

## FEE SME/SMP Congress and beyond – developments in Europe

As highlighted in the October issue of *Audit & Beyond*, the 4th FEE SME/SMP Congress took place in Copenhagen between 3–5 September. The congress was attended by over 300 SMPs, representatives from professional bodies and standard setters. The overall theme of the congress was *think ahead on small and mid-sized business: opportunities and tools for the accountancy profession*. Three plenary sessions and eight workshops were held over a period of two days, covering subjects including financial reporting, auditing, tax, XBRL, corporate responsibility and other EU developments of relevance to SMEs and SMPs.

### FEE SME/SMP Congress

#### *The impact of globalisation*

Throughout the congress, two themes were recurrent: the globalisation of SMEs and the need for accountants to provide appropriate services to meet their needs.

Globalisation has affected SMEs as much as large businesses. For example, the availability of relatively inexpensive but well-motivated labour and lower material costs have attracted some SMEs to move or outsource the whole or part of their production and service facilities overseas. The expansion of Eastern Europe has increased the choice of sites that are relatively nearby.

Support from SME accountants at home and abroad is important when extending business operations overseas. There are various areas which can be confusing to small businesses. These include opening local bank accounts and finding suitable premises and understanding local regulatory requirements. SMEs do not expect all of these issues to be resolved by accountants but they may want their accountants to be able to point them in the right direction to find more information, resources or contacts. It is not only large firms that can offer assistance. Practitioners' contacts overseas and network firms can also provide relevant local support.


As the Danish Minister of Economic and Business Affairs noted, SMEs play a key role in the economy of many countries. As knowledgeable business experts, accountants have much to offer SMEs.

#### *Simplification of accounting and other requirements for SMEs*

During his speech entitled *Recent EU developments of relevance to SMEs and SMPs*, Pierre Delsaux, a director at the European Commission, referred to the European Commission's progress towards the objective of reducing administrative burdens in the EU and stated that the European Commission would shortly be deciding whether to propose the option for Member States of exempting micro-entities from the requirements of the 4th and 7th Company Law Directives.

He also discussed the proposed concept of a European Private Company (*Société privée européenne*, (SPE)), which is designed to enable SMEs to do business more easily throughout the EU. The SPE has been designed to address the current

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## STOP PRESS:

### APB consultation on 'clarity' ISAs

The APB has now issued its Consultation Paper on whether UK and Irish auditing standards should be updated for new international auditing standards that will be issued in early 2009. The paper is available at [www.frc.org.uk/apb/press/pub1742.html](http://www.frc.org.uk/apb/press/pub1742.html) and more information regarding this will be available in the next issue of *Audit & Beyond*.

Members are invited to the ICAEW/APB consultation event on updating UK and Irish Auditing Standards for new International Standards which is taking place on 1 December 2008 at Chartered Accountants' Hall, London. Places are limited. Further details available at [www.icaew.com/aaf](http://www.icaew.com/aaf).

## FEE SME/SMP Congress and beyond – developments in Europe *cont'd from page 1*



obligations on SMEs operating across borders to set up subsidiaries in different company forms in each Member State in which they want to do business. In practical terms, the SPE would mean that SMEs can set up their company in the same form, regardless of whether they do business in their own Member State or in another. The SPE is expected to save entrepreneurs time and money on legal advice, management and administration **R**.

### *Responding to the audit exemption threshold rise*

In the panel session on *The Repeal of Statutory Audits and changes of Accountancy for Small Businesses, focus on Nordic countries*, Henry Irving, head of the faculty, shared information on the UK experience of audit exemption and its impact on companies and on the profession. In contrast, in Nordic countries where practically all companies have until now been required to have an audit, the concept of audit exemption introduced by the European Directives is relatively new. There are concerns among the Nordic practitioners over the uncertainty it might bring. For instance, in Sweden, where the audit exemption thresholds have recently been raised, a large number of companies have become exempt from audit. Delegates heard that the number of practitioners has been relatively stable in the UK despite the decline in the number of audit registered firms and were given some background information about non-audit assurance services currently being offered in countries such as the UK and Canada.

### **Latest news from Europe**

Further to the speech made by Pierre Delsaux at the FEE SME/SMP Congress, Charles McCreevy, the Commissioner for the Internal Market and Services at the European Commission, announced on 29 September that he intends to propose to the European Commission a major review of the accounting directives along with a Member State option to exempt micro-entities from the accounting requirements **R**.

25–30 years and to date they have not been comprehensively updated. Since the directives were designed as general rules with all businesses in mind, some of the Member States have already exempted certain types of companies from some of the requirements.

