THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

Audit&Beyond

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Audit and Assurance Faculty

International Standards on Auditing

Dear Faculty Member

International Standards on Auditing (ISAs) (UK and Ireland) apply to the conduct of all UK audits in respect of accounting periods beginning on or after 15 December 2004. This means audits of every entity, irrespective of size, nature of operations, or whether the audit is 'voluntary' rather than required by law. All audits of 31 December 2005 year ends will be caught and many of you will therefore have started to plan your work under the new auditing standards.

A recent survey conducted by CCH found that 90% of auditors were aware of the change in auditing standards to ISAs (UK and Ireland). This is encouraging. However, only about half of the auditors questioned felt fully confident that they were prepared for implementing them. It is to be expected that such a major development in professional practice will cause practitioners some concern about the adequacy of their procedures, but this is a high proportion showing a lack of confidence. If auditors keep the following points in mind in the conduct of their work, they should be well on the way to satisfying the new standards.

Audit systems and training

ISA (UK and Ireland) compliant systems need to be in place in sufficient time to make sure that 31 December 2005 audits are conducted in accordance with the new standards. Regulators will expect to see this. If systems are bought in, they need to be tailored to meet the needs of the practice and its clients. If they are developed in house, they need to be in place in time to make sure that 31 December 2005 audits are conducted in accordance with the new standards. On-the-job training will be needed to supplement formal training in the new standards.

Documentation

As well as the overarching requirement for documentation in ISA (UK and Ireland) 230, individual ISAs contain specific requirements for documentation, either to record certain procedures such as audit team discussions, or to link an audit assessment to evidence gathered. Auditors need to look critically at their working papers, and see whether the documentation really does record the reasons for the auditors' conclusions as well as procedures, so as to provide a clear basis for the audit opinion reached.

Risk-based approach and fraud

The whole emphasis of the audit is on an approach tailored to the assessed risk of material misstatement in the financial statements, however caused. There must be active consideration of fraud, the presumed risk of management override of control, and of the design and implementation of controls, regardless of the audit approach adopted.

New audit report

The most visible change that will be apparent to clients, and regulators, will be the audit report itself. SAS 600 style reports will no longer be valid. Illustrative examples of unmodified and modified audit reports are set out in APB Bulletin 2005/4.

May I take this opportunity to wish you all a prosperous New Year.

Gerald Russell, Faculty Chairman

in this issue...

2005 review of Faculty activities

2005 has been yet another challenging year for the audit profession. Getting to grips with ISA implementation, understanding the ramifications of the APB's ethical standards and considering the role of assurance services in today's market have all contributed to a year of significant change within the profession. The Faculty has had a crucial role to play in representing members' interests and supporting them through this critical period of change, while addressing profession wide issues around audit quality.

International Standards on Auditing (ISAs)

The ISA Implementation sub-group has met on a regular basis throughout the year to help ensure that the transition to ISAs is as straightforward as possible for practitioners in firms of all sizes. Regular articles have been included in the Faculty's newsletter to assist practitioners in managing the change and members have each received a copy of *Auditing Standards - All Change!* a publication developed from the material produced for the Faculty's 2004 roadshow on ISAs.

Ethical Standards

The Faculty's Ethical Standards Roadshow provided members with timely clarification of the implications of the Auditing Practices Board's (APB's) ethical standards. Through a series of nationwide roadshows in the summer of 2005, the Faculty gave practical help and advice on how to deal with the standards. A CD of the Roadshow was subsequently issued to members.

Assurance services

Significant progress has been made in the area of assurance, an area of increasing relevance where there is little guidance available. The Faculty's first assurance guidance, *Assurance reports on internal controls of service organisations made available to third parties*, was exposed in the summer of 2005 and the Faculty is looking to issue final guidance early in the new year. In addition, the Faculty is launching its assurance prospectus in the New Year, which will provide details of the current work programme and highlight the work streams the Faculty intends to explore further. Alongside this, the Faculty hopes to deliver a set of timely publications, including guidance for reporting on financial statements of audit exempt companies. Consultation has been undertaken throughout the year to ensure the practicality of the guidance and its usability is currently being market tested.

Audit Quality

The *Audit Quality Forum*, which brings together investors, the audit profession, business and regulators has generated a number of timely policy proposals aimed at enhancing confidence in the independent audit by promoting transparency and accountability. The Forum's current work agenda focuses on the overriding need to understand and articulate the purpose of an audit, and it will examine the relationship between shareholders, boards, auditors, regulators and other stakeholders in the audit.

Supporting members

The Faculty has issued a number of publications to assist members in the delivery of quality and good practice in audit and related services. These include:

- *Investor Confidence Survey* (web based report). The Faculty commissioned a survey of 100 investment managers from the UK and US to assess the confidence in audited financial information.
- *IFRS Audit Update* (web only). This document seeks to explain the issues outlined in the APB's draft bulletin 2005/3 in more detail. This is supported by examples in relation to specific IFRSs.
- *Audit liability: claims by third parties*. This review of relevant legal cases (with reference to the appropriate Institute/Faculty guidance) brings all cases together in one document and provides members with a single point of reference for the relevant risk management guidance issued by the Faculty/Institute.
- *CPD Planner*. The planner provides an illustrative example of a CPD planning and recording document, which follows the 'reflect, act and impact' approach to help members to familiarise themselves with the requirements.
- *Promoting best practice in group audits*. This practical guidance is the latest in the Faculty's Audit Quality series and contains an eight point plan to help firms of all sizes to enhance the quality of their group audits (see page 8 for more detail).

