

Audit & Beyond

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Audit Quality Forum

The *Audit Quality Forum*, which brings together representatives of auditors, investors, business members and regulatory bodies, met early last month to discuss three of its current projects: *Making global auditing standards local*, *Third parties*, and *Auditor reporting*.

Making global auditing standards local

Martyn Jones, Chair of the working group updated the *Forum* on this project which seeks to identify the key criteria to drive the development of International Standards on Auditing (ISAs) so that those criteria can be promoted by the UK in the course of the standard-setting process.

Whilst the 8th Directive gives Member States two years to implement the Directive, the ISAs to be implemented are those adopted by the European Commission (EC) and there is, as yet, no set date for this adoption. It is intended that clarified standards will be made available before they are adopted to give users the maximum period in which to implement them. The *Forum* therefore suggested that the paper encourages the EC to adopt clarified ISAs on a timely basis in order to facilitate smooth implementation across Europe. A number of European countries, including the UK have already adopted ISAs and others have made significant moves towards this objective.

The *Forum* gave its approval for the final paper to be published, noting that it is a useful and comprehensive paper which identifies the direction in which global standards are moving and the important

developments that have been made both in the UK and globally.

Third parties

Felicity Banks, Head of Business Law at the ICAEW and Stephen J Lewis, Chair of the working group provided an interesting and thought provoking presentation on the third parties project. The issues being considered by this working group are complex. Third parties have no direct relationship with auditors and may not feel any obligation to provide information to them, even if that information relates to the preparation and audit of the financial statements. Even directors may not have a direct relationship with some third parties, but delegate these functions to management. In addition, legal professional privilege may restrict the nature of disclosure to auditors of legal advice. There is, therefore, room for debate on how auditors can obtain audit evidence from third parties to achieve audit quality in respect of the truth and fairness of financial statements.

The *Forum* considered that there should be a public policy debate on these issues, in particular whether the legal professional privilege should override the right of auditors to have access to adequate audit evidence. There was also a call for professional bodies governing third parties to set standards for their members in respect of auditors' requests for information.

Auditor reporting

Sumita Shah, Manager in the Faculty and Mike McKersie, member of the

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Purpose of Audit Quality Forum

The purpose of the *Forum* is to encourage stakeholders to work together by promoting open and constructive dialogue and contribute to the work of the Government and regulators and by generating practical ideas for further enhancing confidence in the independent audit. To view the papers presented at the seventh meeting of the *Forum*, please visit the website www.auditqualityforum.co.uk.

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working group presented the key findings of the auditor reporting project.

The working group comprises representatives from the investing community, business, audit profession and regulators. The working group has clarified the expectations of investors and their wish for more discursive material within the audit report to enhance the understanding of accounts and has formed a view that current audit reports are too long and standardised, being virtually identical from one company to another, with too much boiler plate language and generic information. It has made some interesting and challenging recommendations that may impact on the way audit reports are written in the future.

The working group having considered the current restrictions that auditors currently face around confidentiality, issues around duty of care and liability, new legislation and standards (e.g. in the context of the 8th Directive) makes the following key recommendations:

- That the wording be structured in line with the proposals in the Companies Bill, in its three distinct parts
- There should be positive statements about adequate accounting records and whether or not there are emphases of matters
- Key issues that shareholders need to be aware of and that the auditor has considered in relation to the audit should be highlighted in the report
- That readability of the report needs to

be improved to make it more user-friendly and accessible, with the opinion located at the start of the report

Needless to say, any recommendations that are taken forward will need to be carefully considered in the context of a developed framework which defines key words (such as adequate accounting records and emphasis of matter) and identifies and considers the legal, regulatory and practical issues that will need to be addressed before the proposals can be implemented.

Sumita Shah, Manager, Audit and Assurance Faculty

Disclosure of auditor remuneration

Regulations in force for accounting periods beginning on or after 1 October 2005 make extensive changes to previous practice regarding disclosure of auditor remuneration. These changes include a significant increase in the amount of information to be disclosed about non-audit work carried out by auditors, including extensive disclosure of non-audit fees in prescribed categories.

