

Auditing Practices Board

Final Work Programme for 2006/7

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In December 2005 the Financial Reporting Council (FRC) issued its Plan & Budget 2006/07 which includes the major planned activities of its Operating Bodies including the Auditing Practices Board (APB). This Paper sets out in more detail the activities that APB plans to undertake in 2006/07. Not all changes to the environment relating to auditing can, however, be accurately predicted; the APB is aware of the need for flexibility in its planning process in order to be able to respond to new events and circumstances as they arise and, given the finite nature of its resources, may need to depart from its intended work programme to address new priorities.

Introduction

In the last two years there have been a number of changes to the environment in which audit services are provided in the UK and Ireland:

- By issuing a complete suite of ISAs (UK and Ireland) as well as revised Standards for Investment Reporting, APB has updated the standards that were issued by the APB's predecessor Boards¹ over the preceding decade;
- APB has issued new Ethical Standards for Auditors and has issued an exposure draft of Ethical Standards for Reporting Accountants;
- Changes in the Combined Code have increased the degree to which audit committees of listed companies provide oversight of the external audit process; and
- Larger audit firms in the UK have been, for the first time, subject to independent audit inspection by a body external to the accountancy profession².

By any standard this represents a significant degree of change which needs to be assimilated by the audit firms and auditors who must apply the new standards and respond to the new initiatives. During recent years there has also been a growing appetite for the international harmonisation of auditing standards. Within the European Union this will be accentuated by work to implement the recently revised Eighth Directive. The APB has anticipated this trend and has sought to be influential internationally by:

- Being represented on the International Audit and Assurance Standards Board (IAASB);
- Contributing directly to IAASB projects (for example, the exposure drafts of ISA 320 and ISA 540 were prepared by joint APB and IAASB task forces);
- Adopting the International Standards on Auditing (ISAs) issued by IAASB as the basis for ISAs (UK and Ireland) and exposing draft ISAs (UK and Ireland) in parallel with the IAASB; and
- Being in the forefront of the development of ethical standards for auditors that reflect current expectations; and
- Being actively involved in debates within the EU concerning auditing standards.

¹ The APB replaces

- the former Auditing Practices Board, which operated from 1991 to March 2002 under the aegis of the CCAB, and
- The Auditing Practices Board Limited which acted as a subsidiary of the Accountancy Foundation Limited from April 2002 to March 2004

The current APB remit remains being responsible for establishing standards of auditing in the United Kingdom and the Republic of Ireland to enhance public confidence in the auditing process and the quality and relevance of auditing services in the public interest.

² The Audit Inspection Unit (AIU) of the FRC's Professional Oversight Board published its first public report on its audit quality inspections in June 2005.

During 2006/7 the APB intends to remain influential internationally and will continue to contribute proactively to the work of IAASB, respond to all of the exposure drafts issued by IAASB and the IESBA³ and be fully involved in discussions within the EU regarding the adoption of ISAs under the recently revised Eighth Directive.

Auditing Standards

APB's objective is to establish Auditing Standards which set out the basic principles and essential procedures with which external auditors in the United Kingdom and the Republic of Ireland are required to comply.

In December 2004 the APB issued ISAs (UK and Ireland) to apply to audits of financial statements for accounting periods commencing on or after 15 December 2004. ISAs (UK and Ireland) are the International Standards on Auditing (ISAs) as issued by IAASB, supplemented, where necessary, by standards and guidance from the UK auditing standards previously in issue. APB adopted this approach in order to benefit from the recently revised ISAs covering audit risk and fraud and future revisions to ISAs on topics such as group audits, materiality, accounting estimates and related parties.

Since APB issued the ISAs (UK and Ireland):

- IAASB has committed itself to change the style of the ISAs as part of its 'Clarity Project', and
- further progress has been made towards the application of ISAs within the European Union by means of revisions to the Eighth Directive.

Given the significant amount of work underway within IAASB and the commencement of the EU adoption process, the APB has no plans to change auditing standards that apply within the UK and Ireland during 2006/7⁴ other than to reflect changes to the legal responsibilities of UK auditors in relation to the directors' report in a revision of ISA (UK and Ireland) 720⁵.

Rather than issuing new auditing standards, the focus of APB's work in 2006/7 will be on responding to IAASB exposure drafts arising from the Clarity Project, contributing to the work of IAASB to update the remaining ISAs and being actively involved in the auditing standards adoption process within the EU.

