

MINUTES

MEETING OF: THE AUDITING PRACTICES BOARD

DATE AND TIME: Tuesday 23 November 2004 at 9.30am

PLACE: 117 Houndsditch
London EC3

PRESENT:

Members	R Fleck (Chairman)	K Nicholson
	J Grant (Executive director)	G Pimlott
	J Beckerlegge	I Plaistowe
	L Hughes	M Powell
	Ms G Laver	D Thomas
	S Murray	T Troubridge
		S Turley

Observers	I Drennan (Republic of Ireland Auditing and Accounting Supervisory Authority)
	G Innes (UK Department of Trade and Industry)
	D Loweth (ASB)
	Ms P Sucher (Financial Services Authority)

In attendance	P Ashton	J Dean
	Ms K Cearns	

Staff	K Billing	H Morgan
	S Leonard	Ms H O'Sullivan
	D Marston	

APOLOGIES:

Member	W Rainey
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1. Chairman's introduction

Implementation of IFRS

The Chairman noted a likely need for guidance on the wording of auditors' reports due to emerging issues surrounding the implementation of IFRS in the UK. These issues included the partial adoption of IAS 39 by the EC and the possible delay in implementation of IFRS 2. Guidance on this could be provided either in the APB's proposed Bulletin on the first-time implementation of IFRS or the proposed Bulletin containing example auditors' reports, both of which are due for issue in final form in the first quarter of 2005. These issues may cause similar difficulties for reporting accountants reporting under the Listing Rules, and the situation will continue to be monitored.

Recent meeting

Mr Jon Grant noted that, at a recent meeting with the Irish Office of the Director of Corporate Enforcement, it had been indicated that the implementation of the new legislation would be deferred and, as a result, the proposed APB Bulletin on new reports by auditors to the ODCE would not now need to be finalised until the middle of 2005.

2. Minutes of previous meeting

The Chairman noted that the minutes of the meeting held on 18 October had recently been approved following circulation to Board members.

3. Ethical Standards

The Chairman noted that the consultation period for the ES-EASE had now closed, and a significant number of letters of comment had been received. The issues arising were to be discussed by the APB Ethics Group later in the week and proposals would be made to the Board at its meeting in December.

Over 500 letters of comment had been received from audit practitioners and from small businesses, as well as from other parties such as the CCAB Bodies, the CBI, the British Chamber of Commerce and the Federation of Small Businesses. There had also been interest from the OFT and the Cabinet Office. The particular areas of concern related to economic dependency, costs and the self-review threat. However, together with the specific issues, the comment letters contained broader contextual concerns including:

- a belief that smaller firms were providing a necessary and high quality service to smaller and medium sized entities (SMEs) and a belief that the application of aspects of the Ethical Standards to the SME sector was unwarranted. The CCAB commented that the standards 'are trying to solve a problem that does not exist';
- a concern that the application of aspects of the Ethical Standards (especially ES5 'Non-audit services') would add costs and impair the service currently provided;

- a strong view that the relief provided in ES-EASE was inadequate in scope and should be made available on larger audits than would be allowed by the APB definition of a ‘Small Entity’;
- a strong belief that reference to application of the ES-EASE in the audit opinion would create the perception of a second class audit and would reduce the demand for voluntary audits and the supply of auditors, and would be to the detriment of the public interest;
- a view that while striving to develop standards that were principles based that would apply to all audits, APB had strayed too far towards inflexible rules and that these rules would have the least benefit (and cause the greatest hardship) in relation to small audits.

In connection with these the Chairman noted that, in the area of ethical guidance relating to small entities, the main problem had previously been perceived as arising from the ‘management’ threat, but this seems to have been resolved in the EASE. Focus was now more on the ‘economic dependence’ and ‘self-review’ threats. In addition, the guidance on ethics previously issued by the accountancy bodies was now being replaced by standards issued by the APB. In developing these standards the APB had consulted, and was continuing to consult, very extensively with the CCAB Bodies and with other interested parties, and comments received were given full and proper consideration. The APB has a responsibility to issue standards in the context of the current legal requirements for a statutory audit, and to ensure they were consistent with the EC Recommendation. As a longer term project the APB and POBA have decided to explore whether changes to current legal requirements were appropriate.

It was agreed that the Board would consider a revised draft of ES-EASE at its December meeting, amended as appropriate to take account of the comments received. Minor consequential and other drafting changes to ESs 1-5, for example relating to contingent fees, would also be considered for approval at that time.

4. ISAs (UK and Ireland)

Mr Keith Billing introduced a discussion of the more significant issues arising from the recent public consultation on draft ISAs (UK and Ireland). He noted that, in general, the response to the new standards had been very positive. It was intended that they would be reviewed by the Board at its December meeting, with a view to approving them for issue in final form both on the APB website in December and in a hard-copy format early in 2005.