The Faculty issued two technical releases in 2005:

- *Audit 01/05, Chartered Accountants' Reports on the Compilation of Historical Financial Information of Unincorporated Entities*. This guidance seeks to provide a framework which helps accountants to manage their risks, when carrying out engagements to compile financial information of unincorporated entities.
- *Audit 02/05, Guidance on the implications of the Freedom of Information Act 2000.*

In addition, the Faculty has continued to keep members abreast of changes in the area of audit and assurance through its newsletter and the quarterly *Technical Update*.

Going forward

Looking ahead, audit quality and the development of guidance to assist members with assurance services remain high on the Faculty's agenda. We hope to see the delivery of a number of key projects in these areas in the forthcoming year.

The most important changes to auditing standards in ten years?

The IAASB is consulting on proposals which will, over time, represent the most important changes to its standards (ISAs) for many years.

These changes will of course be mirrored in due course in changes to ISAs (UK and Ireland). The comment deadline for these proposals is 28 February 2006. IAASB is proposing a staggered implementation timetable which will not bring the first batch of redrafted ISAs into effect until 2008 (periods beginning on or after 15 December 2007) in order to provide a reasonable period for implementation. The full redrafting programme will not be completed until 2011. The main changes are set out below.

All standards will have one overarching **objective** with which auditors *must* comply (such as a requirement to 'determine and implement overall responses to assessed risks at the financial statement level...'). There are no exceptions to the requirement to achieve these objectives unless the standard as a whole is not relevant to the engagement.

Auditors are expected to achieve the objective by (a) complying with the requirements of the standard and (b) by performing other procedures that, in the auditor's judgement, are necessary in the circumstances. The latter requirement is important because auditing standards can never be expected to cover all conceivable situations and because auditors must use their judgement.

Auditors must comply with the **requirements** of a standard (indicated by the use of the word 'shall') where they are relevant to the circumstances of the engagement except in exceptional cases where the auditor judges it necessary to depart from a requirement in order to achieve the purpose of the requirement (which, if not self-evident, will be explained). This is only expected to happen in relation to procedural requirements which would be ineffective in the circumstances. Auditors must document how the alternative procedures performed achieved the purpose of the requirement and, unless otherwise clear, the reason for the departure. A fairly high hurdle is thereby set for departures from requirements.

The use of **application material** is determined by the exercise of professional judgement.

The objective, requirements and application material will be presented in separate sections of the standard. Auditors must consider the application material even though they are not required to follow all suggestions therein.

Other formatting changes include the elimination of duplication, the use of shorter sentences and bullet points.

Requirements

The initial impetus for the change was a lack of clarity with regard to the use of the present tense in ISAs. Some jurisdictions interpreted statements that auditors 'do this or do that' as virtual instructions, others interpreted them as optional or ignorable. IAASB has taken each of these 'present tense requirements' and applied various criteria to determine whether or not they should become one of the new style requirements, or whether they should be included in the application material. This, of course, is a most difficult area as IAASB is under significant pressure from some to keep the level of additional requirements down (some believe that there should be a presumption against the 'present tenses' becoming requirements), and under equally significant pressure from others who take the opposite view. There is a significant increase in the number of requirements, although perhaps not as many as was at first feared. Quantification is difficult because the exercise has not been a simple case of taking each present tense requirement in isolation, as they are interconnected.

IAASB is not seeking comment on its general *approach* with regard to requirements because this is an issue on which it has already consulted. The original proposals identified two levels of requirements, 'mandatory requirements' and 'presumptively mandatory' requirements which created a great deal of confusion and which were dropped.

Early indications on other aspects of the redrafting indicate that the standards are shorter than before, and somewhat clearer.

In a project such as this, the devil is, of course, in the detail. IAASB has dealt with this in two ways:

- It has provided four redrafted standards on which it is seeking comments. These standards are the risk and fraud standards which are some of the most lengthy and complex issued in recent years (comments are requested on the redrafting, not on the substance);
- It has provided mapping documents for each of the four standards showing how all of the text in the existing standard has been dealt with in the new standard.

Implementation

The project timetable extends to 2011, although IAASB is under considerable pressure to deal with the more important standards on a timely basis. The approach to be taken could be described as a 'modified big bang approach', in that existing standards will be redrafted and issued for comment, but the implementation date for the first batch of (approximately 18) standards will be no earlier than accounting periods beginning on or after 15 December 2007.

Comments

Any comments which readers might wish to make through the ICAEW should be sent to *kbagshaw@icaew.co.uk*. An event will be held on 6 February 2006 (see attached flyer) at Chartered Accountants' Hall, which will permit practitioners to discuss the proposals with representatives of the APB.