The 'Clarity Project'. The 'Clarity Project' is of particular importance. At one level it can be seen as presentational changes designed to clarify the status of material that is currently included as guidance within existing ISAs and to make it easier for auditors (especially of small and mid-sized entities) to understand and apply the standards. However, the underlying issue that is being addressed relates to the level of prescription to be established by auditing standards. Some take the view that audit quality is likely to be improved by having detailed

³ IFAC's International Ethics Standards Board for Accountants.

⁴ In December 2005 the APB announced that it would defer implementation of the revised ISA (UK and Ireland) 700 'The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements' until changes in UK company law have been finalised and audit reports have been addressed by the European Commission as part of its endorsement programme. Changing the auditor's report is a time consuming exercise for auditors and the effect of changes needs to be assimilated by the investor community. It appears to the APB to be undesirable to risk having to make significant changes to the auditor's report twice in a short period of time.

⁵ This revision was issued in April 2006.

prescriptive standards that facilitate external monitoring of audit quality. Others, including the APB, favour a more principles based approach recognising that many of the key features of good auditing are dependent on auditor experience and judgment and that too many rules can be distractive and lead to a 'tick box' approach to auditing.

On 31 October 2005 the IAASB announced that it intends to improve the clarity of its ISAs by:

- Setting an overall objective for each ISA;
- Clarifying the obligations imposed on the auditor by the requirements of the ISAs, and by using the word "shall" instead of the current "should" to emphasise the expectation that these requirements are applicable in virtually all engagements to which the ISA is relevant;
- Eliminating any ambiguity about the status of the existing ISAs by modifying the language of current present tense statements, either by elevating them to "shall" statements or by eliminating the present tense to make it clear that there is no intention to create a requirement; and
- Improving the overall readability and understandability of the ISAs through structural and drafting improvements.

The Clarity Project involves the re-exposure of recently revised standards such as ISA 315 relating to audit risk, and reconsideration of recently exposed material such as ISA 600 on group audits. IAASB does not intend that these new standards will come into force before audits of accounting periods commencing on or after 15 December 2007. This will mean that the implementation of several exposure drafts of new or revised ISAs (UK and Ireland)⁶ will be deferred by about a year. Despite this the APB supports the Clarity Project on the basis that it believes that it will make ISAs easier for practitioners to understand and implement and it will increase the likelihood that ISAs will be acceptable for adoption throughout the EU.

The APB has issued a Consultation Paper⁷ setting out its proposals on how to respond to IAASB's Clarity Project. There was broad support for APB's proposals that it should not issue its own exposure drafts of corresponding ISAs (UK and Ireland) in parallel with IAASB but that formal exposure of such standards should take place after the ISAs have been finalised by IAASB and take account of the European Commission's forthcoming process for the adoption of ISAs in the European Union.

The APB will use the new exposure draft on group audits (ISA 600) to explore new ways of obtaining views on important new international standards. The Board plans to organise meeting to receive the comments of auditors and representatives of preparers and users of financial statements and to supplement this with specific meetings with selected stakeholders. Based on the success of this approach the Board will re-evaluate how best to engage with

⁶ ISAs (UK and Ireland) 320 'Materiality', 540 'Accounting Estimates', 600 'Group Audits', 701 'The Independent Auditor's Report on Other Historical Financial Information', 705 'Modifications to the Opinion in the Independent Auditor's Report' and 706 'Emphasis of matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report'.

⁷ The APB issued a Consultation Paper on 4 November 2005 setting out its proposed approach to the exposure drafts issued by IAASB in connection with the Clarity Project and invited comments on it by 30 November 2005.

interested parties, including investors and the corporate sector in relation to responses to IAASB exposure drafts.

EC adoption of ISAs. On 11 October 2005 the Council of The European Union announced that it had agreed on a draft Directive updating rules on the audit of company accounts. Article 26 of the draft directive states that Member States shall require statutory auditors and audit firms to carry out statutory audits in accordance with international auditing standards adopted by the European Commission. Before adopting the international auditing standards the European Commission must determine that they:

- Are generally accepted internationally and are developed with proper due process, public oversight and transparency;
- Contribute a high level of credibility and quality to the annual or consolidated accounts; and
- Are conducive to the European public good.

The new Directive (which will replace the existing Eighth Directive) was finalised in June 2006 and will apply in all Member States from mid 2008. The European Commission is currently establishing arrangements to support the consistent application of the new Directive including consideration of the adoption of international auditing standards. The APB expects to be actively involved in the auditing standards adoption process within the EU.

