

The Auditing Practices Board

Feedback on Responses to the Exposure Draft of SIR 5000

1. Introduction

- 1.1. In June 2007 the APB issued for public comment an Exposure Draft of proposed SIR 5000 “Investment Reporting Standards applicable to public reporting engagements on financial information reconciliations”.
- 1.2. In the accompanying News Release the APB explained that the purpose of the proposed SIR would be to establish Investment Reporting Standards and guidance for a reporting accountant engaged to report publicly on reconciliations of the financial information of “targets” to the accounting policies of an issuer to be included in a Class 1 circular under the Listing Rules. SIR 1000 (which was issued in 2005) establishes generic Investment Reporting Standards applicable to all engagements involving investment circulars.
- 1.3. The proposed SIR used the same structure as SIRs 3000 and 4000 which are both based on ISAE 3000 “Assurance Engagements” issued by the International Auditing and Assurance Standards Board.
- 1.4. Under the Listing Rules a reporting accountant is required to express an opinion as to whether:
 - (a) the reconciliation of financial information in the financial information table has been properly compiled on the basis stated; and
 - (b) the adjustments are appropriate for the purpose of presenting the financial information (as adjusted) on a basis consistent in all material respects with the issuer’s accounting policies.

2. Responses received

- 2.1. Responses were received from the nine organisations listed in the Appendix. The Exposure Draft posed a number of questions for commentators to address and also invited commentators to specify aspects of the ED that may have a significant cost impact.
- 2.2. The APB is pleased that there was general support for the proposed SIR and that none of the commentators opposed the specific proposals being made. Their comments were either recommendations to widen or clarify the scope of the proposed SIR or concerned matters of detailed drafting.
- 2.3. The APB has considered the issues on which commentators expressed views and has made a number of changes to the SIR. An overview of the more significant changes is set out below.

3. Questions posed in the Exposure Draft

- 3.1. The Exposure Draft addressed the following questions to commentators:
 - (a) **Do you support the Standards and guidance in paragraphs 12, 21(d), 22 and 23 that describe the extent to which the engagement team should have knowledge of the target’s financial reporting framework?** Respondents were split between those believing that there should be strengthening of the guidance regarding the extent to which the

engagement team should have knowledge of the targets framework and those who were content with the guidance proposed in the ED.

Changes made: *The APB has responded to the concerns of those who believed that strengthening of the guidance was required through redrafting what have become paragraphs 12 and 13 of SIR 5000 and elevating paragraph 12 to be a requirement of the SIR.*

- (b) **Do you agree that the work effort of the reporting accountant described in paragraphs 36 to 40 of the proposed Exposure Draft is pitched at a level that is appropriate for the opinion to be given by the reporting accountant?** A number of commentators expressed reservations about the proposed work effort. Commentators recommended strengthening the guidance with respect to the completeness of and propriety of adjustments.

Changes made: *The APB has responded to these concerns as follows:*

- (i) *elevating paragraph 38 of the Exposure Draft (now paragraph 45) to being a requirement of the SIR. It requires the reporting accountant to obtain sufficient appropriate audit evidence that the issuer can support each adjustment;*
- (ii) *providing guidance in new paragraph 44 to describe a process that addresses the completeness of adjustments which is based on the impact analysis prepared by the issuer; and*
- (iii) *describing the need for the directors' to perform the "impact analysis" referred to in (ii). This need is described in paragraph 43 of the SIR and paragraph 24 of the Annexure.*

- (c) **Do you support the publication of these conventions by the APB as an Annexure to the proposed SIR?** Commentators supported the publication of the Annexure.

- (d) **Do you agree with APB's description of the conventions?** In general there was agreement. However concerns were expressed by a number of commentators on the guidance that was in paragraph 16 of the Annexure concerning whether changes in an accounting estimate that would be made by the issuer should give rise to an adjustment.

