant's report on service change accounts: watch this space!  
Mary-Lou Wedderburn provides information about forthcoming changes to the law on information and reporting requirements
07. Bulletin Board
08.  Related  
Links to briefings and guides mentioned in this issue

# ICAEW charity audit report examples updated

The September issue of *Audit & Beyond* article **R** about the Institute's response to the Auditing Practices Board (APB) on consultation draft Practice Note 11, *The audit of charities in the United Kingdom (Revised)* pointed out that the report examples in the draft Practice Note will not apply until accounting periods starting on or after 1 April 2008, or in the case of Companies Act 2006 examples, accounting periods starting on or after 6 April 2008. The example reports on the ICAEW website have therefore been updated **R** to take account of applicable changes to law and regulations affecting audit reports on the accounts of charities with financial periods starting before 1 April 2008.

The introduction has been revised and example reports that are now out of date have been removed. These are the report on the accounts of a charitable company in Great Britain or Northern Ireland with an accounting period commencing before 1 April 2005, and the report on the accounts of a non company Scottish charity with an accounting period commencing before 1 April 2006. The remaining examples are little changed.

The example reports include a 'Bannerman'

paragraph based on the guidance set out in ICAEW technical release AUDIT 1/03 *The audit report and auditors' duty of care to third parties*. As indicated in the technical release, other wording may be appropriate and auditors will have regard to any legal advice they may take. The guidance in AUDIT 1/03 is not endorsed by the APB and auditors registered with bodies other than the ICAEW may consider it appropriate to omit the paragraph.

Examples of audit reports on charities registered in Scotland may be found on the Institute of Chartered Accountants of Scotland (ICAS) website **R**. The Scottish examples contained in the ICAS guidance apply to accounting periods commencing before 1 April 2008.

Reporting on the accounts of

charities that are registered in both England and Wales and Scotland is particularly complicated, because the reports have to meet the requirements of two different jurisdictions. The wording of the opinion paragraph and the scope of the report will depend on the date the accounting period commenced and the constitution of the charity and because there are so many potential variations, the Institute has decided not to include an example report.

Members are advised to contact the ICAEW Technical Enquiries Service if they have any queries on the wording of a report.

**Mary-Lou Wedderburn** | *Consultant, Audit and Assurance Faculty*

## Faculty Autumn Roadshow *cont'd from page 1*

### Analytical review

The QAD have examples of firms performing inadequate preliminary analytical review which ought to be used to help to direct the audit. There are also examples of over-reliance on analytical review and John emphasised the need for sufficient audit evidence on any medium/high risk areas although sample sizes might be reduced.

### Communications

ISA (UK and Ireland) 260 has created real challenges for auditors and the QAD sometimes find that firms have not recorded the relevant communications with those charged with governance. John reminded delegates of the requirements including reporting all threats to independence and the communication of uncorrected misstatements about which a written response from clients is needed. John also covered management representations and the need for these representations to be tailored to the circumstances with specific non-standard information being provided if this is significant to the audit.

### Other problems

Other common problems include incorrect disclosures in the financial statements and failure to fully comply with the APB's Ethical Standards (now revised) including the Provisions Available for Small Entities.

### Other issues

Finally John provided brief updates on some topical issues including:

- Common points from Practice Assurance visits
- New faculty guidance on related parties and the forthcoming revised guidance on group audits
- Compilation assignments
- The latest position on the IAASB's clarity project and what

this is likely to mean for the UK

### Booking for remaining roadshows

There are still some places available on several of the remaining roadshows on this topic. For more information (including dates and venues) please refer to the booking form available on the Faculty website **R**.

**Chris Cantwell** | *Manager, Audit and Assurance Faculty*

# Member survey – a better understanding

If you have attended one of our roadshow events this spring, you may have noticed that we were handing out green sheets in addition to our regular, pink course assessment forms. We wanted to understand what is taking place amongst our membership: what our members from practising firms, who come to our roadshows, are like and what services their firms provide. We have recently processed the finds from the survey and will consider how the faculty can most effectively reflect the way firms are operating in the services we provide. Here is a short summary of what we have learnt.

## Focus of the survey

The survey consisted of two sections: practice profile, and faculty services. Each section was made up of set themes with one to four specific questions.

The practice profile section consisted of practising firms, clients, and services offered to the clients. The faculty services section covered publications, website, roadshow, and other services.

The questionnaire was handed out at the majority of roadshow venues which 1,800 members attended. Nearly 600 forms were completed and returned. To those among you, thank you for taking the time.

