

MINUTES

MEETING OF: THE AUDITING PRACTICES BOARD

DATE AND TIME: Tuesday 28 July 2004 at 9.30am

PLACE: 117 Houndsditch
London EC3

PRESENT:

Members

R Fleck (Chairman)	I Plaistowe
G Ward (Vice-chairman)	M Powell
J Grant (Executive director)	W Rainey
J Beckerlegge	Ms G Laver
L Hughes	D Thomas
S Murray	S Turley
K Nicholson	

Observers

D Loweth (ASB)
G Innes (United Kingdom Department
of Trade and Industry)
R Thorpe (Financial Services Authority)

In attendance

Ms K Cearns	Ms J Ford
Ms S McAlpine (for item 10)	P Hughes (for item 11)
A Lambe (for item 10)	J Anderson (for item 11)
I Drennan (for item 10)	K Desmond (for item 11)

Staff

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

APOLOGIES:

Members

G Pimlott

Observer

P Donegan (Republic of Ireland
Department of Enterprise, Trade
and Employment)

1. Chairman's introduction

Letter of understanding

The Chairman reported that following the APB becoming a part of the FRC, the APB had now signed new letters of understanding with the CCAB Bodies. Inter alia, the letters contain the agreement of the CCAB Bodies to promulgate APB pronouncements to their members.

Meeting with an institutional investor

The Chairman noted a recent meeting that he and Mr Jon Grant had attended with a large institutional investor. Whilst much of the discussion had involved corporate governance issues, the investor had expressed the view that there should be increased communication from auditors directly to shareholders so as to assist with investment decisions.

Ethics meetings

The Chairman noted two recent meetings to discuss issues arising from the proposed Ethical Standards. One of these was with the CCAB joint ethics group, where the discussion focussed on the proposed Ethical Standard (ES) on Small Entity Reliefs. The other was with regulators including representatives of the Charity Commission, Opra and the FSA to discuss appropriate thresholds for small entity reliefs in the regulated sectors.

Turnbull guidance

The Chairman noted that the FRC had set up a working party, which included Mr Graham Pimlott, to revise the 'Turnbull' guidance on corporate governance. As this process may not be completed until mid-2005 a second working party, which included the Chairman, had been set up to draft interim guidance primarily for the benefit of companies that will be required to report to authorities in the United States under the Sarbanes-Oxley Act.

2. Minutes of previous meeting

The Chairman noted that the minutes of the meeting held on 29 June had recently been approved, following circulation to Board members.

3. OFR consultation paper

Mr Grant introduced a draft FRC response to a DTI consultation paper on the Operating and Financial Review (OFR) and the proposed reporting requirements for auditors. Relevant parts of the response had been drafted by an APB working party, whose main concerns related to the need for greater clarity as to the standard of care expected of directors in compiling the OFR and to identify the key elements of a process designed to meet that standard of care.

It was noted that the DTI currently intended to introduce the requirement for OFRs from January 2005. Whilst some Board members welcomed the introduction of OFRs as soon as reasonably possible, it was agreed that the draft response should indicate that achieving this deadline could be challenging because of significant other

pressures on preparers of accounts arising in 2005, due primarily to the introduction of IFRSs and to other accounting developments in the Financial Services sector. Other information required to be disclosed (for example, concerning the adoption of IFRSs) could result in key messages in the new OFR being obscured.

4. Anti-money laundering

Mr Hugh Morgan introduced a draft of Practice Note 12 (Revised) 'Money laundering – guidance for auditors in the United Kingdom'. The working party proposed that the draft should be submitted to HM Treasury for approval. As obtaining this approval might take several months, it was thought to be beneficial for auditors if the APB's guidance could be issued in an interim form as soon as possible, with the final version being published following receipt of Treasury approval.

It was noted that the CCAB money laundering working party had been in discussion with the Home Office regarding whether legal professional privilege should be extended to accountants, auditors and tax advisers, but that the timing of any developments on this matter was uncertain. It was also noted that Appendix 2 of the draft PN, concerning guidance as to whom the legislation applies, had been amended following recent discussions with the APB's legal adviser, and would be circulated shortly to Board members for comment.

The Board agreed that HM Treasury's approval of the revised PN should be sought, and in the meantime it should be issued as interim guidance.

