

## MINUTES

**MEETING OF:** THE AUDITING PRACTICES BOARD

**DATE AND TIME:** Tuesday 29 June 2004 at 9.30am

**PLACE:** 117 Houndsditch  
London EC3

**PRESENT:**

<b>Members</b>	R Fleck (Chairman)	I Plaistowe
	G Ward (Vice-chairman)	M Powell
	J Grant (Executive director)	W Rainey
	J Beckerlegge	Ms G Saunders
	S Murray	D Thomas
	K Nicholson	S Turley

**Observers**

D Loweth (ASB)  
Ms K Marshall (United Kingdom Department  
of Trade and Industry)  
R Thorpe (Financial Services Authority)

**In attendance** Ms K Cearns

<b>Staff</b>	K Billing	H Morgan
	S Leonard	Ms H O'Sullivan
	D Marston	

**APOLOGIES:**

<b>Members</b>	L Hughes	G Pimlott
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**Observer** P Donegan (Republic of Ireland  
Department of Enterprise, Trade  
and Employment)

## **1. Chairman's introduction**

### Mr Ward

On behalf of the Board, the Chairman congratulated Mr Graham Ward on being awarded the CBE in the recent Birthday Honours for services in connection with British exports.

### Publications

Mr Jon Grant noted the recent publication of exposure drafts of ISAs (UK and Ireland), and of Bulletin 2004/2 concerning corporate governance in local government bodies. He noted that the ISAs (UK and Ireland) exposure draft did not cover two significant areas – planning and auditors' reports.

IAASB has recently finalised a new ISA 300 on planning. An exposure draft of an ISA (UK and Ireland) 300 on planning is to be issued in August.

The timing of IAASB's finalisation of a revised ISA 700 on auditors' reports is less clear. It is likely that IAASB will not consider a revised draft until December. After discussion it was agreed that a paper would be prepared for the next APB meeting discussing options for issuing an ISA (UK and Ireland) 700 on reporting by the end of 2004.

### FEE meeting

Mr Grant reported on a recent meeting with FEE, and German and French national standard setters to discuss the way forward in connection with the provision of pan-European guidance for auditors to address the EC Prospectus Directive. In this connection, it was noted that progress was being made by the APB Investment Circulars sub-committee and that a plan had been developed to produce new and revised SIRs by June 2005.

### IAASB meeting

Mr Grant reported on a meeting of the IAASB held recently in Copenhagen. He noted that the new ISA 300 on planning had been approved, a revised ISA 230 on documentation was nearly finalised, and that progress had been made on the 'clarity' project.

Discussions on clarity had focussed on three issues: clarifying the use of 'the present tense' in guidance material, developing principles of auditing, and reformatting the Standards so as to include all the requirements at the front of the document with the guidance set out in subsequent sections. It was noted that IOSCO were currently not in favour of the latter proposal, and it was suggested that they might be more comfortable with it if the requirements were to be comprehensively cross-referenced to the later guidance material.

### ASB Insurance FRED

Mr Keith Nicholson reported on a meeting he and other members of the APB insurance working party had held the previous week with ASB staff to discuss a proposed FRED on accounting for with-profits funds. He noted that the ASB's proposals responded to a request from HM Treasury following from the findings of the Penrose report on Equitable Life. ASB plans for its Standards to be effective for

December 2004 year-ends. The centrepiece of the FRED is for 'realistic' valuations of insurance liabilities to be included in balance sheets of insurers that had large (over £500 million) with-profits funds – realistic valuations are to be based on assumptions about future economic scenarios and management actions and were therefore heavily dependent on estimates and complex modelling. Auditors would be required to express 'true and fair' opinions on these valuations. The FRED is due to be issued at the end of July for a 3 month consultation period, with the final FRS due in December.

Mr Nicholson noted that due to the uncertainties attaching to realistic valuations, it was likely that the APB insurance working party would seriously consider recommending to APB that 'emphasis of matter' or other forms of paragraphs should be included in 2004 audit reports and noted that this could cause particular difficulties for those insurers that were SEC listed.

## **2. Minutes of previous meeting**

The Chairman noted that the minutes of the meeting held on 25 May had recently been approved, following circulation to Board members.

## **3. Response to DTI consultation**

Mr Steven Leonard introduced a draft APB response to the DTI/HM Treasury consultation on 'Modernisation of Accounting Directives/IAS Infrastructure'. He noted that the principal concern in the draft letter of comment related to the terminology to be used in the Companies Act 1985 to describe the 'true and fair view'. IAS 1 will require publicly traded companies to 'present fairly' their consolidated accounts, whereas other financial statements can continue to be prepared under UK GAAP and give a 'true and fair' view. As the auditors' report with respect to both IAS and UK GAAP accounts will be required to express an opinion as to whether the accounts 'give a true and fair view in accordance with the relevant financial reporting framework' it was considered necessary for the DTI to clarify that the three terms were synonymous.

The draft letter of comment also commented on the 'true and fair override', which provides companies with the option to depart from promulgated accounting standards in special circumstances. For IAS accounts the override will now be as set out in IAS 1 but will be more restricted in its application than the override defined in the Companies Act that will apply to UK GAAP financial statements. The comment letter recommended that an undertaking be obtained from the IASB to the effect that the override would not be further restricted.