The proposal to allow Member States to exempt very small companies, or so called micro entities from the accounting directives was subject to consultation in 2007. Of the replies received by the European Commission, 59 per cent were in favour of the proposal. The proposed EC definition of micro-entities, is currently:

- less than 10 employees
- balance sheet total below €500,000
- turnover below €1,000,000

The proposal will now be debated in Europe with opportunities for interested parties to comment. We will keep you informed of developments in future issues of *Audit & Beyond*.

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

The accounting directives have been in place for

# The consultation on the needs of audit-exempt companies

## The ICAEW consultation on the needs of audit-exempt companies

The ICAEW consultation on the needs of audit-exempt companies formally concluded on 31 August 2008. Up until this date, the faculty consulted with a number of stakeholders including practitioners, businesses, banks and credit reference agencies. We are currently processing the findings from the consultation to develop a consultation report.

Over the past two years, the environment that surrounds small companies has changed significantly. When the consultation was launched in 2006, we were primarily concerned with the impact of the audit exemption threshold increase in the UK and sought to apply the latest international thinking as set out in IAASB's *International Framework for Assurance Engagements* to develop a limited assurance (also known as a review-type) engagement.

Today, interest in the financial reporting requirements of small companies and the value of external assurance has increased considerably, partly influenced by the Europe-wide developments in simplifying the business environment and partly influenced by further increases in the audit exemption thresholds. The current economic downturn also highlights the importance of reliable financial information that underlies the healthy functioning of the market economy.

## The changing business environment

The European Commission is considering ways to reduce administrative burdens by 25 per cent by 2012. The independent advisory body to the European Commission (Stoiber Group), recommended measures including exempting micro companies from the annual accounting and auditing requirements of the European accounting directives (see page 2). The UK Government strongly supported these recommendations in its paper entitled *25 ideas for simplifying EU law* **R**: 'In the UK alone ... if the Commission follows the Stoiber Group recommendation, it could deliver savings of €317.5 million'. Further development in this area is likely to influence the use of financial information produced by small entities.

## Detailed procedures versus professional judgement

The consultation also highlighted an issue concerning how detailed the guidance would need to be for practitioners performing the new assurance service. For statutory audits, there are many auditing standards, covering various aspects from planning to reporting. In contrast, the technical release AAF 03/06 is merely 32 pages including appendices. It sets out key principles for each stage of an

engagement without detailed requirements. The guidance also provides example reports, illustrative contents and extracts of the engagement letter and an illustrative management representation letter.

Most importantly, the work procedures primarily consist of management enquiry and analytical review: practitioners are expected to supplement them with substantive procedures, according to their identification and consideration of significant risk. The guidance contains illustrative work procedures but the ultimate decision on the nature and extent of substantive work rests with practitioners' judgement as to what they need to do to reach a conclusion.

Some pointed out that this might lead to the extent of work being different from one engagement to another. Some of the practitioners we have spoken to said that this is exactly what the service is about – allowing flexibility depending on factors such as the nature of the business and their knowledge of the client for each engagement. The subject appears to indicate what is professional judgement and, if so, how we assess the soundness of judgement.

## The IAASB discussion paper

The IAASB issued a consultation paper on 29 September developed by a group of national standard setters (New Zealand, Canada, and South Africa) entitled *Matters to Consider in a Revision of International Standard on Review Engagements (ISRE) 2400 Engagements to Review Financial Statements* **R**. The consultation paper focuses primarily on the review of historical financial information.

The paper is developed to consider issues relevant to the revision of ISRE 2400, originally published in the 1990s, and the intention is to align ISRE 2400 with the latest IAASB

pronouncements, in particular with the *International Framework for Assurance Engagements* and the revised and redrafted 'clarity' International Standards on Auditing (ISAs). It is also intended to be relevant for the development of the review engagement in countries or jurisdictions where a statutory audit is no longer required for certain types of company.

Whilst the consultation paper was drafted by national standard setters, the respondents are expected to send the responses directly to the IAASB. Any comments are requested by 15 December. We will be responding to this paper, drawing on the experience gained from our own consultation.

A number of questions raised by the paper are very much like the ones we have been considering ourselves e.g. what 'moderate level' of assurance (we use 'limited assurance' in accordance with the latest IAASB terminology) means for practitioners, the usefulness of illustrative detailed procedures, and if possible, how best a risk-based approach can be applied to a review engagement.