Tech 06/06 *Disclosure of auditor remuneration* provides guidance on the application of these new legal requirements, which are set out in the Companies (Disclosure of Auditor Remuneration) Regulations 2005 (SI 2005/2417). These requirements replace all of the previous requirements for disclosure of auditors' remuneration, and not just those in relation to the disclosure of remuneration for non-audit work.

In broad terms, the Regulations preserve the requirement for all companies to disclose auditors' remuneration for audit services, although there are some

differences of drafting which have an effect on the amounts disclosed in some cases. In relation to other services, the Regulations require more extensive disclosure than was previously the case, including fees in respect of subsidiaries outside the UK. The 1991 Regulations required only a single aggregate figure for non-audit services and this was restricted to amounts for services provided to the company and its UK subsidiaries.

However, small and medium-sized companies ('SMEs') are exempt from the requirements relating to disclosures for other services (as they were in relation to the previous requirements in relation to non-audit services).

The disclosure requirements of the Regulations are part of a series of measures designed to improve the regulation of the audit profession and to strengthen the enforcement of certain aspects of financial reporting. According to the Explanatory Memorandum accompanying the Regulations, they have been introduced in order to address 'concerns that an auditor whose income from any one audit client derives mainly

from non-audit services might face a conflict of interest which could result in a less robust appraisal of the company accounts than would otherwise be the case'.

Accordingly, the Institute guidance aims to ensure that directors (or their equivalents for entities other than companies) and auditors understand both the nature and purpose of the detailed requirements, which are difficult to interpret in some areas. Particular attention is given to the basis for deciding into which categories and sub-categories a service provided by the auditor falls.

The Regulations have been drawn up in the light of, but differ in detail from, the disclosure requirements of the Directive on Statutory Audit of Annual and Consolidated Accounts ('the Audit Directive' and formerly 'the revised Eighth Directive'). Consequently, the Regulations may eventually need to be amended by the DTI.

Desmond Wright, Senior Manager, Corporate Reporting, ICAEW

Bank reports for audit purposes

The July/August issue of *Audit & Beyond* carried a short article about the work being undertaken by representatives of the British Bankers' Federation (BBA), the major clearing banks and CCAB to update and improve the procedures for obtaining audit information from client's banks.

The CCAB/BBA working group met a number of times over the summer and early autumn, to discuss the practicalities of obtaining bank confirmations and how the system could be improved to make it quicker and better, in the interests of all concerned.

The group considers that PN 16 needs to be revised substantially, to change practice so that the procedures for obtaining bank reports are part of the audit planning process, rather than a routine often carried out by administrative staff. In accordance with International Standards on Auditing (UK and Ireland), decisions about the nature of evidence to be sought from an entity's bankers should flow from the risk

assessment, and procedures developed in response to the assessed risks. Such decisions should be approved by a senior member of the audit team.

As well as revising PN 16, the group is developing a protocol to be issued by the BBA to the Banks to advise them of the new procedures. The protocol, which will be appended to the Practice Note, will set out an acknowledgement process whereby the bank will state a timetable for providing the information requested and give contact details in the event that the auditor has any queries. The acknowledgement process will also enable the bank to get in touch with the auditor if it has any questions about matters such as the authority to disclose information.

The group is pilot testing the proposed procedures on a sample of December 2006 year-end audits to ensure that they are practical. The draft guidance will be revised if necessary on the basis of the results and a new consultation draft issued in Spring 2007. In view of the delay beyond the date originally anticipated for

publication of the draft revised Practice Note, APB has issued the 2005 consultation draft as interim guidance. The current PN16 is not withdrawn, so there is no formal implementation date for the interim guidance. However, members are encouraged to adopt the proposed revised procedures for December year-ends onwards by:

- Submitting requests for information a month, rather than two weeks, before the year-end (bearing in mind that postal deliveries are especially slow in December)
- Using the acknowledgement procedures set out in Audit 3/02
- Providing the sort code and number for the main bank account for the client

This should enable a faster and more accurate response by banks, and save auditors considerable time and trouble in following up late or incorrect reports.