## Practice profile

### Practising firms

Most typically the members who fill out the questionnaire, hereafter just 'members', said that they came from firms that have one to five partners (principals), followed by sole practitioners and six to ten partner firms. About 15 per cent of members said that they came from firms that have more than 10 partners.

Over half of our members said that there are up to 20 staff who carry out accountancy related work within the firm. 62 per cent of members operate from one office.

### Clients

Almost all members offer services to companies, sole traders and partnerships. A large number of members (89 per cent) also offer services to other unincorporated entities such as pension schemes and charities. Most clients have a turnover below £6.5 million, the current audit exemption threshold.

### Services offered to the clients

Although many clients fall below the audit exemption thresholds, nearly all members continue to do statutory audits. As audit exemption thresholds have other criteria to be met, some of these clients may not be audit exempt in practice. 91 per cent of members said that their clients have an audit because it is required by statute, whilst a

third said that it gives comfort for management, value to external stakeholders (eg banks, suppliers) or it is required by the company's Articles & Memorandum.

However, 66 per cent said that less than 10 per cent of clients require audits, and a further 23 per cent said that between 11 per cent and 30 per cent of clients require audits.

Other than audits, many members offer a variety of services. Over 75 per cent of members said that they offered related services such as book-keeping, accounts preparation and other assurance services. The most popularly offered services are, however, tax advisory and compliance (both 97 per cent). A large number of members also provide business advisory and management accounting services. Overall, it appears to indicate that many of our members are in general practice and provide audits and related services to meet the clients' needs.

## Faculty services

### Publications

Nearly all members who responded read *Audit & Beyond* and *Technical Update* always or at least sometimes. Equally, nearly all members thought the length of both publications are about right. In terms of means of providing our publications, members predominantly prefer receiving hard copies. Only 16 per cent of members said that they would prefer to receive publications solely in an electronic format.

### Website

Whilst many members find the information on the faculty website useful (78 per cent), its use is fairly limited. Overall the majority of members use the faculty website only when reference or technical information is required with 28 per cent of members saying that they rarely or never used it. We will consider this in the light of current website development.

### Roadshow

The main reasons for attending the roadshows include:

- Topical/timely subjects
- For CPD
- Technical/practical content that matches the needs of the practice

There were many suggestions for possible themes for events, though none received wide spread support. The suggestion for a conference, as practised in the Tax Faculty or some other professional organisations, only received 13 per cent support.

### Other services

Many members use the other publications that we issue, such as technical releases. Not many had views on areas other than those we already consider. Only three per cent thought other services, such as podcasts, might be useful.

## Your view matters to us

We are keen to meet member needs. The survey indicates that we are offering relevant services to our practitioners. The faculty will strive to help members to respond to the changing market place. What do you think about the findings? Do they reflect our typical practising members? Do you have any views on our conclusions? Please get in touch at [tdaf@icaew.com](mailto:tdaf@icaew.com).

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

## IFAC's Small and Medium Practices Committee

This is the first in an occasional series of articles on the increasingly important work of IFAC's Boards and Committees; this article focuses on the Small and Medium Practices Committee (SMPC) [R](#) of the International Federation of Accountants (IFAC).

The SMPC's objectives are, as might be expected, to:

- Work with IFAC boards and other standard-setting bodies to ensure that they are aware of and give due consideration to issues relevant to SMEs and SMPs
- Facilitate the communication and sharing of information between member bodies, IFAC boards and committees and other external groups
- Support SMPs that provide accounting and assurance services to SMEs by leveraging the work of member bodies and others
- Identify other issues relevant to those providing accounting and assurance services to SMEs and develop guidance on these issues

It is the recent output of the SMPC that is of most interest to practitioners though. The SMPC issues good practice guidance, information papers and consultation papers. Earlier this year it issued its long-awaited *Guide to using International Standards*

on Auditing in the audit of small- and medium-sized entities [R](#). The ICAEW is currently preparing comments on this in advance of the publication of the all-important 'clarity' edition. Other recent papers have dealt with matters such as micro-entity financial reporting and significant documents in the pipeline include a practice management guide being developed by CPA Australia and a quality control guide being developed by CGA Canada.

Other current SMPC activities include input into revisions to the Code of Ethics by IFAC's International Ethics Standards Board for Accountants (IESBA), to the International Auditing and Assurance Standards Board's (IAASB) clarity project and to its strategic and operational review [R](#). In the fullness of time, the SMPC intends to develop guidance to help SMPs implement the relevant provisions of the Code of Ethics.