Audit documentation

Documentation is a perennial problem for auditors. The Quality Assurance Directorate (QAD) and its predecessors have for many years commented on this area as one that could always 'do with improvement'. The IAASB has recently issued a revised standard on audit documentation ISA 230 *Audit Documentation*. This further clarifies and widens existing audit documentation requirements, and may well represent a challenge for some practitioners. It seems likely that APB, which has already exposed the same ISA for UK purposes, will issue the UK and Ireland version in the near future.

Some of the changes to previous requirements are enhancements, others are entirely new requirements.

There is more emphasis on the 'timely' preparation of documentation that will not only support the audit report, but that will also show that the audit was carried out in accordance with standards and legal and regulatory requirements. There are new requirements:

- for auditors to complete the assembly of the audit file on a 'timely' basis which would not normally be later than 60 days after the audit report. This has been achieved through an amendment to ISQC 1 on quality control which also now requires firms to have policies and procedures for the completion and assembly of audit files, and suggests that a retention period of no less than five years will be appropriate in the absence of other legal and regulatory requirements (UK requirements may be more stringent);
- which prohibit auditors from deleting or discarding documentation after the file has been assembled;
- for auditors to document how and (if it is not otherwise clear) why, they have departed from the requirements of ISAs and performed alternative procedures to meet the objective of the audit;
- for the documentation to enable an experienced auditor with no previous connection with the audit to understand the work performed, the results and evidence obtained, and the significant matters identified and the conclusions reached thereon. Previous requirements were somewhat looser than this and an 'experienced auditor' has been defined.

Whilst the new requirements may require changes for some firms, there is some additional clarity which was absent in the previous guidance.

The ISA is effective for audits of financial information for periods beginning on or after 15 June 2006. It seems likely that the ISA (UK and Ireland) issued by APB will have a similar implementation date.

Improving the bank confirmation process

At the end of October the Auditing Practices Board (APB) published a consultation draft of Practice Note 16 (PN16), *Bank reports for audit purposes*, revised in line with recommendations made by a joint working group of the Faculty and the British Bankers' Association (BBA). This article looks at three key changes which are designed to resolve the problems identified by auditors in their replies to the Faculty's 2004 survey, and so make the system of obtaining bank reports work better.

Recommended date for auditors to submit requests to banks one month, rather than two weeks, before the year end date

One of the main problems identified by auditors was how long it took banks to reply to requests for reports. Bankers' representatives explained that sometimes the volume of requests received simultaneously makes it difficult to send all replies within a month of the confirmation date. 31 December year ends are especially busy, and time problems are exacerbated because of delays in pre-Christmas post.

The banks have said that if requests are sent so as to be received by them at least a month before the year end date, they can prepare much of the information in advance, and so be able to send the reports to auditors much more promptly after the confirmation date. When the auditors cannot send the request out by the recommended date, for example if they are appointed after the year end, the banks will still process the request, but may not be able to do so in less than a month from the date of receipt.

Incorporation of acknowledgement procedure from Audit 3/02

A key problem identified by respondents was the amount of time they had to spend in following up requests when there was no reply from the bank, or if the information received appeared to be incomplete or incorrect. The guidance explains the acknowledgement procedure and an appendix includes a pro-forma that auditors can use to request contact details. This should make follow up much easier.

Inclusion of main account details in the audit request letter

The details will make it easier for banks to identify the customer, because an individual branch may have customers with very similar names, or may be confused if the name in the auditor's request differs in any way from that in their records. The audit value is not reduced if the details given to the bank are taken from bank statements made available to the auditor by the client.

The consultation draft of PN16 (Revised) may be downloaded from the APB website at *www.frc.org.uk/apb*.

Company Law Reform Bill

The Company Law Reform Bill was introduced in the House of Lords on 1 November 2005. The intention is to change company law to make it more flexible and easier to understand, with a particular focus on small businesses.

To this end, the Government has 4 key objectives:

- To enhance shareholder engagement and a long-term investment culture
- To ensure better regulation and a think small first approach
- To make it easier to set up and run a company
- Provide flexibility for the future

Background

In 1998 the DTI launched a long-term review of company law. This review was led by an independent steering group whose aim was to develop a simple, modern, efficient and cost effective framework for carrying out business activity. The final report was presented to the Secretary of State in 2001.

The Government subsequently published two White Papers, an initial partial response in July 2002 and then a full statement of its proposals in March 2005. The full statement included draft clauses and explanatory material on many elements of the Bill and additional draft clauses and explanatory material have subsequently been published.

Key proposals affecting smaller businesses

Clearer law and better guidance

Current company law has been written from a large company perspective. The provisions for private companies tend to be expressed as exceptions to the provisions for public companies but this makes it harder to understand what the requirements are for smaller companies. The Bill is designed to 'think small first' and uses simpler and clearer language. Also the Government intends to make company law easier to understand by supplementing it with clear guidance so that small companies will be able to easily identify the requirements placed on them.

Improved website

With small companies increasingly using Companies House website, Companies House will provide a wider range of web-based guidance, better links to related websites and on-line access to up to date companies' legislation. It is also expected that Companies House will offer web incorporation during 2007.