Mary-Lou Wedderburn, Audit and Assurance Faculty

Launch of the new Financial Services Faculty

The ICAEW is launching a new Faculty in January 2007 for professionals working in the financial services sector. The Financial Services Faculty will be the first new Faculty since the Corporate Finance Faculty was launched in 1997. The Institute sees the new Faculty as strategically important, meeting an increasing need for specialist support in a complex and developing segment. It conducted extensive market research into the new Faculty which showed that over 30 per cent of financial services professionals surveyed see new regulations and compliance as the main challenges facing them in the next two years.

The Financial Services Faculty provides a unique opportunity to establish the ICAEW as a leading authority on financial services issues. The Faculty will

develop and deliver innovative services targeted at three key segments within financial services:

- Finance professionals dealing with reporting and auditing
- Managers responsible for regulation, risk and capital management
- Specialists in financial planning and advice

The pace of change in financial services is fierce. The complexity of financial products, rapidly evolving regulatory systems and new accounting standards combine to create sector specific challenges.

Focusing upon auditing, the changing environment places pressure upon auditors required to keep up-to-date with the latest regulations and report

upon increasingly complex information, such as risk disclosures. As the FSA looks more closely at the use of auditors for regulatory purposes, opportunities arise for auditors to provide non-audit assurance services, for example auditor's reports on client money and skilled person's reports.

The Faculty can help by developing guidance, information, and analysis of the issues. The new Faculty will provide practical, straightforward and relevant support in each of the key segments identified by the research. It will be clearly differentiated from the existing faculties by maintaining a focus on areas specific to the financial services industry.

For more information please visit www.icaew.co.uk/fsfaculty.

2006 Enterprise Survey released

The Institute released its 2006 Enterprise Survey Report – *Enterprise in a Global Economy* – on 23 October. This is the tenth anniversary of the Survey which seeks members' views on business issues. The main findings were as follows.

UK businesses are embracing globalisation

The extent to which UK businesses have embraced globalisation is perhaps the most surprising result in this year's survey. Three-quarters of respondents' businesses either have customers or operations abroad or secure goods or services from overseas. Attitudes towards globalisation vary, with 42 per cent believing it will have a positive impact on their business in the next five years against 18 per cent believing it will have a negative impact. Although respondents' initial attitudes towards globalisation are positive, 78 per cent of those surveyed identified at least one threat from it but only 57 per cent identified one opportunity. The highest rated opportunities were the

internationalisation of markets (36 per cent) and moving part or all operations overseas (24 per cent). The threats were headed by the need to work harder to compete (58 per cent) and needing to offer higher value-added products (33 per cent). Eleven per cent of respondents felt that globalisation would make their businesses more vulnerable to fraud or crime.

The findings on globalisation suggest a two-tier divide among UK businesses. Some large businesses, already engaged in the global market, are encouraged by their experiences and generally recognise that their survival requires even greater involvement. Smaller businesses' responses were more varied. Some small businesses were neutral about globalisation or considered their market as too domestic or their products and services too specialised to be affected by globalisation, but 55 per cent of small business respondents have overseas customers and 13 per cent have overseas operations. Small businesses are also starting to outsource activities overseas.

Growth aspirations constant

Similar numbers of businesses (12 per cent) as in previous surveys are seeking very high growth (defined as over 30 per cent per annum for the next two years) with a further 13 per cent looking for growth between 15 per cent and 30 per cent. Competition was the main barrier to growth but lack of leadership and skills gaps and shortages were also cited as barriers.

But regulatory burdens remain

The total cost of implementing legislative and regulatory changes has increased from £6.9 billion to £7.7 billion. Employment legislation is the main administrative burden but corporate governance and financial reporting requirements were also considered significant administrative burdens, particularly amongst quoted companies.

A copy of the survey *Enterprise in a Global Marketplace* can be downloaded from www.icaew.co.uk/enterprise.

Got a technical problem or an ethical dilemma?

The Technical and Ethics Advisory teams offer free expert assistance to all members and students to help with these issues.

Ethics Advisory Services deal with ethical dilemmas and issues in both business and practice areas. Guidance is also given on interpretation and compliance with the Members Handbook.

The Technical Enquiries Service provides technical advice on a wide range of subjects including accounting, company law and auditing, but not taxation, which can be dealt with through the Practice Society helpline or Tax Faculty membership.