Changes made: *The APB has responded by amending the guidance in paragraph 15 of the Annexure to state that adjustments are not made for changes in accounting estimates. However, the possibility of supplemental disclosure where a change in accounting estimate is material is discussed in the Annexure. Additional guidance (paragraphs 16 to 19) has been added to the Annexure which is derived from IFRSs and provides some guidance as to what constitutes a change in accounting policy.*

- (e) **Are there any significant conventions that you believe should be added to the Annexure?** Some commentators suggested that there should be a convention to provide guidance as to which of the issuer's accounting policies the target's financial information should be reconciled to (i.e. "last published" or "soon to be used").

Changes made: *The APB concluded that a convention was not needed as the Listing Rules are clear on this point. Therefore, clarification that the policies should be the issuer's last published accounting policies is provided in paragraph 7 of both the SIR and the Annexure.*

- (f) **Do you agree that the Annexure should include paragraphs 18 to 25 on management's processes?** Almost all commentators considered that

the Annexure should include these paragraphs. However, concern was expressed by many that paragraphs 24 and 25 should apply in all circumstances and not be restricted to issuers having experience of financial information reconciliations.

Changes made: The APB has addressed this concern by deleting what was paragraph 24 and redrafting what was paragraph 25 to be of universal applicability.

4. An issue was raised concerning the need for more active role of reporting accountant where an issuer determines that no material adjustments need to be made

4.1. One commentator focused on those circumstances where directors determine that no material adjustments need to be made in order to reconcile a target's accounts with the issuer's accounting policies and, therefore, do not include a reconciliation in the Class 1 circular. The commentator strongly advocated that the SIR should require the reporting accountant to evaluate the directors' process and thinking underlying their determination that no material adjustments are necessary.

APB conclusion: The Listing Rules do not require the reporting accountant to evaluate such conclusions of management. However, in the Exposure Draft at what was paragraph 26 (now paragraph 28) guidance is provided to the effect that where a reporting accountant becomes aware that a material adjustment needs to be made and no reconciliation has been prepared that the reporting accountant discuss the matter with the directors of the issuer. The APB concluded that it would be inappropriate to implement the commentator's recommendation into the SIR because this would be tantamount to the APB changing the FSA Listing Rules. However, the APB has dealt with this issue in the Annexure by emphasising, in paragraph 6, that the issuer is required to make a determination as to whether material adjustments need to be made to the target's financial statements and that such a determination will need to be made by an appropriately qualified person.

5. Other significant issues raised by commentators where the Board does not propose to make changes

5.1. A number of commentators suggested that standard report wording, which purports to limit the liability of reporting accountants, recommended by the Audit Faulty of the ICAEW should be included in the example reporting accountant's report in Appendix 4 to the SIR. The proposed wording begins as follows:

Save for any responsibility arising under [insert reference to applicable rule or regulation] to any person as and to the extent there provided [, and save for any responsibility that we have expressly agreed in writing to assume], to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for that loss...

APB conclusion: APB does not generally use wording of this nature in its illustrative reports.

5.2. A number of commentators requested that the SIR clarify various issues that arise when a Class 1 circular is issued in combination with a prospectus.

APB conclusion: Most of these comments sought clarification with respect to the application of various Listing Rules and Prospectus Rules. The APB has not addressed these issues in the SIR because they relate to the interpretation of FSA Rules rather than the provision of guidance for auditors with respect to financial information reconciliations.

6. Regulatory Impact Assessment

6.1. The Exposure Draft noted that APB had not undertaken a formal regulatory impact assessment because it believed that the proposed Standards and guidance were consistent with current practice and would not significantly increase costs. Commentators were invited to specify any aspects of the ED that would have a significant cost impact. As no such comments were received the APB has concluded that commentators agree with its assertion in this regard.

Respondents to the Exposure Drafts

Accountancy Bodies

- The Institute of Chartered Accountants in England & Wales
- The Institute of Chartered Accountants in Ireland

Investment Banking Bodies

- London Investment Banking Association (LIBA)

Firms of reporting accountants

- BDO Stoy Hayward LLP
- Deloitte & Touche LLP
- Ernst & Young Global Limited
- Grant Thornton UK LLP
- KPMG LLP
- PricewaterhouseCoopers LLP