Specific legislative changes affecting small companies

- The requirement for a company secretary will be abolished
- There will be separate model articles of association for private companies
- The bill includes a statutory statement of directors' general duties. Currently these duties are established in case law rather than statute.
- Private companies will no longer need to hold an annual general meeting unless they have positively opted to do so.
- There will be scope for greater electronic communication with shareholders
- Companies will find it easier to take decisions by written resolutions rather than holding a meeting
- The provisions on accounts and reports have been simplified and made clearer.
- The deadline for filing accounts will reduce from ten to nine months
- The rules on providing financial assistance for private companies are to be abolished and it will be made easier for private companies to make capital reduction.
- The Government is simplifying the rules on updating the law. A special form of secondary legislation will be introduced.

Key audit-related provisions

- Changes to requirements for auditor resignation statements
- Signature of auditors' reports
- Rights of members of quoted companies to raise audit concerns at accounts meeting
- Provisions protecting auditors from liability
- Criminal sanctions for knowingly or recklessly providing an incorrect audit opinion, including where it has proved to be incorrect through, for example, omitting to make statements that proper accounting records or returns are kept or received or are not properly reflected in the accounts

What next?

The Bill will take several months to pass through parliament and is not expected to come into force before 2007.

Institute's response

The Institute issued a press release and whilst supporting the broad aims of the bill and welcoming many of its provisions, it has continued to call for greater clarity of the intentions behind the introduction of a criminal offence for auditors who 'knowingly or recklessly' provide an incorrect audit opinion. The full press release can be viewed at *www.icaew.co.uk/pressoffice*.

The Institute is lobbying Parliament for changes to the Bill, in particular in relation to the offences, as we believe that as drafted this will cause particular problems in respect of SMEs, where the less formal systems in operation could lead to auditors issuing qualified opinions in respect of accounting records, in order to avoid a potential criminal prosecution.

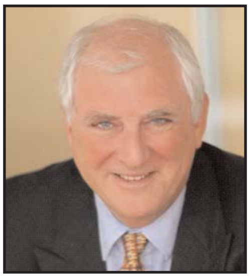
A copy of the Bill is available on the UK Parliament website at *www.parliament.uk*.

How is your faculty governed?

The Faculty is governed by the Faculty Committee, which oversees the work of the Faculty. Its members are elected by the Faculty membership. The Faculty Committee delegates its powers to a number of committees to undertake the technical work on behalf of the Institute.

Members of the various Faculty Committees are volunteers, predominantly from practice, who work closely with Faculty staff.

The following are members of the Faculty Committee:



Gerald Russell FCA.

Gerald is the current Chairman of the Faculty, taking up the role in July 2005. Gerald is a Senior Partner at Ernst & Young having been Managing Partner of the Industrial and Commercial office for the last six years. He is also Chairman of the *Audit Quality Forum* which was formed at the behest of the government and is Chairman of the Faculty's Assurance Panel.

Anthony Bingham FCA.

Tony has been a member of the Faculty Committee since 1995. As chairman of the Technical and Practical Auditing Committee (TPAC) for the last 10 years, Tony has played a crucial role in TPAC's representational work and in leading the debate to ensure the timely delivery of practical and effective technical guidance and publications on topical auditing and assurance matters for firms of all sizes. Tony is a UK and global senior technical partner at PricewaterhouseCoopers.

Stella Fearnley BA FCA.

Stella is an observer on the Faculty Committee. She is a Professor in Accounting at Portsmouth University. Her research interests include auditing, financial reporting and corporate governance. She is a past member of the ICAEW's Council and is currently a member of the Professional Oversight Board for Accountancy - a board of the Financial Reporting Council which is responsible for the oversight of the accountancy profession.

Mary Hardy BA FCA.

Mary was elected on to the Committee in 2002. She is also a member of the Institute's Internal Audit Committee and Corporate Governance Committee. Mary has spoken extensively on risk management, reputation risk and corporate governance at both private and public sector conferences. Mary was formerly Director of Business Risk Assurance at Diageo and an external Audit Partner at Ernst & Young.

David Isherwood BSc ACA.

David, who was elected to the Faculty Committee during 2005, is also a member of the Institute's ISA Implementation sub-group. Working within BDO Stoy Hayward's national technical department he has wide-ranging responsibilities in such areas as professional standards, audit method-ology development and related risk management issues.

Clive Jones FCA.

Clive is also Chairman of the Faculty's Practitioner Services Committee. He has worked with the Faculty since its estab-lishment in 1995. He is heavily involved in the service offering to members, providing valuable input on content for *Audit & Beyond* and publications issued to members. Many of you would have seen him at our Roadshows. Clive is recently retired but formerly a partner in Clifford Towers in Rugby.

Steve Maslin BSc FCA.

Steve became a member of the Committee in 2004 and is also a member of the Institute's Audit Registration Committee. Steve is Head of Assurance Services at Grant Thornton UK LLP. He is a member of the European Contact Group, which comprises partners from the six largest international auditing organisations, and which liaises with the European Commission on developments in audit and financial reporting. Steve has undertaken expert witness work and lectures, internally and externally, on audit and business topics.