## The ICAEW consultation report

Whilst accepting that there is more work to be done beyond the scope of the initial consultation, the faculty will be summarising the information collated over the past two years in its report. The report will cover a broad range of issues that have resulted in the current interest in the non-audit assurance service.

The faculty is interested in your views on the discussion in this article and comments on the consultation paper from the IAASB. For more information or to comment, please contact Jo Iwasaki at [jo.iwasaki@icaew.com](mailto:jo.iwasaki@icaew.com).

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

# Managing internal audit – achieving the right balance



The role of internal audit is continually evolving and has generated much debate over the years. The Institute of Internal Auditors UK and Ireland (IIA) has carried out extensive research, published in its *Blueprint* report, as part of the debate to provide insight about how the profession is changing,

the skills base that is now required and where it will provide value in the future.

Karen Dignan, head of internal audit services at Old Mutual, who has been in internal auditing for 22 years, delivered an insightful presentation to delegates attending the Internal Audit Lecture in September. Asking how internal auditors should balance the concept of adding value with that of independence, Karen shared her thoughts on how internal auditors should respond to the challenges ahead, what the challenges signalled for recruiters and trainers and what employers need to consider in order to retain their staff.

From the outset Karen, a previous president of the IIA and a long-standing member of its Council of Directors, stressed the IIA is passionate about internal auditors working towards common standards. After all, the role of internal audit is to provide independent, objective assurance and consulting activity to an organisation's senior management team. The information provided by the internal auditor should add value and improve operations by helping an organisation to understand risk and respond effectively.

## Extending value into new areas

Karen highlighted several interesting findings from a survey report entitled *Towards a blueprint for the internal audit profession*, which was researched and published by the IIA in association with Deloitte. The report showed there is a strong desire to take the independent and objective assurance that internal audit provides into new areas. Karen emphasised that internal auditors feel their remit should expand to include important risk areas such as reputation (this is true for the Financial Services Authority and Deutsche Bank that place a strong emphasis on reputation and have developed a strategy to safeguard its status in the marketplace), corporate social responsibility, technology and project risk. Internal auditors also want to challenge management and to act as a catalyst for improvement, using their knowledge of risk and control to improve business practices.

According to the report, internal auditors should be a catalyst for change. However, Karen stated the

profession successfully provides opinions but asked the question: are internal auditors providing the challenge that is required by many organisations? Karen went on to explain that project risk assurance is a growth area with 72 per cent carrying out assurance, and this figure is expected to rise to 90 per cent by 2012. However, some organisations are worried about independence and are concerned about the internal auditor remaining objective, and balancing this against cost constraints.

The IIA recommends that internal auditors work closely with management to identify and address skills gaps within the organisation. Organisations that do not keep a watchful eye on risks and conduct effective internal audit will fail to optimise performance and this will damage relationships with their stakeholders.

In today's economic marketplace, there is an increasing reliance and emphasis on internal audit, which Karen says is reflected in the number of organisations that have joined the IIA in 2008. However, she told delegates that more often than not stakeholders have a different understanding of the internal audit function compared to that of the internal auditor. Therefore, it is the responsibility of the internal auditor to develop and implement a strategy to educate stakeholders on the role, remit and value they add to the organisation.

## Plugging the gaps

The role of the internal audit will continue to evolve, and by 2012 the IIA believes that more and more organisations will have a good grip on risk, control and assurance. Karen, agreeing with the conclusions of the *Blueprint* report, stressed that in order for

organisations to improve, they must invest in the internal audit function. Many internal auditors said the biggest challenge they faced was a lack of resources, a lack of staff with the right skill set, knowledge and experience to carry out internal audit effectively. Karen also highlighted the most significant issue was the difficulty of attracting and recruiting people to the profession due to low salaries and benefits.

Bringing the presentation to a close, it was suggested that if internal auditors are to win the debate for better resources as well as an expansion of their remit, they must carry out formal measurement on the internal audit process in order to demonstrate the value to the organisation. Likewise, if internal auditors have a clear understanding of what their stakeholders want from them, they will find it easier to refine and improve what they have to offer. Only then will the internal auditor achieve the right balance and deliver the expertise that is needed within the organisation.

For more information on the Institute of Internal Auditors and to request a copy of *Towards a blueprint for the internal audit profession*, you can contact the IIA on [enquiries@iia.org.uk](mailto:enquiries@iia.org.uk) or visit their website [www.iia.org.uk](http://www.iia.org.uk).

**Lorna Webley** | Independent Consultant



# The cost of conflict

The cost of conflict can have a devastating effect on the accounting profession. Learn how the ICAEW can help its members to manage conflict.

