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2 October 2009

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Dear Ms O'Sullivan,

## Exposure Draft of Practice Note 26 (Revised) - Guidance on Smaller Entity Audit Documentation

### INTRODUCTION

Ernst & Young LLP welcomes the opportunity to comment on the Exposure Draft of Practice Note 26 (Revised) "*Guidance on Smaller Entity Audit Documentation*" ("the Exposure Draft") issued by the Auditing Practices Board ("APB").

We have made a number of overall observations, outlined below, before commenting on the APB's specific question.

### OVERALL OBSERVATIONS

1. We support the decision by the APB to revise Practice Note (PN) 26 and believe the updated guidance, which takes into account the documentation requirements contained within the clarified International Standards on Auditing, will provide useful guidance to smaller professional practices and practitioners in undertaking efficient and good quality audits.
2. The APB may wish to consider including a note in the introduction of the PN stating that the examples reflect the guidance and that additional documentation may be required, for example where an auditor of a simple entity has encountered some complex and subjective matters in a particular year's audit. In such a case, we would expect the documentation to reflect the complexity and subjectivity of the issues encountered.
3. For the sake of completeness, it would be useful to include an example of how the audit team has considered and concluded on issues that arose during the audit.
4. We also note that a number of the examples are in manuscript format. However, we believe that most practitioners would now use computers as part of the audit process and that most documents would be in a typed format. Consideration should therefore be given to updating the examples.



INVESTOR IN PEOPLE

5. For the PN to be widely used and accepted as best practice, we urge the APB to ascertain, with the profession's regulators (e.g., the Quality Assurance Directorate) whether they concur with the proposed level of documentation included in the ED.

## RESPONSE TO SPECIFIC QUESTION

**“APB is now seeking views on the proposed updates to Practice Note 26 and in particular on whether the new illustrative examples properly reflect the requirements of the proposed ISAs (UK and Ireland) and are a realistic illustration of appropriate audit documentation? If not, how should the examples be amended?”**

1. Overall we believe the examples are reasonable and it is encouraging to see the APB recognise that documentation for smaller entities "may be simple in form and relatively brief", which helps to prevent excessive costs being incurred whilst ensuring quality is maintained throughout the audit process.
2. We note that there are some minor amendments to the examples included in the revised PN 26, which we have chosen not to comment on. We concur with the explanations given in the Introduction, Purpose and Special Considerations sections of the draft PN and believe they adequately summarise the special considerations which should be made when auditing smaller entities.
3. We provide comments on specific examples in the paragraphs below.
4. *Example 1: the Audit Strategy Memorandum*
  - ▶ We would expect to see brief commentary on IT considerations, taxation, fraud risks, going concern and the auditor's consideration of their independence, all of which are integral parts of the audit process irrespective of the size of the entity being audited.
  - ▶ We believe that significant risks and how they will be addressed should have their own section, given their importance to the audit. At present, they are subsumed within the heading "risk assessment procedures performed".
  - ▶ Although reference is made to the preliminary analytical review, the narrative could be improved to show how the business has performed during the year and how this in turn impacts the audit strategy.
  - ▶ The section on materiality states that materiality has been calculated as 5% of profit. The guidance could note that the measurement basis will vary depending on the users of the accounts and the circumstances of each entity. The documentation could be expanded to include the rationale for selecting the basis as well the appropriate percentage within a given range.

**5. Example 10: Audit working paper: property valuation**

- ▶ This example does not include any narrative explaining the auditor's consideration of the competence and objectivity of the surveyor. For example, we would expect brief documentation as to how the auditor verified the surveyor's professional qualifications and experience.
- ▶ It is also unlikely that a small entity will have non-executive directors. We recommend this is changed to director/owner-manager, and consequently that the team's consideration of the "expert's" objectivity and independence is expanded.

**6. Example 11: Audit work paper: going concern (and pg 29 in Appendix A "Concerns if any about going concern")**

- ▶ Appendix A states that the key matter to document in respect of going concern is "the extent of the auditor's concern, if any, about the entity's ability to continue as a going concern". We believe this does not correctly reflect the auditor's duty which is to evaluate management's assessment of the entity's ability to continue as a going concern. As currently worded, it puts the onus on the auditor (rather than management) to document concerns and make an assessment.
- ▶ The working paper as drafted seems to place an over reliance on management's plans and projections without explaining how the auditor has challenged and evaluated the reasonableness of their assertions in making their evaluation of management's assessment.

**7. Example 12: The evaluation of misstatements identified during the audit**

- ▶ This working paper could be more explicit in its analysis of the prior year unadjusted audit differences and consideration of turnaround.
- ▶ There is also no indication of whether the unadjusted difference is a "hard" error or judgmental.
- ▶ We would expect to see each difference identified (adjusted or unadjusted) cross-referenced to the appropriate audit working paper.
- ▶ There is also no consideration of the tax impact of the unadjusted errors.
- ▶ We also believe it would be more appropriate to use a numerical format rather than narrative.

**8. Example 13: Group Planning Memorandum**

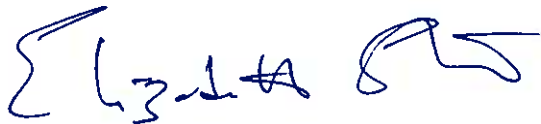
- ▶ We believe that this example is out of context because it is the only example that pertains to a group audit. If the purpose of the PN is to provide guidance on the documentation of

group audits, then the APB should consider including fuller documentation (e.g., a simple set of instructions to send to other auditors, allocation of materiality etc.).

- ▶ There is also a lack of documentation on the rationale/thought process of how the conclusions have been reached.

We sincerely hope that you find this response helpful. If you would find it useful, we would be more than happy to discuss further with you or your colleagues any of the points we have raised. We look forward to reading the responses and the APB's feedback in due course.

Yours sincerely



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