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Andrew Ratcliffe MA ACA.

Andrew was Faculty Chairman between 2001 and 2005. Over the years he has made a significant contribution to the Faculty's thought leadership programmes, including audit quality. He has played a key role in developing the strategy and direction of the Faculty. Andrew is a partner at PricewaterhouseCoopers.

Richard H Reid FCA.

Richard was co-opted onto the Committee in September 2005. He is a senior audit partner at KPMG in the UK and has focused on working with international clients primarily in the Industrial and Consumer sectors. Richard has had significant experience in restructuring investigations, acquisition and disposal reports, and related work required by the London Stock Exchange and SEC. As well as his client work, Richard is the UK Chairman of Consumer and Industrial Markets, one of KPMG's four UK Market Groups.

Peter Upton FCA ATII.

Peter has been a member of the Audit and Assurance Faculty since its inception and was the first elected member of its Committee. He qualified as a Chartered Accountant in 1971 and has been a sole practitioner since 1988. He currently has offices in Maidenhead and Sutton Coldfield. His clients are all in the SME sector. From 1991 to 1997 he represented the Thames Valley on the Council of ICAEW. In 1999-2000 he was the President of the Thames Valley Society.

Chairs of the other Faculty Committees

The following volunteers are chairpersons of the various other Faculty Committees.

John Chastney MA FCA.

John is a member of three technical Committees at the ICAEW and chairs the Public Sector Special Reports of Accountants' Panel. John has extensive experience of governmental audits and in advising several Departments and Agencies. John's experience spans the public and commercial sectors where he has used his wide range of skills. For two years he was seconded to the DTI as Director of the Industrial Development Unit. He has been a partner at Mazars since 1984 and has been Head of three divisions: Education, Charities and Consultancy. He is currently an elected member of Mazars National Governance Council and the International Partners' Appeal Committee.

Janet Eilbeck BA FCA.

Janet currently chairs the Public Sector Sub-Committee of the Faculty, leading on discussions with government and the audit institutions on public audit on behalf of the Institute. She is a member of TPAC representing our members in the public sector and she is also a member of the APB Public Sector Sub-Committee. Janet is a very experienced public service auditor with a client base that includes advisory work and a sizable audit portfolio focussing on government bodies, local government, health and the charity sector.

Andy Harris MBA BSc FCA.

Andy has been a member of the Technical and Practical Auditing Committee since 2000. He has also been a member of the Special Reports of Accountants Panel (SRAP) since its formation and took over the chair of SRAP in 2004. The Faculty has taken a keen interest in the risk management and liability issues facing its members and Andy has been a leading contributor to the various pieces of risk management guidance issued over the last five years. Many of these are listed in the recent Faculty publication *'Audit Liability: Claims by Third Parties'*. Andy is a partner in Deloitte's National Risk Management Group.

Martyn E Jones FCA.

Martyn is Vice-Chairman of the Audit and Assurance Faculty's Technical and Practical Auditing Committee and Chairman of the ISA Implementation sub-group. Martyn is also a member of the ICAEW's Corporate Governance Committee and its Technical Strategy Board and Chairman of the Institute's Centre for Business Performance. He is also a member of the CBI's Companies Committee. Martyn has been National Technical Partner at Deloitte & Touche since 1987.

Further information about the work of these committees is available on the Faculty's website at *www.icaew.co.uk/aafac*.

If you would be interested in being involved with any of the Faculty's Committees, please email *louise.thornton@icaew.co.uk*.

Group audits: promoting best practice

The Faculty has now issued its good practice guidance on group audits (see last month's *Audit & Beyond*). This article summarises the recommendations being made by the Faculty in the publication's eight point plan.

The Faculty's latest publication in its *Audit Quality* series is aiming to provide a useful tool in further improving the quality of group audits.

Research carried out for the Faculty by Lighthouse Global covered firms of all sizes and found much good practice but also identified scope for continuous improvement. Reviewing current practice now will also give practitioners a head start with Article 27 of the new EU Statutory Audit Directive (see last month's *Audit & Beyond*) and the likely requirements of the forthcoming revised ISA 600 which is likely to come into force in a couple of years time.

The top tip for group auditors is establishing good communication with the other auditors. This can be a real challenge and good people skills are needed in addition to an understanding of the technical issues involved. Communication with clients is also important, covering the complex accounting requirements and making clear that they have the primary responsibility for producing the group accounts - clients should not rely on their auditors to do the consolidation for them!

1. Get organised

Speaking from experience, auditors told the researchers that good project management is essential given the complexity of most group audits. Start early and provide very clear instructions and requirements for deliverables to other auditors - the publication includes an Appendix listing suggested contents of communications between auditors. The telephone can play an important role rather than relying solely on letters and email.

2. Analyse the group structure

Maintaining an up-to-date understanding of the group structure, particularly where it is complex, is crucial to the group auditor. It allows work to be planned to deal with differing accounting frameworks and policies applied around the group and different local auditing requirements.