The technical and ethics advisory teams have used their experience of common issues arising to put together material for publication on the members' area of the

Institute website. These dedicated web pages include helpsheets and frequently asked questions (FAQs) which allow members to resolve enquiries by reference to the relevant material on the website.

Where information is not available on the website to resolve the enquiry, or where enquirers need further assistance, advisors are available to provide guidance in respect of the issue. The majority of enquiries are dealt with via telephone helplines which are manned by experienced and knowledgeable advisors. Non-members calling on behalf of a member firm are also entitled to advice from our helplines.

Enquirers can consult with an advisor knowing that the discussion will be in complete confidence. Membership details are requested and details of enquiries are

noted in order to provide a record for the member if it is needed at a later date. Enquiry details are confidential and are not divulged to any other party unless the member requests it.

Generic enquiry data is analysed in order to enable development of additional website material in response to emerging or common issues.

Helpsheets and FAQs can be found on the members' area of the Institute website: www.icaew.co.uk.

The technical and ethics advisory teams can be contacted on:

Technical Enquiries Service: 01908 248025

Ethics Advisory Services: 01908 248258

Reports by auditors on the financial statements of charities

Practice Note 11

Example audit reports

In its consultation draft work programme for 2006/07 APB announced that it would update Practice Note 11, *The audit of charities in the United Kingdom*, to take account of the introduction of ISAs (UK and Ireland), new legislation, and other changes. However, this work is unlikely to start until 2007.

The Institute is concerned that the changes referred to, including the publication of new APB Bulletins on audit reports, have made the examples in Appendix 5 to PN 11 seriously out of date. Whilst auditors may have adapted recent examples to reflect the developments, there is a risk of mistakes and inconsistencies in the absence of authoritative guidance.

One example that raises particular difficulties is that of an audit report on a receipts and payments account and statement of assets under s. 42(3) of the Charities Act 1993, which are not required to show a true and fair view. Although charities that are eligible to prepare accounts on a receipts and payments basis are also entitled not to have an audit, many may continue to seek this form of independent scrutiny.

The Faculty has developed the following examples:

- Unqualified opinion: unincorporated charity in England and Wales preparing a receipts and payments account and statement of assets under s. 42(3) of the Charities Act 1993
- Statement of trustees' responsibilities for the above
- Unqualified opinion: charity incorporated under the Companies Act (limited by guarantee) in Great Britain or Northern Ireland
- Unqualified opinion: unincorporated charity in England and Wales preparing financial statements under s. 42(1) of the Charities Act 1993

- Unqualified opinion: unincorporated charity in Scotland (it should be noted that this will be superseded by the Charities Accounts (Scotland) Regulations 2006, applicable for periods starting on or after 1 April 2006)

Consideration was given to providing examples of modified reports, to cover circumstances such as uncertainty about a charity's ability to continue in operation for the foreseeable future. It was decided that this was not necessary because, if auditors have the basic 'building blocks' of the report wording to apply in different legal contexts, they can refer to the guidance contained in APB Bulletin 2006/6 for specific circumstances.

The examples are available from the Institute's website on the pages for members of the Audit and Assurance Faculty (www.icaew.co.uk/aaf) and Charity and Voluntary Sector Group, and Technical Advisory Service.

Mary-Lou Wedderburn, Audit and Assurance Faculty

What is the Practitioner Services Committee (PSC) and what are its objectives?

The PSC is a subcommittee of the Audit and Assurance Faculty Committee and put simply its objectives are to ensure that the Faculty meets the needs of its members, particularly those in the small and medium-sized firms. We provide a focus for members' interests, help them to promote best practice and assist them to keep up to date via publications and courses. We need to be flexible and adaptable to ensure that we achieve these objectives, particularly as the needs of our members change.

Our main means of communication is this newsletter. This is issued 10 times a year and I am reassured by the feedback we get. We are, however, always looking for new ideas and new authors so any help would be appreciated.

Our other big projects have been the Roadshows which we take around the country. Our current Roadshow, which I

believe is our 12th, is proving to be extremely popular with over half the venues sold out.