ISA (UK and Ireland) 720. In October 2005 the APB issued an exposure draft of revisions to ISA (UK and Ireland) 720 primarily to provide standards and guidance on auditor reporting on the statutory OFR. The exposure draft also included standards and guidance on a new legal requirement in the UK for auditors to report whether the information in the directors' report is consistent with the financial statements (this is already a legal requirement in Ireland). Although the Government has repealed the law relating to the statutory OFR the change in UK law relating to directors' reports will remain. In April 2006 the APB revised ISA (UK and Ireland) 720 in the light of these legislative changes.

Auditing Guidance

APB's objective is to issue guidance on the application of Auditing Standards in particular circumstances and industries and timely guidance on new and emerging issues.

The APB currently has in issue 20 Practice Notes the majority of which provide guidance on the application of auditing standards to particular industries, and 28 Bulletins which provide guidance on new or emerging issues.

Practice Notes. A priority for APB in 2006/7 is to update the industry specific Practice Notes. The introduction of ISAs (UK and Ireland) has a 'ripple effect' through the industry specific Practice Notes, many of which can also be usefully updated for changes in legislation and regulations. Work on this commenced in 2005/6 and is planned to be completed in 2006/7 as follows:

UK	2005/6	2006/7
Public sector	Exposure draft of PN 10 issued in June 2005; finalised January 2006	
Charities*		Exposure draft and finalisation of a revised version of PN 11.
Registered social landlords	Exposure draft of PN 14 issued in June 2005; finalised March 2006	
Pension schemes*		Exposure draft and finalisation of a revised version of PN 15.
Banks and building societies*		Exposure draft of PN 19 issued in May 2006. Finalisation of a revised version of PN 19.
Insurers	Exposure draft of PN 20 issued in December 2005.	Second exposure draft planned for July 2006. Finalisation of a revised version of PN 20.
Investment businesses*	Exposure draft of PN 21 issued in March 2006.	Finalisation of a revised version of PN 21.
Friendly societies	Exposure draft of PN 24 issued in February 2006.	Finalisation of a revised version of PN 24.

Republic of Ireland	2005/6	2006/7
Central government	Exposure draft of PN 10(I) issued in March 2006	Finalisation of a revised version of PN 10(I)
Pension schemes*	Exposure draft of PN 15 (I) issued in July 2006. Interim guidance finalised December 2005.	Finalisation of PN 15(I).
Banks*		Exposure draft and finalisation of a revised version of PN 19(I).
Insurers		Exposure draft and finalisation of a revised version of PN 20(I).
Investment businesses*		Exposure draft and finalisation of a revised version of PN 21(I).
Credit unions		Exposure draft and finalisation of a revised version of a new PN

* Bulletin providing supplementary guidance for auditors on the new auditing standards on audit risk and fraud published in early 2005.

Other Practice Notes address particular issues. APB is aware that PN's 8, 9 and 13 are in need of updating:

- PNs 8 and 9 addressing reports by auditors under company legislation in the United Kingdom and Republic of Ireland need to be reviewed in the light of changes in legislation and best practice, especially relating to the form of reporting. In particular, finalisation of the Company Law Reform Bill will impact PN 8.
- PN 13 'The Audit of Small Businesses' does not reflect the adoption of ISAs (UK and Ireland) and the issuance of APB Ethical Standards for Auditors. The APB has established a SME audit sub-committee to consider PN 13 taking account of the IAASB's Clarity Project, the Professional Oversight Board for Accountancy's research on the accounting and auditing needs of small businesses and any emerging issues following the implementation of the Ethical Standards. PN 13 will also be impacted by any guidance on audit documentation that is developed⁸.

Bulletins. APB will review its guidance to auditors on requirements relating to the Combined Code on Corporate Governance in the context of the recent update to the 'Turnbull' guidance on internal controls and possible changes to the FRC Combined Code in 2006.

A number of changes to UK legislation affecting auditors are likely to be finalised in 2006⁹. The Company Law Reform Bill is currently going through various legislative stages in Parliament and the APB and the FRC are monitoring its progress and the amendments that are being made to it. The APB is receptive to developing guidance in certain areas but does not plan to commence work until the legislation has been finalised which will not be before the autumn of 2006. Some areas of guidance may more suitably be issued by the FRC rather than the APB.