The revised ISA (UK and Ireland) 600 is likely to introduce new requirements regarding continuance and acceptance, in particular consideration of the group auditor's access to information relating to 'significant' components of the group (20% or more of group assets, liabilities, cash flows, profit or turnover). Auditors will need to consider whether to accept an engagement where they are only directly responsible for a minority of the total group.

3. Focus on the quality of other auditors

The qualifications, independence and competence of other auditors need to be considered up front, along with their quality control procedures. For unrelated auditors, or related auditors where the group auditor is unable to rely on common policies and procedures, there are various possible measures to consider, including visiting the other auditor.

4. Focus the group audit on high risk areas

The research highlighted the importance of identifying risk areas, an area covered by the proposed revised ISA. Group auditors need to ask for enough information from other auditors to form their own conclusion on significant risks arising in components that affect the group financial statements. Fraud risks should be discussed with other auditors as appropriate.

5. Understand internal controls across the group

Any weaknesses in group-wide controls and significant weaknesses in internal controls of components should be communicated to group management and those charged with governance of the group. To do this, group auditors will need to obtain details of weaknesses identified by other auditors.

6. Understand the technical complexities of group audits

Group audits raise a host of potential technical accounting issues from intra-group transfers to share options and bonuses. Group auditors need to identify when there is a difficult technical issue and when to bring in specialist help.

7. Review other auditors' working papers

At the moment, other auditors' working papers tend to be reviewed in response to specific concerns, rather than as a matter of course. Going forward, a more proactive approach will be needed, given the requirements of Article 27 of the new Directive. The publication contains recommendations to help in gaining access to information as required.

8. Review and update procedures, training and tools

Questionnaires are very widely used in group audits but may not always be the most effective means of obtaining the information required. In particular, it is important to tailor the questions asked to the specific company. The use of up-to-date documentation and formal training on group audits is recommended.

The publication '*Promoting best practice in group audits*' is included with this issue of *Audit & Beyond* and is also available online on the Faculty's website *www.icaew.co.uk/aafac*. Further hard copies are available for purchase from the Faculty for £10 each - see our website for more information.

FRC publishes updated Turnbull guidance

In October 2005, the Financial Reporting Council published *Internal Control: Revised Guidance for Directors on the Combined Code*, its update to the 1999 'Turnbull Guidance'. The work was undertaken by the Turnbull Review Group (TRG), chaired by Douglas Flint, Group Finance Director of HSBC Holdings plc.

The revised guidance followed two consultation phases. In the first phase, the TRG sought evidence to help it form a judgment on a number of key areas. In the second phase it proposed changes to the guidance, and consulted on those changes.

The TRG stated that it wanted to ensure that the resulting guidance and disclosures provide a framework that is effective and proportionate, and that when considering possible changes to the guidance it would pay particular attention to the potential impact of such changes on:

- the ability of companies to better achieve their business objectives;
- the ability of investors to make better informed decisions in pursuance of their investment strategies;
- improving confidence in corporate reporting and governance;
- the balance of costs and benefits; and
- the perceived impact on litigation risk and liability.

Having gathered a substantial amount of evidence, the TRG applied four tests when determining whether any specific changes should be made:

- Does the proposed change address an issue that is not already substantially covered by the existing guidance?
- Is a change to the guidance the most appropriate way to address the issue concerned?
- Would any proposed change materially improve internal control and risk management at a reasonable cost?
- Would any proposed change restrict a company's ability to apply the guidance in a manner suitable to its own particular circumstances?

The result is a new preface with only limited changes to the guidance itself. The new preface encourages boards to review, on a continuing basis, their application of the guidance and to look on the internal control statement as an opportunity to communicate with their shareholders. Other changes include:

- clarification that directors will be expected to apply the same standard of care when reviewing the effectiveness of internal control as when exercising their general duties. The new wording replaces the old wording of forming a view 'after due and careful enquiry';
- boards should now confirm that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from their review of the internal control system. This has always been in the Turnbull 'process' but is now also part of the disclosure statement.

The new guidance takes effect for financial years beginning on or after 1 January 2006 and is available from *www.frc.org.uk /corporate/internalcontrol.cfm*.

Institute steps up campaign to promote Chartered Accountants

You will know that a media relations programme is currently underway in the national, regional and professional media promoting the benefits of using a chartered accountant, under the theme of "You Can Count on a Chartered Accountant". The Institute supported this with a short term press advertising campaign in some key national daily/ Sunday newspapers and regional newspapers from 28 November - 13 December.

The advertisements were fairly generic in terms of message, to have an appeal across the key audiences of SMEs and private individuals. The Institute's aim is to:

- help to raise awareness of the ICAEW brand and position the Institute as the leading chartered accountancy brand;
- raise awareness of the range of services a chartered accountant can provide to the SME business and the private individual;
- help to position chartered accountants as business advisers.

The Institute had concentrated on the 'mid market' national press (Daily/Sunday Express and Mail) as well as key regional press (Manchester Evening News, Birmingham Post, Yorkshire Post, Scotsman, Glasgow Herald) in this phase of the advertising campaign. This ensured maximised awareness raising ability across our key target audiences. These titles together have given the Institute an audience of some 42 million over the course of the campaign.