Today's multi-contractual, litigious society presents numerous challenges, not least when things go wrong. The number of contractual relationships in the business and commercial world means that it's easy for misunderstandings to occur that affect the scope and quality of our relationships – with staff, partners, clients and suppliers. Conflicts usually arise because poor processes lead to serious breakdowns in communication. In turn, these can have a devastating and negative effect on the business, resulting in delays in the provision of services, reduced productivity and increased costs in trying to resolve them.

Money is usually at stake and when this is the case, each party involved in the dispute starts looking after their own interests – usually at the expense of the relationship and trying to resolve the issue in the spirit of compromise.

## How do conflicts affect the profession?

In the profession, conflicts arise between:

- firms
- firms and their clients
- clients and their contractors or suppliers
- partners and employees

Partners often spend more time with their fellow partners than they do with their families. Running a practice can lead to enormous pressure and, without proper processes in place, stress can build up. When disputes arise, all these factors can combine, leading to serious misunderstandings and consequent breakdowns in relationships affecting both work and family life.

When relationships break down, it is usual to review contracts and agreements. Often, it transpires that a lot of partnerships don't have such agreements in place. Even when they do, a written agreement can be open to misinterpretation. Often one partner's recollection and interpretation of what was agreed can be very different from another's. The situation escalates into a serious dispute involving lawyers.

Once individuals take extreme positions in litigation, the parties find themselves in a long and arduous court case from which they have difficulty exiting. Partnership and client disputes have been known to continue for years, resulting in significant monetary costs to the practice as well as diverting the partners from their operational responsibilities. They can also

have a serious effect on the morale and productivity of other staff.

## Alternative dispute resolution

Resolving disputes through the legal process should be a last resort for any firm engaged in a dispute. The costs involved, as well as the reputational damage that could be caused by a court case, should encourage those involved in disputes to find other ways to resolve them.

The courts themselves are keen for parties involved in disputes to consider Alternative Dispute Resolutions (ADR) before taking their conflicts before a judge.

One form of ADR is mediation – a voluntary, non-binding, private dispute resolution process in which an experienced and independent third party helps the parties reach a negotiated settlement. It is particularly helpful if the parties wish to continue a business relationship and works well regardless of the figures and issues involved.

The ICAEW has a team of accredited mediators that are specifically trained to help parties negotiate a settlement.

## How does the ICAEW mediation service work?

When parties agree to mediation, they pay a mediation fee and arrange to meet with the mediation team. At the meeting, the lead mediator explains the process and each side provides a short summary of their case. The mediators work with each side separately to:

- clarify issues
- make the parties focus on the important issues
- promote discussion of the possible solutions
- separate personalities from the problem
- examine the consequences of

- not settling
- negotiate and reach a settlement

The parties are in control and the process is confidential and 'without prejudice'. Negotiations cannot be referred to in court or relied upon by the other party if the discussions fail. Nothing is revealed to either party without the express permission of the other.

The advantages of using the service include:

- cost savings, both in legal fees and time spent away from the business
- confidentiality is maintained
- our ability to deal with a number of issues and needs
- the parties control the outcome and agree a settlement
- relationships are preserved

The ICAEW's service deals with civil and commercial disputes and is available to all members and their clients. Most settlements are negotiated in one day which is a small price to pay if the impasse can be broken and a sensible solution reached.

As those who go through the process will acknowledge, mediation is often hard work but it's worth it. Disputing parties reap the benefits of an improved working relationship or a settlement that they are reasonably comfortable with, without getting involved in a long litigation process.

**Paul Turner** | Solicitor with the ICAEW and an accredited mediator with the Legal Services Commission, the ADR group and CEDR.

**Sumita Shah** | Manager within the Audit and Assurance Faculty and an accredited mediator with the ADR group.

To view the full article, see the November edition of *Accountancy Magazine*.

# Group audits



Chris Cantwell provides details of a revised faculty publication on group audits which updates the existing publication on the subject and looks ahead to the UK implementation of the IAASB's clarity ISA 600.

## Group audits – revised faculty publication

The faculty will shortly issue a revised publication on group audits with the title *Auditing in a group context: practical considerations for auditors* [R](#). This replaces the previous publication on the subject issued in November 2005. A hard copy of the revised publication will be included with the mailing of the next issue of *Audit & Beyond*. Prior to this, the publication will be available to members on the faculty website.