In November 2005 the APB issued Bulletin 2005/4 "Auditor's Reports on Financial Statements in Great Britain and Northern Ireland". This is the first edition of the Bulletin referred to in ISA (UK and Ireland) 700. It is expected that new editions will be published when there are changes in law, regulation or auditing standards that need to be reflected. APB plans to update Bulletin 2005/4 during 2006 to reflect the changes to audit reports necessitated by the new legal requirement in the UK for auditors to report whether the information in the directors' report is consistent with the financial statements.

⁸ At a recent meeting between IAASB and National Standard Setters APB agreed to explore whether supplementary guidance on audit documentation on small audits could usefully be developed.

⁹ In particular the Company Law Reform Bill will require audit engagement partners to sign audit opinions in their own name on behalf of the audit firm and there will be changes in the law relating to auditor resignation statements.

Assurance Services

APB's objective is to establish standards and related guidance for accountants providing assurance services.

APB's objectives include establishing standards and related guidance for accountants providing assurance services. To date APB has interpreted this role in the context of those assurance engagements that are reported in the public domain and are therefore in the public interest. Examples include the work of auditors in connection with the Combined Code, interim financial information, preliminary announcements and accountants reporting in connection with investment circulars. The APB has not promulgated IAASB's 'International Framework for Assurance Engagements' or its generic standard on assurance engagements (ISAE 3000). APB intends to continue with this approach in 2006/7 and focus its work on accountants reporting in connection with investment circulars and the auditor's review of interim financial information.

Investment circulars. The EU Prospectus Directive came into force on 1 July 2005 and the FSA's and Irish Stock Exchange rules were revised at the same time. This gave rise to a need for APB to revise the existing SIRs and to prepare new ones. Reporting accountants have a very important role in providing assurance on the financial information provided in investment circulars and APB expects this work will be influential in ensuring that reporting accountants perform to a high standard and on a consistent basis throughout the European Union.

In July 2005 APB issued SIR 1000 'Investment Reporting Standards applicable to all engagements in connection with an investment circular' (to replace the existing SIR 100) and SIR 2000 'Investment Reporting Standards applicable to public reporting engagements on historical financial information' (which replaced the existing SIR 200). In January 2006 the APB issued SIR 3000 – 'Investment Reporting Standards applicable to public reporting engagements on profit forecasts' and SIR 4000 – 'Investment Reporting Standards applicable to public reporting engagements on pro forma financial information'. At the same time the APB also issued an exposure draft containing proposed Ethical Standards for Reporting Accountants.

In 2006/7, in addition to its finalising the Ethical Standards for Reporting Accountants the APB will consider whether additional standards and/or guidance are needed in relation to Investment Reporting including GAAP reconciliations.

Interim reviews. APB is planning to implement International Standard on Review Engagements (ISRE) 2410 'Review of interim financial information performed by the independent auditor of the entity' in the UK and Ireland. This will be co-ordinated with the implementation of the EC Transparency Directive.

Ethical Standards

APB's objective is to establish Ethical Standards in relation to the independence, objectivity and integrity of external auditors and those providing assurance services

Ethical standards for auditors. APB's Ethical Standards for Auditors were finalised in December 2004 and apply to audits of accounting periods commencing on or after 15 December 2004. The first calendar year audits to which they apply are therefore those for 31 December 2005. The APB currently believes that use of the standards for at least two audit cycles will be needed before any systematic review of them is undertaken. The earliest that this is likely to commence therefore is summer 2007. This timing may also fit with other developments as, by then, there may be greater clarity as to whether specific EC requirements are to be developed and IFAC is expected to have revised its Code of Ethics. The APB does not plan to make piecemeal changes to ethical standards in 2006/7 but recognises that additional guidance may be appropriate. The accountancy bodies are publishing answers to Frequently Asked Questions about the APB ethical standards on their websites and the APB co-operates in this process.

Ethical standards for reporting accountants. In January 2006 the APB issued an exposure draft containing proposed Ethical Standards for Reporting Accountants, the intention is that these ethical standards will be finalised in 2006.

Statutes, Regulations and Accounting Standards

APB's objective is to take an appropriate role in the development of statutes, regulations and accounting standards which affect the conduct of auditing and assurance services, both domestically and internationally.

APB will respond to consultation papers in relation to changes in law or regulations relating to the role of auditors.

Public Understanding and Research

APB's objective is to contribute to efforts to advance public understanding of the roles and responsibilities of external auditors and the providers of assurance services including the sponsorship of research.