Whilst the advertisements did not specifically address the 'unqualified' issue, they highlighted the quality and reliability of a chartered accountant and the range of services they can provide to businesses and individual consumers. The Institute website is featured to drive readers to the "Find a Chartered Accountant Area", where they can access the on-line Directory of Firms and other information about choosing and using a chartered accountant (*www.icaew.co.uk/find*). The Institute has improved this area of the site and has also negotiated with Waterlow a special discount for members who may wish to update or upgrade their on-line entry.

During 2006 the Institute plans to build on this campaign with more targeted advertisements which will, for example, focus on specific issues relating to SMEs (such as red tape and bureaucracy).

International standards for internal auditors gain recognition

While external auditors are working hard to implement the International Standards on Auditing, internal auditors are in the happy position of having shared global, principles-based standards since 1978.

These *International Standards for the Professional Practice of Internal Auditing* and the *Code of Ethics*, set by the Institute of Internal Auditors (IIA), set out the principles and behaviours internal auditors are expected to apply to their work.

The Standards help internal auditors to deliver objective assurance by providing a systematic methodology and a framework for resourcing and reporting. They are followed by over 108,000 IIA members in 165 countries worldwide and over 7,000 in the UK and Ireland. They form the foundation of the profession of internal auditing, and are its quality benchmark.

In the UK, the internal audit profession has been in ascendance since the mid-1990s. But its rise has been fuelled more recently by financial scandals at companies such as Enron, WorldCom and Parmalat. These events encouraged organisations to question the quality and rigour of their own internal control and risk management systems. The response by regulators put internal audit issues at the top of many board and audit committee agendas.

But regulation and fear of scandal are not the only drivers of change. An increasing number of organisations have come to appreciate the positive effects of internal audit work. Boards in receipt of assurance that systems of internal control and risk management are sound are in a better position to take informed risks and seize opportunities. These are the key issues opined on by internal audit.

In recent times the Standards have been recognised and adopted by regulators and professionals outside the immediate world of internal audit. These include the Financial Reporting Council (in the Smith Guidance on Audit Committees) and HM Treasury (in the Government Internal Audit Standards). They provide invaluable guidance for internal auditors and for those outside the profession who work with them.

If you are an internal auditor you will already be well aware of these Standards. If you work with internal audit in any way, for example as an audit committee member or auditee, you might want to take a look at the Standards, and ask how they are applied in your organisation.

The Standards can be found at *www.iia.org.uk/knowledgecentre/professional guidance*.

Risk based internal auditing

Back in 2003, the Institute of Internal Auditors - UK and Ireland published a position statement on risk based internal auditing (RBIA), a methodology that links internal auditing to the organisation's overall risk management framework. In a move designed to harmonise what it means to different organisations, the IIA expects shortly to issue technical guidance for adopting RBIA.

During October's internal audit lecture, Dr Sarah Blackburn gave a preview of that guidance, explaining how RBIA might be conducted given different levels of understanding of risk. Dr Blackburn chairs the institute's Technical Development Committee that developed the guidance and holds a number of non-executive posts which give her an overview of management approaches to risk and of what internal auditors might usefully consider before adopting RBIA.

Thus if the level of risk maturity can range from risk naïve to risk enabled (with three intermediate levels), pure RBIA can be carried out in a risk enabled or risk managed environment, while in a risk naïve organisation, internal audit will need to promote risk management before RBIA is possible.

In risk enabled organisations internal auditors can agree with the audit committee which risks require independent assurance and where management assurance can be relied upon. This will also dictate where audit services are required and where improvement reviews may be appropriate.

In less sophisticated organisations internal auditors must devote time to championing risk management processes and ensure that the audit plan covers the organisation's objectives as best it can.

Whatever the risk maturity, it is critical to assess the organisation's level of inherent risk, ie risk *before* controls or management responses, and residual risk, ie risk remaining *after* controls and responses. An overall opinion can only be given if all the significant inherent risks are covered.

There are downsides to RBIA: as an audit approach focused on inherently high and residually low risks, it can be boring. Fewer, more highly skilled staff are usually required - bad news for those whose CPD is falling behind. However the case for RBIA remains strong as it:

- provides a process for evaluating an organisation's system of control against its risk appetite;
- is currently the definitive basis for giving an overall assurance opinion; and
- is the most rigorous way to justify the right level of internal audit resources.

Crucially it reinforces internal auditors' sense of purpose: to provide independent assurance and consulting services and to challenge organisations to achieve what is best for stakeholders.

Audit exemption and groups

Question: My firm is the auditor of a UK subsidiary of a Spanish holding company. The UK company has turnover and gross assets below the new audit exemption thresholds and the directors wish to take advantage of audit exemption in order to reduce costs. The holding company has not requested an audit and has stated that they will be satisfied with a compilation report from my firm. The holding company auditor has also not requested that the subsidiary is audited. Can the UK company directors take advantage of audit exemption when the company is part of a group?