We are continually looking for new ways to serve our members – our representatives in the District Societies help us to do this. We try to meet these liaison members regularly and we are in the process of arranging a day for the next meeting.

The Committee currently has six members, including myself. Three of the members are from small firms, one is from a medium-sized firm and the remaining member is John Selwood, who has been our speaker at our recent Roadshows. I chair the Committee, as I have done since the Faculty was formed, but I am now retired and am all too aware of how quickly you lose touch in this increasingly changing environment, so it's time for a change.

The work PSC does is vital if the Faculty is to remain relevant to the small and medium-sized firm. The Committee meets five times a year with agendas that are interesting and not too heavy and we try to make the meetings fairly informal and enjoyable.

Over the years the work PSC has done has been important to the success of the Faculty and I am anxious to ensure that this continues. If you feel you could help or would like to know more then please contact Tracy Gray at the Faculty (tracy.gray@icaew.co.uk). If you would like to talk to me about anything to do with PSC let Tracy know and she will contact me. We look forward to hearing from you.

Clive Jones, Chairman, Practitioner Services Committee, Audit and Assurance Faculty

Faculty website – you can make a difference

As you know, the Institute's new website has now been up and running for just over six months. The look and feel of the new site has taken some getting used to, but feedback from members has been positive. The main difference has been the improved ability to navigate around the site as the new layout has made it easier for members to find what they are looking for. The Faculty's web pages have also been improved.

Within the Faculty pages you will be able to access past issues of *Audit & Beyond* as well as the majority of the Faculty's publications. Faculty members

are able to download the publications free of charge. The Institute's technical releases, including those from the Faculty, are also available via the website. As you are undoubtedly aware, the Faculty lobbies government and regulators on your behalf, and you will be able to find past and present consultations and representations on the website.

It is your website and your feedback is crucial to its success. There is a wealth of information on this site that is only available to members of the Audit and Assurance Faculty. We need to know what you would want to see available on

the site. Any suggestions can be e-mailed to the Faculty at tdaf@icaew.co.uk.

Inform your colleagues about the Faculty and its website. If they want to take advantage of the website, let them know that it is only available through privileged access. If they want access they need to become a Faculty member and it is now even easier to join the Faculty, as online joining has recently been launched.

To further discover what the Faculty's website can offer you, visit www.icaew.co.uk/aaf.

Public sector news

Public sector strategy

Over the last few years, as part of its public sector strategy and programme of work, the Public Sector Audit Committee (PSAC) has:

- Responded to a number of key consultation papers to a range of public sector stakeholders, including CIPFA, (the then) Office of the Deputy Prime Minister, HM Treasury and the Audit Commission
- Provided guidance to members on public sector special reporting engagements and Freedom of Information
- Provided factual information through the Handy Guide to Public Sector Bodies (see below)

On behalf of its members, the Faculty is currently actively lobbying the European Commission, the National Assembly for Wales and other government departments in relation to accountants' reports that they require in relation to funding provided to private sector organisations.

PSAC is currently reviewing and updating its strategy in the light of the overall Institute Strategy. So that we can determine our overall objectives and key focuses for the next few years, it would be helpful if those of you working in the public sector, having public sector

clients or with an interest in the public sector (perhaps because you provide third party reports to government departments) could outline any high level issues that you think the committee could take account of in its review of its strategy. Please send your comments or suggestions to sumita.shah@icaew.co.uk.

Public sector handy guide

Government structures within the UK can be complicated at the best of times. Not only do we have the various parliamentary structures with the House of Commons, House of Lords, but we also have the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly which exist for the particular jurisdictions. And to add to the structures, there are regional governments, local government bodies, national health and related organisations, education bodies, public corporations, nationalised industries and regulatory, inspection and audit bodies.

The Public Sector Audit Committee (PSAC) of the Audit and Assurance Faculty has therefore developed a *Handy guide to Public Sector Bodies* which provides a brief overview of the UK government structure. The guide gives a snapshot of the UK government structure as at September 2006. It will be updated on a regular basis by the Committee.

Further details of the Faculty's work in the public sector (including its publications and consultation responses) are available on its website www.icaew.co.uk/aaf.