The International Center for Small and Medium Practices [R](#) is a website hosted by the SMPC that provides resources and facilitates the exchange of knowledge and best practices among SMPs, including a newsletter [R](#). Within the Center IFACnet [R](#), provides a global search engine developed by IFAC and its members to serve, among others, SMPs and SMEs.

18 members are appointed to the SMPC for three years. The current member representing CCAB is David Chitty, Partner at Horwath Clark Whitehill, ICAEW Council Member and past Vice-Chairman of the ICAEW's Practice Advisory Board. David is supported by his Technical Adviser, Katharine Bagshaw, of the faculty's staff.

**Katharine Bagshaw** | *Manager, Audit and Assurance Faculty*

## The ICAEW leads the debate over non-audit assurance at the European SME/SMP Congress

Henry Irving, the Head of the Faculty, presented our experience on the consultation on the needs of audit-exempt companies and the ICAEW Assurance Service at the SME/SMP Congress organised by the European Federation of Accountants (FEE). The annual Congress in Copenhagen took place between 3–5 September and its overall theme was: *Think ahead on small and mid-sized business: Opportunities and tools for the accountancy profession*. Through this theme, the Congress addressed a wide spectrum of subjects in the accounting and auditing profession, of interest to small- and medium-sized entities. This year's agenda included financial and other types of reporting, assurance, ethics and quality control.

At the session entitled *Repeal of statutory audits and changes of accountancy for small businesses, focus on Nordic countries*, Henry discussed the consequences of the successive increases in audit exemption in the UK and the responses to the ICAEW Assurance Service. At the same time, delegates, from countries that are only recently waking up to the challenges the audit exemption threshold rise may bring

exchanged their views. Other speakers at the session included practitioners and representatives of the accountancy profession from Sweden and Finland.

Other agenda items included the impact of globalisation for SMEs and how accountants could assist the growth and development of increasingly international SMEs, and the effectiveness and quality of SME audits. A number of SMP Committee members of the International Federation of Accountants (IFAC) were also there to participate in the Congress, and there were interesting debates over the role of international standards and related practice development. The President and Deputy President of FEE and the EC Director of Directorate General

Internal Market also took part in the Congress.

The Congress was organised by FEE in association with the NRF, the Nordic Federation of Public Accountants. Further reports on the topics discussed and the feedback on the ICAEW presentation will follow in the next issue of *Audit & Beyond*.

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



# American Accounting Association annual meeting



The ICAEW has recently participated in the American Accounting Association (AAA) annual meeting in August 2008 in Anaheim, California. The theme of this conference, attended by nearly 3,000 accounting academics, was 'Building our accounting community'.

Five panel sessions were accepted by the AAA from the ICAEW this year. AAA panel sessions involve a brief presentation by each panellist and then it is opened to the floor for questions. One of these sessions explored stakeholder expectations of audit and considered tensions between these different stakeholder expectations and their practical consequences for how the audit evolves. This built on ongoing *Audit Quality Forum (AQF) Evolution* work, which primarily focuses on UK experience, by taking a look at the subject from a largely US perspective. The June 2008 issue of *Audit & Beyond* provided an update on the AQF Evolution work programme **R**.

The stakeholder expectations panel included: Marty Baumann (PCAOB – the US auditing regulator), Bob Colson (Grant Thornton), Bill Kinney (McCombs School of Business and International Auditing and Assurance Standards Board member), and Mark Peecher (University of Illinois) with Robert Hodgkinson (ICAEW) as the moderator.

The views expressed by the US panel members reflected US legislation and their assurance market. Only listed companies are required to file financial statements or have an audit in the US. Regulation is complex and wide-ranging: US regulators wish to avoid a repeat of the Enron and Worldcom scandals and so have specified a wealth of disclosure and verification to control the activities of their largest corporations. This has resulted in an integrated audit which requires the auditors to opine on the internal controls over financial reporting as well as the financial statements of a listed company. Fair value accounting is viewed with suspicion in the US and

investors are against any relaxation of the stringent ethical rules for auditors.

However, for the US unlisted private sector non-statutory audit, non-audit and bespoke assurance services are much more common than in the UK. However, statutory, liability and confidentiality/insider information regulation limits the ability for auditors to provide bespoke assurance across the listed market.

In addition, the financial statements which are audited do not always promote the full disclosure of uncertainties and ranges of outcomes which might damage the market for companies' shares and therefore also contribute to the expectation gap.

The auditors' role in the prevention and detection of fraud is another area, in the US as well as in the rest of the world, where auditors are sometimes seen as falling short of stakeholders' expectations, especially as risk management in response to liability threats have resulted in much boilerplate and unread reporting. The integrated audit has not improved perceptions in this area.