### Background

The previous publication provided practical guidance to auditors based on the findings of research commissioned by the Institute at that time. This research highlighted some good practices on group audits already established in firms and the publication provided an eight point plan for firms carrying out group audits. The publication also alerted firms to the International Auditing and Assurance Standards Board's (IAASB's) project to revise its standard (ISA 600) covering this area.

### The current requirements in the UK

The number of group audits will increase as the Government has abolished the group accounts exemption for medium-sized companies (this was covered in the February 2008 issue of *Audit & Beyond*). This means that some audit partners (and perhaps firms) will be doing group audits for the first time.

As reported in the May issue of *Audit & Beyond*, the Auditing Practices Board (APB) issued a revision of

ISA (UK and Ireland) 600 *Using the Work of Another Auditor*

[R](#) in April 2008. This revision of the UK standard was simply to add a new requirement that in group audits the principal auditors should document any review they undertake, for the purpose of the group audit, of the audit work conducted by other auditors. The revision is effective for periods commencing on or after 6 April 2008.

The issue of the revised UK standard followed on from the APB consultation paper on group audits issued in December 2007. The Institute response to the APB consultation (ICAEW Rep 23/08) is still available on the website [R](#).

The revised UK standard has a new paragraph 14-1 which is worded to reflect a new requirement in the Companies Act 2006 which arises from Article 27(b) of the European Statutory Audit Directive.

There is also a new legal requirement for group auditors arising from Article 27(c) of the Directive. This concerns access to audit papers by public oversight bodies rather than the conduct of the audit itself. However, a footnote in the revised UK standard makes reference to the Audit Regulations covering this.

The new requirements flowing from the Directive highlight the increasing international interest in group audits, reflected in the EU deciding that there should be specific legal provisions in this area.

### The IAASB's ISA 600

As with all the clarity ISAs already issued by the IAASB, no decisions have yet been taken regarding the UK adoption of the revised and redrafted ISA 600 *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*,

issued in October 2007 by the IAASB [R](#).

### Other developments

There has also been attention given to group audits issues by the Financial Reporting Council, for example in the context of its *Choice in the UK Audit Market* project, and in the recent reports from the Professional Oversight Board and the Audit Inspection Unit based on the findings from audit inspections.

### Revised Faculty publication

The faculty's revised publication is issued in the light of all the above developments and it is hoped that the publication will prove to be a valuable tool in helping to improve the quality of group audits. Whilst the position regarding adoption of clarity ISAs is not settled at this stage, the faculty believes it is useful for firms to consider the requirements in the new standard now so they can plan ahead.

An important feature of the new publication is that it contains suggestions for both group auditors and component auditors. The guide describes special considerations at each stage of the group audits cycle (see below) and aims to provide group and component auditors with practical help that will allow them to evolve their practices in the various stages of the cycle.

To reflect and emphasise the distinction between current and future audits, the guide is deliberately split into three sections:

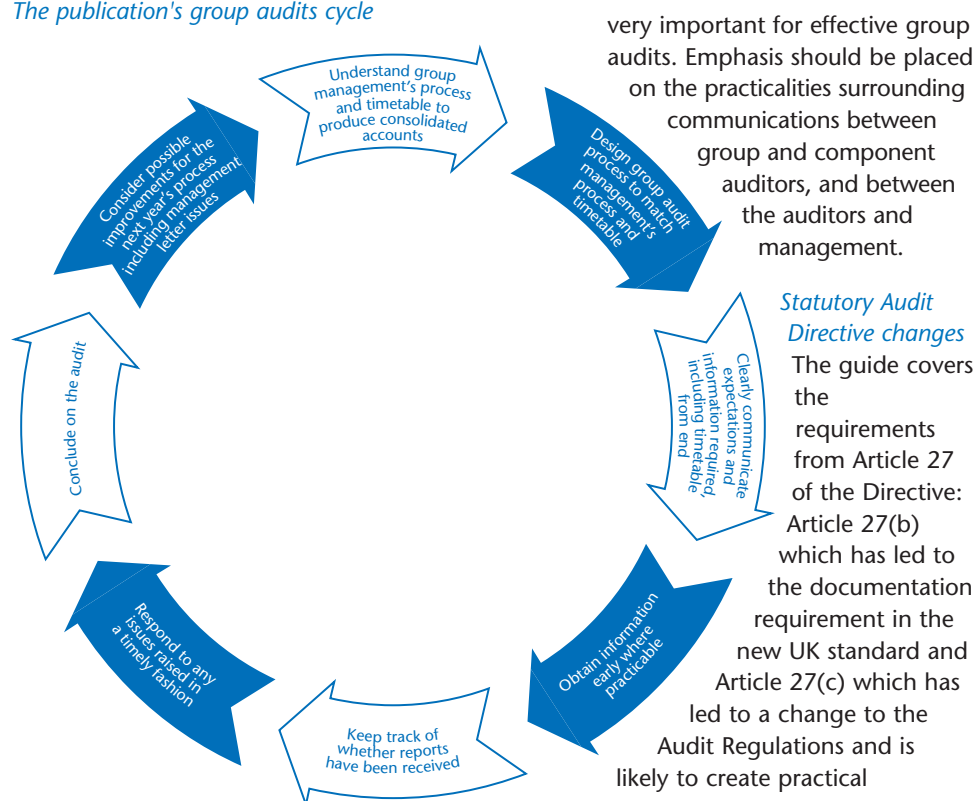
- Practical guidance for current audits
- Dealing with the Statutory Audit Directive changes relating to group audits
- Preparing for the clarity ISA 600 (revised and redrafted)