Answer: The Companies Act allows group companies to take advantage of audit exemption provided that the company is part of a qualifying group. From 2004, a qualifying group has:

- turnover not more than £5.6million (or gross £6.72 million); and
- gross assets not more than £2.8 million (or gross £3.36 million).

The Act does not specify that it is referring only to UK groups. Therefore the size of the whole group, including foreign companies, has to meet the above criteria in order to be eligible for audit exemption.

From the question it appears likely that the group is larger than the UK audit exemption thresholds, as the Spanish auditor appears to have dismissed the UK subsidiary as immaterial. However, if it did qualify under the Act as a small group, then there are other restrictions when considering audit exemption, because there are certain entities which are not eligible:

- Listed entities, or companies who are members of a group containing a listed company.
- Certain regulated businesses, (although many FSA regulated businesses who in the past could not have taken advantage of audit exemption may now do so under Statutory Instrument 2280).
- Charities have lower thresholds.

Question: Currently, my firm is considering whether to accept appointment as advisors for a UK company who takes advantage of audit exemption. The company is a subsidiary of a holding company incorporated in an offshore jurisdiction where financial statements are not publicly available. The UK directors say that they do not have access to financial information for the holding company or other group companies. Is this company eligible for audit exemption?

Answer: As set out in the question above, group companies may only take advantage of audit exemption where the group meets the audit exemption criteria. In this instance the directors have opted out of audit on the basis of lack of knowledge.

However, when the directors prepare the accounts they should state on the balance sheet that they confirm that the company is eligible to take advantage of audit exemption. In fact they are not in a position to do this and hence cannot forgo the audit on this basis.

Therefore, the company does require an audit, unless the directors receive information concerning the size of the group that proves contrary.

John Selwood is a Chartered Accountant and independent training consultant, who lectures for the major training accountancy companies and publishers.

And on a lighter note...

Anagrams

Here is a list of anagrams to unscramble. They all have an accounting/auditing theme except one. Can you spot the Christmas Cracker? With one exception, they are all one word answers. Answers to be sent or faxed to the Faculty* to be received no later than noon on 30 January 2006. For those submitting the correct answers the draw will take place on 31 January 2006. A bottle of Champagne will be sent to the first correct entry drawn.

NEED NICE PEND
ACTUAL SANS
CONDITION ALSO
MAGNET GENE
AUTONOMIC DENT
TUTOR STAY
PORTRAIT NICE
CURSE NASA
SUCROSE LID
TOUCAN CANT

Su Doku

	3				1			
		6					5	
5						9	8	3
	8				6	3		2
				5				
9		3	8				6	
7	1	4						9
	2					8		
			4				3	

The latest puzzle craze has reached the Audit and Assurance Faculty! Send or fax your completed Sudoku to the Faculty* to be received no later than noon on 30 January 2006. For those submitting the correct answers the draw will take place on 31 January 2006. Marks and Spencer £30 vouchers will be sent to the first correct entry drawn.

* Audit and Assurance Faculty, Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ. Fax number: 020 7920 8754. Please include your name, telephone number and email address.

bulletinboard

Faculty update

Information for markets and society

Regulatory burdens and the risk of failure in public policy could both be cut by paying more attention to getting the information flows right says a new report, *Information for markets and society*, published by the Institute in November 2005. The Institute also suggests that business perceptions of red tape are often the fault of poorly designed information requirements.

The report looks at examples of information failure in public policy, and puts forward some ideas for discussion on how the quality of information could be improved so as to increase the effectiveness of public policy design and delivery.

Comments on the report are requested. The report can be downloaded from the Institute website at *www.icaew.co.uk/technicalpolicy* (click on Thought Leadership and then Information for better markets).

Internal audit lecture series

Corporate Governance (including an update on Turnbull) - Martyn Jones, Deloitte

Monday 16 January 2006

Future dates for your diaries:

Monday 6 March 2006
Monday 24 April 2006
Monday 19 June 2006 (subject to change)

All lectures will start at 6pm and will be followed by wine and a finger buffet. The lectures will be held at Moorgate Place, London EC2P 2BJ. Tickets cost £32.50 plus VAT. For more information please contact Louise Thornton on 020 7920 8493.

APB finalises Bulletins on the application of IFRSs and updated example auditor's reports

The Auditing Practices Board (APB) has recently published:

- Bulletin 2005/3, *Guidance for auditors on first-time application of IFRSs in the United Kingdom and the Republic of Ireland* and
- Bulletin 2005/4, *Auditor's reports on financial statements in Great Britain and Northern Ireland*.

Both related Bulletins were issued as interim guidance earlier in the year. The finalised Bulletins may be downloaded from the publications section of the APB's website at *www.frc.org.uk/apb*.

CCH Professional Development events

Audit update - ethics and ISAs
Glasgow, 27 March 2006, £125
Pennines, 29 March 2006, £125

Charities: audit, accounting and tax update
London, 24 April 2006, £125
Merseyside, 25 April 2006, £125

For further details on how to book any of the above events, please visit *www.cchseminars.co.uk* or call 01635 588898.

Faculty members receive a 10 per cent discount on the prices listed above for these courses, please mention *Audit & Beyond* when booking.

Audit & Beyond editorial information

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