5. Planning

Mr Keith Billing introduced a draft of ISA (UK and Ireland) 300 'Planning an Audit of Financial Statements'. He noted that it was now possible to issue this as an exposure draft as the revised ISA on this subject had recently been finalised by the IAASB. The new ISA revises the standards and guidance on planning the audit to align them with the new audit risk model.

Board members made a small number of detailed comments on the draft, including that an appropriate cross-reference should be made to ISA (UK and Ireland) 260 to pick up the communications suggested in the 'Smith' guidance on audit committees. It was agreed that the ISA (UK and Ireland) should be issued as an exposure draft, with comments to be received by mid-October.

6. Auditors' reports

Mr Grant introduced a discussion of options concerning an ISA (UK and Ireland) 700 'The Auditors' Report on Financial Statements'. He noted that this has not so far been issued as an exposure draft as ISA 700 is in the process of being revised by the IAASB.

The main options involved waiting for the revised ISA to be issued (which might not be until 2005) or APB could publish an ISA (UK and Ireland) before the end of 2004 that was based upon the current ISA 700. Mr Grant recommended the second approach.

It was noted that there were two main differences between the extant ISA 700 and SAS 600 that would have to be taken into account in drafting ISA (UK and Ireland) 700 – SAS 600 is more restrictive than ISA 700 in the use of ‘fundamental uncertainty’, whereas ISA 700 states that an ‘emphasis of matter’ paragraph may be used to highlight matters which are described in notes to the financial statements. In addition ISA 700 includes a number of illustrative audit opinions (most of which would not be suitable for use in the UK) whereas SAS 600 sets out example opinions in an appendix. Board members considered that, in the light of experience, the position taken by SAS 600 on emphases of matter might be too restrictive and that it was prepared to consider a move towards the international position on this matter. As the APB would need to issue new illustrative auditors’ reports by the end of 2004 to reflect changes in auditing standards and the Combined Code, and then again in 2005 to reflect the introduction of IFRSs, it was thought that this could be most conveniently achieved by issuing a separate Bulletin containing illustrative auditors’ reports.

The Board agreed that a draft ISA (UK and Ireland) 700 should be prepared based upon the extant ISA 700, and should be circulated for comment during August before being issued as an exposure draft in September. The aim was that the related Bulletin setting out illustrative auditors’ reports would be issued by the end of the year.

7. Adoption of IFRSs

Ms Kathryn Cearns introduced a draft Bulletin ‘Guidance for auditors on first-time adoption of IFRSs’. She noted that the Board had agreed at its June meeting that a draft of the Bulletin should be issued as soon as possible, and finalised later in 2004 when certain outstanding issues had been resolved. A number of helpful comments had been received from the DTI and these had been incorporated into the draft.

It was noted that the proposed draft Bulletin no longer included an example auditors’ report, as there were likely to be a number of regulatory developments in 2005 affecting auditors’ reports that were not yet finalised. In addition, it was unclear whether the Companies Act ‘Section 230’ exemption of the publication of a profit and loss account will be available to parent companies that use IFRSs in their individual financial statements. These matters, together with any implications arising from the delay of the adoption by the EU of IAS 39, would be dealt with in the final version of the Bulletin.

Board members made a number of comments on the draft. It was agreed that guidance to the effect that 2005 auditors’ reports should include an ‘other matter’ paragraph to highlight that the comparative figures may differ from those published in the prior year, was not necessary. In addition, it was agreed that the draft version would just apply to the UK and the final version would be expanded to cover the Republic of Ireland. Subject to these comments, the Board agreed that a draft of the Bulletin should be published.

8. Ethical Standard 5

The Chairman introduced the latest draft of ES 5 ‘Non-audit services provided to audit clients’, redrafted to take account of comments received during the exposure period.

The Board discussed the redraft in some detail. Particular issues included whether:

- prohibitions should refer to the acceptance of the non-audit service or the service being undertaken. On balance it was agreed that the focus should be on the non-audit service being undertaken;
- reference should be made to the overall magnitude of non-audit fees. While it was agreed that non-audit fees should primarily be viewed within the wider context of economic dependency overall it was thought that a reference to the perception of loss of independence within the discussion of the self-interest threat would be helpful;
- in relation to contingent fees, the prohibition should be linked only to the materiality of the fees to the audit firms. It was concluded that while materiality of the fees to the audit firm was an important issue consideration also needed to be given to whether the contingent fee was dependent on a future audit judgement;
- the standards applied to completion accounts and audits thereof. It was agreed that the working party should consider this.