Institute wide

Learning and Professional Directorate

In response to demand from the public sector for professional skills, the Institute has been working with organisations to support training for the ACA qualification. Currently the following organisations are accredited to train HM Revenue & Customs, Ministry of Defence, HM Treasury and the Department for Constitutional Affairs. However, several more public sector organisations are in the process of being authorised. For more information or for details on the benefit of offering ACA training please contact anna.crilly@icaew.co.uk.

Members Services Directorate

The Institute has just launched a public sector special interest group. For more information, please refer to the members' part of the Institute website.

Sumita Shah, Manager, Public Sector Audit (Policy and Practice), Audit and Assurance Faculty

New Ethical Standard for Reporting Accountants (ESRA)

The Auditing Practices Board (APB) has issued a new Ethical Standard for Reporting Accountants (ESRA) together with a paper providing feedback on the actions taken by APB in response to comments received on the exposure draft issued in January 2006.

To support the implementation of the EU Prospectus Directive, new Standards

for Investment Reporting (SIRs) have been published by the APB. Under the associated regulations reporting accountants are required to be independent when undertaking a public reporting engagement on historical financial information in connection with an investment circular. In APB's view, given the nature of investment circulars and the level of public interest

in the reliability of the information contained within them, the level of independence appropriate for such engagements is similar to that for an audit of financial statements.

Copies of the ESRA may be downloaded from the Publications (Standards for Investment Reporting) section of the website at www.ifrc.org.uk/apb.

bulletinboard

Faculty update

IFACnet – international knowledge resource

The International Federation of Accountants (IFAC) has collaborated with its member organisations to develop *IFACnet – A KnowledgeNet for Accountants in Business* (www.ifacnet.com). This new global resource will provide one-stop access to thousands of leading-edge articles, good practice guidance, and tools and techniques developed by IFAC and more than a dozen professional accountancy organisations worldwide for professional accountants in business including industry and the public sector.

International Forum of Independent Audit Regulators

Eighteen independent audit regulatory organisations from around the world have established the International Forum of Independent Audit Regulators (IFIAR). The purpose is to share knowledge of the audit market environment and practical experience of independent audit regulatory activity; to promote collaboration in regulatory activity; and to provide a focus for

contacts with other international organisations which have an interest in audit quality. The UK Financial Reporting Council (FRC) strongly supports the creation of IFIAR, as indicated by Paul Boyle, Chief Executive of FRC accepting the role of Vice-Chair. The first meeting of the IFIAR will take place in March 2007.

Auditor's reports on financial statements

The Auditing Practices Board (the APB) has recently issued Bulletin 2006/6 *Auditor's Reports on Financial Statements in the United Kingdom*. The Bulletin provides illustrative examples of both unmodified and modified auditor's reports of financial statements of companies incorporated in the United Kingdom for periods commencing on or after 1 April 2005. It is the second edition of the Bulletin referred to in various paragraphs of ISA (UK and Ireland) 700 *The auditor's report on financial statements* and supersedes Bulletin 2005/4.

The example auditor's reports included in the Bulletin take account of changes made to the Companies Act 1985 to require the auditor to give a positive

opinion as to the consistency of the directors' report with the financial statements and the revised standard formulation for expressing compliance with IFRSs as adopted by the European Union. The revised Bulletin also provides examples of unmodified reports of publicly traded companies that are not required to prepare group accounts. The Bulletin can be downloaded from their website at www.frc.org.uk/apb.

Internal audit lecture series

Business ethics and the role of internal audit

Monday 4 December 2006, Simon Webley, Research Director of the Institute of Business Ethics

The lecture will start at 6pm and will be followed by wine and a finger food buffet. The lecture will be held at Moorgate Place, London EC2P 2BJ. The cost of this lecture is £34.04 + VAT.

For more information please call Louise Thornton on 020 7920 8493 or visit www.icaew.co.uk/aaf where you can now book online.

Audit & Beyond editorial information

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If you have enjoyed reading *Audit & Beyond*, please pass this copy to one of your colleagues or associates who may be interested in joining the Audit and Assurance Faculty. All enquiries should be directed to the Faculty address above.

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