### A key message

Good two-way communication is

## Group audits *cont'd from page 6*

*The publication's group audits cycle*



difficulties in obtaining access to non-EEA auditors' working papers.

### *Preparing for the IAASB's clarity ISA*

The guide covers the various requirements in the standard and again includes suggestions for both group and component auditors. It is suggested that firms take time to understand the new requirements and prepare changes to policies and procedures. The lead time for planning a group audit is normally longer than for a standalone audit. Training will be needed for partners and staff who will be involved in applying the new standard.

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

## Bulletin Board

### Faculty update

#### IFAC/IAASB documents

- IFAC has issued a policy position paper expressing support for a single set of auditing standards.
- The IAASB has issued a Staff Audit Practice Alert focusing on fair value accounting estimates.
- The IAASB has also issued a staff update on the clarity project. Seven key clarified ISAs including ISA 200 have been issued.

These and other recently issued documents are available at [www.ifac.org/IAASB/](http://www.ifac.org/IAASB/)

#### Statutory Audit Directive

The Institute has revised its technical update on the Directive. [www.icaew.com/index.cfm/route/147481/](http://www.icaew.com/index.cfm/route/147481/)

#### Who won't be beaten by the credit crunch? Enterprise survey 2008 explains

Despite the last 12 months being a period of economic instability, driven by the credit crunch, increased raw material costs, changes in oil prices and fluctuating consumer demand, businesses across the world taking part in the ICAEW's *Global Enterprise Survey Report* show they remain committed to growth and positive about globalisation.

The survey paints a unique detailed picture of the opportunities and threats facing UK businesses of all sizes, in all regions and all sectors - as well as their

counterparts across the globe.

To download the full 2008 Enterprise Survey Report, visit [www.icaew.com/enterprise](http://www.icaew.com/enterprise)

#### Moorgate Internal Audit Lecture Series

Monday 12 January 2009

**Title:** Corporate governance and other regulatory developments.

**Speaker:** Martyn Jones, National Audit Technical Partner at Deloitte.

**Commences at:** 6.00pm followed by wine and a finger buffet.

Further details can be found at [www.icaew.com/aaf](http://www.icaew.com/aaf).

#### Disclosure of audit profitability

The CCAB has issued an Exposure Draft of a Voluntary Code of Practice on the Disclosure of Audit Profitability. This takes forward a recommendation in the FRC's Choice in the UK Audit Market project. The Exposure Draft is available at [www.ccab.org.uk/documents.php](http://www.ccab.org.uk/documents.php) and the deadline for comments is 31 December.

#### Bank reports for audit purposes – updated practical guidance

The faculty has updated its practical guidance to encourage members to use the new procedures following the revision of Practice Note 16. [www.icaew.com/index.cfm/route/159731/](http://www.icaew.com/index.cfm/route/159731/)

#### Charity audit report examples

Updated example audit reports are now available to take account of changes to charity and company law. [www.icaew.com/index.cfm/route/160902/](http://www.icaew.com/index.cfm/route/160902/)

#### Clients' money accounts

The Institute has issued guidance on clients' money accounts and the financial services compensation scheme. This is in response to recent developments and concerns regarding bank failures. [www.icaew.com/index.cfm/route/160749/](http://www.icaew.com/index.cfm/route/160749/)

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4	Managing Internal Audit – achieving the right balance	<i>Towards a blueprint for the internal audit profession</i>	<a href="http://www.iaa.org.uk">www.iaa.org.uk</a>
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