Board members suggested that the draft letter of comment make it clearer that the APB was uncomfortable with the implications of having two alternative accounting frameworks and that the auditors' report, whether it be a 'presents fairly' or 'true and fair view' opinion, should reflect the basis used by the directors in preparing the accounts.

It was agreed that the draft letter would be amended to reflect the comments made, and would then be recirculated to the Board for final approval.

#### **4. 2005 guidance**

Ms Kathryn Cearnis introduced an initial draft of a proposed Bulletin entitled 'Guidance for auditors on first-time application of IFRSs'. It was noted that a working party drawn from the APB's Technical Advisory Group had reviewed the draft Bulletin, and concurred that it was important that it should be issued as a draft during the summer to assist listed companies and their auditors to prepare for the introduction of IFRSs in 2005. The working party envisaged the Bulletin being issued in final form late in 2004 or early in 2005 once certain outstanding matters had been resolved.

The draft was not discussed in detail. Board members agreed with the general direction of the Bulletin and that, if possible, it should be issued as a draft before the summer break. It was noted that an amended draft would be considered at the next Board meeting.

#### **5. Ethical Standards**

Following discussion of the main issues at both Board meetings and meetings of the Ethics working party, amended drafts of Ethical Standards (ESs) 1-4 were tabled for discussion. The main points discussed were:

##### ES 1 – Integrity, objectivity and independence

- A change may need to be made to references to the 'true and fair view' to reflect the proposed changes in company law,
- There is a need to clarify that both possible and actual breaches should be communicated and evaluated,
- The guidance relating to self-interest threats in cases where the fees are borne by a non-audit client should be clarified,
- References to the IFAC Code of Ethics in connection with reliance on other auditors should be explained by footnotes, and
- Guidance should emphasise that the main responsibility lies with the parent company management to communicate company policy on the purchase of non-audit services to its affiliates.

##### ES 2 – Financial, business, employment and personal relationships

- It was agreed that, following comments made by the CCAB Bodies and others, ES2 would be strengthened by extending the prohibition regarding financial interests to all partners and that material indirect interest holdings would be prohibited,
- There is a need to insert guidance enabling firms and individuals to dispose of part of an indirect financial interest so that it is no longer material,
- The cooling off period prohibition should be extended to independent partners, and
- Guidance should be inserted to clarify when resignation might not be immediate.

##### ES 3 – Long association with the audit engagement

- There was a need to review this to ensure that it is consistent with the latest version of the draft EC 8<sup>th</sup> Directive,

- Guidance was needed on the need to document reasons why an individual has continued in a role beyond 10 years;

ES 4 – Fees, remuneration and evaluation policies, litigation, gifts and hospitality

- there was a need to consider the definition of affiliates if their fee income was to be included in the test for economic dependency.

It was agreed that the draft ESs would be amended further to reflect comments made at the meeting, and the drafts would then be considered again at the next meeting of the APB Ethics working group.

## **6. Amendments to the Combined Code**

Mr Grant introduced a discussion on the points to be made in a response to the FSA Consultation Paper on the responsibilities of the company's auditors under the Combined Code. The APB agreed to support the FSA's proposals for auditors to 'objectively verify' compliance with the 10 provisions in the Audit and Accountability section of the Combined Code. The APB also supported the proposal of the FSA to explore a wider reporting remit. This wider remit should reflect the reporting arrangements on the OFR and take account of reporting requirements in relation to internal control following the issue of amended 'Turnbull' guidance next year. A draft of the FRC's letter of comment, including the APB's points, will be circulated to the Board shortly for comment.

## **7. OFR**

Mr Minnow Powell reported on a recent meeting of an APB working party set up to consider the DTI Consultation on the Operating and Financial Review and the proposed reporting requirements for auditors. The working party noted that the CBI had expressed concern about the requirement to report whether the directors had prepared the OFR after "due and careful enquiry" which was believed to be a very high legal standard. The working party considered other possible terms and concluded that "reasonable care" might be more acceptable as it is a phrase used in the Listing Rules in relation to continuing obligations. The Chairman noted, however, that the Listing Rules actually use the expression "all reasonable care". The Board observed that the use of the word "all" would potentially make the report requirement very onerous, possibly more so than "due and careful enquiry". Another factor affecting the choice of terminology is that it would be important to be consistent with other areas where the auditors do/will report on directors' process, including in relation to the Combined Code and reporting on internal control.

The working party recognises that there might be debate over a suitable term and concluded that the important issue was that whatever term was finally used there should be clarity as to its meaning. The legislation or applicable standards should establish criteria against which the auditors could assess the directors' process. The working party had felt that it might be left to the APB to develop such criteria, although it would be more desirable for another body to do so. The Chairman reported that the ASB may be prepared to include relevant 'process' criteria in the standards for preparers. It was agreed that the APB working party would prepare a paper for presentation to the ASB on this matter.

## **8. Ethical Standards issues papers**

The Chairman reported on the status of issues papers 13-18 concerning ES 5 – ‘Non-audit services provided to audit clients’. He noted that there were outstanding issues in the area of corporate finance services – in particular the circumstances in which auditors should not provide such services on a contingency fee basis, and the ‘advocacy threats’ that might arise when auditors acted as sponsors for admissions to listing. These issues would be discussed again at the next meeting of the Ethics working group.

## **9. Next meeting**

It was noted that the next meeting of the Board would be held on Wednesday 28 July.

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