In short, expectation gaps exist across the pond as well as here notwithstanding the different

financial reporting structure and audit and assurance markets that exist in the US. There are around 50,000 audit professionals working for the top six firms in the US, so the audit must be seen as adding value and meeting the expectations of certain groups of stakeholders, though it may be mainly the expectations of securities and audit regulators!

The AQF report on *Stakeholder expectations of audit* is expected to be published later this year and will be covered in a future issue of *Audit & Beyond*.

**Henry Irving** | *Head of the Audit and Assurance Faculty*

# Limiting auditor liability in engagement contracts



Until earlier this year, UK company law did not allow any form of limitation of the auditor's liability to the company for which it was carrying out a statutory audit. However, the legal principle of joint and several liability could result in auditors in, say, a fraud case actually being held financially liable not only for the consequences of their own actions but often those of the perpetrator, who would typically have insufficient assets to settle the damages awarded against him.

The Institute has therefore long held proportional liability limitation (where the parties, including the auditors, are held liable only for their own contribution to the damages) to be in the best interests of efficient markets, shareholders and companies, as well as auditors.

A change was eventually made in the Companies Act 2006. With effect from 6 April 2008, sections 532–538 permit auditors to conclude limited liability agreements (LLAs) with the companies they audit, subject to some important safeguards.

## Action needed

Liability limitation is not being imposed by law: merely allowed. The default position is that liability is unlimited unless valid limitation terms are included in the terms of engagement. The auditor must propose an LLA and have it agreed by the client.

To be valid in law, an LLA has to be subject to shareholder approval annually and its terms must be 'fair and reasonable'. These safeguards, while understandable, have led to complications.

- The shareholder approval requirement has raised some concerns that directors would face a conflict with their shareholder duties by recommending LLAs to their shareholders for approval
- The 'fair and reasonable' requirement is not straightforward. Although the government had

made statements saying that proportionality was what they envisaged, the legislation actually allows any form of limitation to be included in an LLA, other examples being a fixed monetary cap or a cap linked to, say, a multiple of audit fees. However, any LLA is subject to challenge in the courts and if the courts consider the terms not to be 'fair and reasonable in all the circumstances of the case', they can substitute alternative terms.

## How to implement LLAs

Guidance can be found in two key documents. The first, aimed at company directors but useful for auditors too, is from the Financial Reporting Council. Entitled *Guidance on Auditor Liability Limitation Agreements*, it seeks to address a number of issues by:

- Summarising the law on LLAs
- Explaining what an LLA should cover
- Providing specimen clauses for LLAs
- Noting institutional shareholders views, who have indicated that they would be likely to oppose types of LLA other than proportionality
- Explaining the process for obtaining shareholder approval, including specimen wording for resolutions and the notice of the general meeting
- Setting out some of the factors that will be relevant when assessing the case for an LLA.

Comments on the last point are spread around the guidance, with a reference in the introduction to the impact on audit market concentration, comments in section 1 on the problems caused by joint and several liability, and examples in section 3 of reasons why companies might conclude it appropriate to enter into an LLA.

The second helpful document is a

legal opinion obtained by the Institute. This principally addresses the concern that if directors recommend LLAs to shareholders, they might face increased personal liability for breach of their fiduciary duty to act in the interests of the shareholders. However, the opinion confirms that this is not an issue, provided the directors lay before the members the information they need to make an informed decision. The fact that an LLA works in favour of the auditor does not mean that concluding an LLA works against the directors' duties: it is commonplace to accept contractual terms of this kind as part of doing business.

The opinion also highlights that there is no problem with 'going first' and discusses in more detail some of the points directors would be expected to consider, set out in section 3 of the FRC guidance. These include the fairness of the LLA, the availability of other terms elsewhere, and the undesirability of changing auditors too often.

The FRC guidance is available on their website [R](#). The legal opinion and other information on LLAs is available at [www.icaew.com](http://www.icaew.com) (under 'Technical and Business Topics', 'Audit and Assurance').

## Next moves

The main problem is generally thought to lie with the size of potential claims from large multi-nationals, so it is expected that LLAs will start with listed company audit engagements. However, the issues are the same throughout the audit market. Accordingly, LLAs are likely to become standard terms of engagement for all company audits in due course.

**Tony Bromell** | Head of Accountancy Markets and Ethics, ICAEW

## The accountant's report on service charge accounts: watch this space!

The Government has at last paved the way for updating the provisions of the Landlord and Tenant Act 1985 relating to service charge accounts. This article describes the main provisions and likely timetable for implementation.