Board members discussed certain of the issues arising, and agreed upon proposed changes to the wording of the standards as appropriate to address these. Areas of concern, and comments made by Board members, included:

- the extent to which the IFAC Code of Ethics should be adhered to: APB agreed that additional wording should be included in the APB’s revised Scope and Authority statement and, as appropriate, in the ISAs (UK and Ireland) to clarify that the ‘relevant ethical requirements’ in the UK and Republic of Ireland are the APB Ethical Standards and the ethical guidance issued by the CCAB Bodies;

- the need always to issue a written report at the end of an audit to those charged with governance: APB agreed that guidance should be added to clarify the requirement for auditors of groups with many subsidiaries;
- the need to evaluate the effectiveness of the two-way communications between auditors and management: APB agreed that the guidance should be amended to clarify the options available to auditors in circumstances where communications are not satisfactory;
- the inclusion of the Auditors' Code in the revised Scope and Authority of APB Pronouncements: APB agreed that it was appropriate to continue to append the Auditors' Code to the statement of the APB's Scope and Authority;
- the timing of implementation of the ISAs: APB agreed that implementation in the UK and Ireland for accounting periods commencing on or after 15 December 2004 was considered to be appropriate. However, in relation to ISQC 1, systems of quality control in compliance with the ISQC would be required to be established by 15 June 2005 to allow firms sufficient time fully to adopt the requirements.

It was agreed that Board members should provide any further drafting comments to Mr Billing prior to the final drafts being circulated for approval at the next meeting.

5. SIRS

Mr Tom Troubridge updated the Board on the progress being made on revising the existing SIRS and on drafting new Statements. He indicated that, as part of this work the Investment Circulars sub-committee was developing a framework for the SIRS so that, as far as practicable, they were aligned with the relevant international standard on assurance engagements, ISAE 3000. Board members agreed with this approach.

Mr Troubridge noted that there would not be sufficient time at the meeting to review the draft of SIR 300 on profit forecasts, which had been included with the agenda papers. It was recognised that the draft would need some further refinement so as to fit in with the framework discussed earlier. Board members were asked to submit comments on the draft to Mr Steven Leonard to assist with its further development.

6. The Combined Code

Mr Hugh Morgan introduced a draft of Bulletin 2004/3 'The Combined Code on Corporate Governance: Requirements of auditors under the Listing Rules of the Financial Services Authority'. He indicated that the main area of difficulty in drafting the Bulletin related to clarifying the auditors' responsibilities in relation to the Code recommendation for the annual report to explain how auditor objectivity and independence is safeguarded.

Board members discussed this point and agreed a small number of other changes to the draft. It was agreed that an amended draft would be circulated to the Board for final approval before publication. It was also agreed that a version of the Bulletin for use in the Republic of Ireland would be circulated for approval shortly.

7. Accounting Estimates

Mr Philip Ashton provided the Board with an update on the joint APB/IAASB project for the revision of ISA 540 'Auditing accounting estimates and related disclosures (excluding those involving fair value measurements and disclosures)', and reviewed a draft of the revision which was to be presented to the IAASB in December, for approval for issuance as an exposure draft. He indicated that the task force's recent work had been focused on how to describe management's sensitivity analysis and scenario planning activities that lead to the development of ranges of outcomes, and on the subject of management bias.

During discussions on the draft, Board members noted that whilst there were international standards being drafted to cover accounting estimates and materiality, there was no active project to update the existing ISA on fair value accounting, and that the IAASB should be asked to give this topic a higher priority. The Board took the view that the linkage between ISA 540 and ISA 320 (on materiality) should be improved. Mr Ashton undertook to report the views expressed to the IAASB during its forthcoming meeting at which the tabled draft was to be discussed.

8. Materiality

The Chairman introduced a discussion on references to materiality in the audit opinion. The Board had considered this matter at its previous meeting, and had expressed concern that wording in the proposed revision of ISA 320 might give a misleading impression that the determination of materiality is driven by cost and timing considerations. Possible approaches might be to amend the wording in the draft ISA 320, and to specify the assumed characteristics of users of accounts in example auditors' reports in the next revision of ISA 700.

After discussion, Board members agreed that the issues arising in the areas of audit cost and materiality should be specifically raised with the IAASB by Mr Plaistowe at its next meeting, but that the publication of ISA (UK and Ireland) 700 should not be delayed because of this matter.

9. Audits of insurers

Mr James Dean introduced two draft Bulletins providing supplementary guidance for auditors of insurers and friendly societies. The Bulletins had been drafted in response to new FSA rules which extend the scope of the auditors' work to cover long-term insurance liabilities, and require auditors to engage a 'reviewing actuary' to assist them in forming their opinions on regulatory returns. The Bulletins also included guidance for engagement partners on judging whether the reviewing actuary was independent of the insurer.

Board members noted that the example reports by auditors now referred to an 'audit', rather than an 'examination', being carried out on the regulatory return, and questioned whether this change was appropriate: it was agreed that this matter would be discussed with the FSA. Otherwise, the Board approved the Bulletins for issue as soon as possible in draft form, and then in final form when the relevant rules had been approved by the Board of the FSA.

10. Next meeting

It was noted that the next meeting of the Board would be held on Tuesday 14 December at the APB's new offices – Aldwych House, 71-91 Aldwych, WC2 commencing at 8.30am.

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