Audit quality. Audit quality is fundamental to several of the FRC's operating bodies. In particular APB's objectives include enhancing public confidence in the quality of audit services and the AIU is charged with monitoring audit quality rather than merely compliance with auditing standards and regulations. Fulfilling these responsibilities would benefit from a common understanding of the key drivers of audit quality. It has been agreed that an FRC project will be undertaken to develop a common view of what audit quality is, focussing in particular on the audits of listed companies. The APB will fully participate in this work.

Audits of small and medium sized entities. There is also a need to re-evaluate the role of auditing standards on smaller audits. In the past, auditing standards have been relatively broad

and, therefore, capable of being applied on audits of different sizes. Over recent years, however, the pressure to improve the quality of the audits of listed companies has led to greater specificity in the standards and increased documentation to support external monitoring. Some believe that this creates difficulties and results in disproportionate cost increases for SME audits and the audits of other smaller entities such as charities. In the UK the problem is eased, but not eradicated, by the recent increases in the audit exemption threshold for companies.

To help re-evaluate the feasibility of continuing the 'one size fits all' approach to auditing standards the APB has formed a new SME audit sub-committee. One aspect of this issue is to understand more about the demand for and provision of audit services to SMEs and the extent to which voluntary audits will continue to be requested for companies below the exemption threshold or alternatively whether other assurance services might be introduced. Another dimension relates to international developments not least as the revised Eighth Directive is likely to mean that international auditing standards will have to be applied to all statutory audits in the EU.

Summary APB Work Programme 2006/2007

	Revisions to auditing standards
Revised international standards	<p>Obtain UK and Irish views on new IAASB exposure drafts and submit comment letters to IAASB. During 2006/7 responses are likely to be needed on the following exposure drafts:</p> <ul style="list-style-type: none"> • ISA 550 ‘Related Parties’ • ISA 580 ‘Management Representations’ • ISA 620 ‘Using the Work of an Expert’ <p>Contribute to IAASB’s work to revise ‘older’ ISAs.</p>
Clarity Project	<p>Obtain UK and Irish views on exposure drafts arising from the ‘Clarity Project’ and comment to IAASB. During 2006/7 responses are likely to be needed on the following exposure drafts:</p> <ul style="list-style-type: none"> • ISA 220 ‘Quality Control for Audits of Historical Financial Information’; • ISA 230 ‘Audit Documentation’; • ISA 260 ‘The Auditor’s Communication with Those Charged with Governance’; • ISA 500 ‘Audit Evidence’; • ISA 540 ‘Auditing Estimates and Related Disclosures’; • ISA 600 ‘The Audit of Group Financial Statements’; • ISA 700 ‘The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements’; • ISA 701 ‘The Independent Auditor’s Report on Other Historical Financial Information’; • ISA 705 ‘Modifications to the Opinion in the Independent Auditor’s Report’; • ISA 706 ‘Emphasis of matter Paragraphs and Other Matters Paragraphs in the Independent Auditor’s Report’; • ISA 800 ‘The Independent Auditor’s Report on Summary Audited Financial Statements’.
Adoption of ISAs by the EC	To be actively involved in debates within the EU concerning auditing standards.
Documentation requirements in relation to audits of SMEs	Explore whether useful guidance can be issued on how documentation requirements apply to SME audits.

	Guidance
UK Industry specific Practice Notes	Complete the update of Practice Notes relating to charities, pensions schemes, banks, insurers, investment businesses and friendly societies.
Irish Industry specific Practice Notes	Complete the update of Practice Notes relating to the public sector, pensions schemes, banks, insurers and investment businesses. Prepare a new Practice Note on credit unions.
Example auditors reports	Update Bulletin 2005/4 for the new legal requirement in the UK for auditors to report whether the information in the directors' report is consistent with the financial statements.
Reports by auditors under company legislation	Consider updating PNs 8 and 9
Assurance engagements	
Other reporting engagements	Consider preparation of standards and/or guidance on GAAP reconciliations within investment circulars.
Interim reviews	Introduce ISRE 2410 into the UK and Ireland in conjunction with the EC Transparency Directive
Ethical standards	
Ethical Standards for Reporting Accountants	Finalise Ethical Standards for Reporting Accountants
Other	
Audit quality	Participation in the FRC review of the drivers of audit quality.
SME audit	Re-evaluate the feasibility of continuing the 'one size fits all' approach to auditing standards for SMEs.