Technical Release TECH 03/07, *The accountant's report on service charge accounts prepared in accordance with regulations made under the Commonhold and Leasehold Reform Act 2002* **R**, was issued for comment in October 2007. An article in *Audit & Beyond* November 2007 **R** summarised the key issues on which members' views were sought. The draft guidance was based on the Department for Communities and Local Government (CLG) proposals for safeguarding service charge monies and for the accountant's report to be made on the Landlord's regular statement of account. The CLG proposals were incorporated into the Housing and Regeneration Act, which received Royal Assent on 22 July 2008 (the 2008 Act).

The 2008 Act enables the Secretary of State to make regulations in relation to England (there will be separate regulations for Wales) that change the requirements in the 1985 and 1987 Landlord and Tenant Acts (LTA) about the information that landlords will be required to supply to service charge payers and how service charge monies are held. The key provisions relate to:

- The service charge information that must be provided by the landlord, subject to any exceptions provided for in the regulations – the regulations will contain details of the information and reports that need to be provided by the landlord, the periods in relation to which information or reports are to be provided, the times at or by which they need to be provided, and the form and manner in which they may be provided
- The form and manner of the report to be made by a qualified person, which must accompany the specified service charge information, ('qualified person' to be defined by the regulations)
- Circumstances in which tenants may withhold payment of a service charge
- Banking arrangements for service charge contributions.

CLG intend to finalise the regulations during the autumn so

that they can be issued in early 2009, coming into force for service charge accounting periods beginning on or after 1 April 2009. The faculty will update TECH 03/07 over the same period, so that authoritative guidance will be in place for members when the new regulations come into force.

**Mary-Lou Wedderburn** | *Consultant, Audit and Assurance Faculty*

## Bulletin Board

### Faculty update

#### Faculty Roadshow The quality of audit files – common problems and solutions

This roadshow draws upon the experiences of the QAD reviewers to identify the most effective and efficient solutions to common audit problems being identified during their visits. As previously advised, this faculty roadshow is currently touring the country and several venues are now sold out. To book your place, and to check availability, visit [www.icaew.com](http://www.icaew.com) and then click on the events link.

#### Introducing ICAEWjobs.com...

ICAEWjobs.com is the Institute's new online job service, advertising the latest vacancies from a variety of employers in Business, Practice and Not-for-Profit. Whether you're actively seeking a new job or simply want to keep an eye on the market, ICAEWjobs.com has a range of audit and assurance opportunities at all levels, both in the UK and worldwide.

Visit [www.ICAEWjobs.com](http://www.ICAEWjobs.com) to sign up for job alerts by email, browse vacancies and to apply for roles online – there is also a career advice centre and a list of career resources available from the ICAEW. If you're looking to recruit, contact the ICAEWjobs.com team for information.

#### Do you have an interest in Asia-Pacific?

Institute members and students now have free access to a new database that provides information on tax developments, legislative updates, tax planning issues and tax data in Asia-Pacific countries (China, Hong Kong, India, Japan, Indonesia, Korea, New Zealand, Pakistan,

Philippines, Singapore and Thailand).

Access this database from [www.icaew.com/asiapacific](http://www.icaew.com/asiapacific). For more information, contact the Library & Information Service on 020 7920 8620 or email [library@icaew.com](mailto:library@icaew.com).

#### Access to information by successor auditors

Unfortunately, Technical Release AAF 01/08, *Access to information by successor auditors* was not included with the September edition of *Audit & Beyond*. Therefore, it is now enclosed with this issue.

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4	IFAC's Small and Medium Practices Committee	SMPC Website Guide to using International Standards on Auditing in the audit of small- and medium-sized Entities. SMPC Strategic and Operational Plan International Center for Small and Medium Practices <i>SMP eNews</i> : issued three to four times per year.	<a href="http://www.ifac.org/SMP/Committee.php">www.ifac.org/SMP/Committee.php</a> <a href="http://www.ifac.org/Store/Category.tml?Category=Small%20and%20Medium%20Practices%20%28SMPs%29">www.ifac.org/Store/Category.tml?Category=Small%20and%20Medium%20Practices%20%28SMPs%29</a> <a href="http://www.ifac.org/SMP/files/SMPC_Strategic_and_Operational_Plan_2007-2010.pdf">www.ifac.org/SMP/files/SMPC_Strategic_and_Operational_Plan_2007-2010.pdf</a> <a href="http://www.ifac.org/SMP">www.ifac.org/SMP</a> <a href="http://www.ifac.org/E-news">www.ifac.org/E-news</a>
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