Board members made a number of comments on these matters. It was agreed that another draft, revised to take account of comments made at the meeting, would be circulated shortly to the Board.

9. Small Entity Reliefs

The Chairman noted that a new ES on Small Entity Reliefs was in the process of being drafted. A meeting had recently been held with certain regulators to discuss thresholds for the application of the Ethical Standards to entities such as charities and pension schemes; these thresholds were likely to be based on a monetary amount or on whether the entity was required to submit regulatory returns. A draft of the ES would be considered by the Board in due course.

10. Directors' compliance statements

Ms Shelagh McAlpine introduced a draft Bulletin for the Republic of Ireland on reports to the Office of the Director of Corporate Enforcement. She noted that one of the key recommendations of the Irish Review Group on Auditing was that directors should explicitly report on compliance with relevant legislation and auditors would review such compliance statements; these requirements have been enacted in the Companies (Auditing and Accounting) Act 2003. Draft guidance for directors on this subject has already been issued for comment by the ODCE.

The legislation required that the auditors should express a 'fair and reasonable' opinion on the directors' compliance statement, and this was reflected in the draft Bulletin. Board members suggested that the guidance should clarify that:

- if auditors, as part of their review of the directors' statement, come across facts that call into question an answer previously given by the directors, then they should investigate the matter fully and qualify their opinion if considered necessary;

- it should be made clear that the law was complex and had not as yet been tested in a court case;
- the opinion wording should be expanded to refer to the legislation on which the compliance statement is based.

It was agreed that:

- the work level described in the draft is appropriate to support an opinion that the compliance statements are ‘fair and reasonable’;
- the guidance on qualified auditors’ opinions in the draft Bulletin was considered to be appropriate; and
- it will be acceptable for CCAB-I to conduct the consultation process on the Bulletin on behalf of the APB, subject to Board members being provided with copies of the comments received.

On the basis of the above observations, it was agreed that a draft of the Bulletin should be issued for consultation in the Republic of Ireland.

11. SIR 200

Mr Peter Hughes, chairman of the SIR 200 working party, introduced a discussion of certain issues arising from the proposed revision of SIR 200 ‘Accountants’ reports on historical financial information in investment circulars’. He noted the forthcoming implementation of the EU Prospectus Directive, which will continue the extant requirement of the Listing Rules that prospectuses present historical information for a three year period, and introduces a new requirement for this information to be adjusted to align the basis of accounting with that to be adopted in the next annual financial statements. Such adjusted financial information will need to be ‘independently audited or reported on as to whether it gives, for the purposes of the registration document, a true and fair view’.

The Board commented on a number of specific conceptual issues raised, as follows:

- the Listing Rules currently require reporting accountants to make any necessary adjustments to the financial information in the accountant’s report. SIR 200 is drafted to meet the requirements of the Listing Rules. It was considered that the revised SIR should cease to sanction an approach whereby a reporting accountant may both adjust and report on historical financial information. In this connection it was noted that the FSA was likely to amend the Listing Rules to clarify that it will require issuers to take responsibility for the presentation of all the financial information;
- SIR 200 currently recognises that if the unadjusted numbers have already been subject to a true and fair audit opinion it should not be necessary for the reporting accountant to perform an entirely independent audit of the historical track record in order to provide an opinion on the adjusted information. It was agreed that this approach continued to be acceptable, but that the reporting accountant would

need to be satisfied as to the quality of the audit work on which he would be relying; and

- how the term ‘true and fair view’ should be interpreted. The Board noted the arguments for the need to apply ‘true and fair’ as appropriate in the context of a comparative table prepared for the purposes of the registration document. The Board also noted that the Prospectus Directive requires the accountant to report in true and fair terms. It was agreed that if the report is absolutely clear as to the basis on which the opinion is given and the purpose of the opinion, that it would be acceptable to use the term ‘true and fair’ as interpreted in the specific context.

In addition to the above observations, Board members noted that an ‘APB view’ on what might constitute ‘good practice’ for preparers of the financial information would be included in an Appendix to the revised SIR if guidance on this subject was not issued by a body such as the ICAEW. It would also be helpful if the SIRs working party would identify any matters in the new APB Ethical Standards that would not be applicable to reporting accountants, so that an ES relating to Assurance Services could be prepared in due course.

12. Next meeting

It was noted that the next meeting of the Board would be held on Tuesday 28 September.

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