

MEETING SUMMARY

MEETING OF: APB SME audit sub-committee

DATE AND

TIME: Thursday 6th July 2006 at 11.00am

PLACE: Aldwych House - London WC2

PRESENT:

Richard Fleck (Chairman)	Jon Grant
John Brace	Peter Hollis
Malcolm Bacchus	Robert Holland
Jayne Clifford	Martin Longmore
Alan Donaldson	Prof Neil Marriott
Jane Grant	Valerie Steward

Staff: Hazel O'Sullivan Keith Billing

In attendance: Dries Schockaert - IRE, Belgium (agenda item 5)

APOLOGIES:

Alan Farrelly	Craig Jenkins
David Finch	Martin Ward
James Hunt	

1. Introduction

The sub-committee reviewed APB developments since the last meeting. It was agreed that the paper relating to the update of Bulletin 2005/4 on audit reports would be circulated to the sub-committee prior to the APB meeting on 25 July. Richard Fleck explained that while the primary focus of the audit quality project related to the audit of listed companies, he would welcome the views of the sub-committee and would consider the optimal timing for its involvement.

Richard Fleck summarised the debate on adequate books and records, as part of the current Company Law Reform Bill. Committee members felt comfortable that they knew what their responsibilities were in connection with this issue when they were carrying out an audit, but it was less clear what they were in relation to compilation engagements and who should issue guidance on this matter. It was suggested that any FRC guidance to be issued should emphasise the objectives of the legal requirement. Sub-committee members thought that it would not be helpful for FRC to issue detailed 'how to' type guidance either for directors or auditors to make the adequacy requirement more specific.

Jon Grant outlined what he understood to be the ICAEW Audit Faculty plans for their small entity assurance product (SEAS) which had been presented to

the sub-committee at its meeting in October 2005. Jon understood that the technical material supporting SEAS was due for approval at an Audit Faculty meeting the following week.

The primary concern of committee members was that release of the product would create further confusion in the market place. The POBA research indicated that there was already confusion between an audit and a compilation service. The introduction of a third level would only make matters worse. One of the POBA recommendations following their review of the needs of small and medium sized companies and their stakeholders was that the professional accountancy bodies should consider the use of a cross-profession compilation report. The committee took the view that this should be the top priority of the accountancy bodies at this time. As an assurance product released by only one professional accountancy body, SEAS detracts from the implementation of this recommendation, especially as the level of assurance proposed was already built into the compilation service of one of the other bodies.

The following additional concerns were expressed:

- There was little substance to a review engagement and it would not be helpful if banks were to start requiring accounts with a SEAS report in order to provide further funding.
- It was far from clear that the published information about the ICAEW survey indicated demand for SEAS.

Richard Fleck assured sub-committee members that the FRC was committed to making progress on SME issues and that the concerns expressed would be fed back to the ICAEW.

2. ISA 600 – Group Audits

The sub-committee discussed the recent exposure draft of ISA 600. Jon Grant outlined the themes which had arisen in recent meetings which the APB had held with interested parties. The following points were made in discussion:

- Paragraph 26 requires the group auditor to be involved in the work of other auditors where necessary, following an evaluation of the report of work performed. Bullet points (a) to (f) are options for actions to take and, as such, should be application material. It was also observed that the ideas of 'determining' and 'performing' in (d) should be differentiated.
- Paragraph 12 creates a problem where the group auditor cannot get audit information on an associated company. There may be some relatively small UK companies with investments in other countries (such as China) where this problem could be encountered. The requirement to disclaim an opinion and/or resign is not helpful as the company may be unable to get an audit as required by the Companies Act.

- The standard was thought to apply to medium-sized groups who did not produce consolidated accounts, but did need to provide details of net assets and profits for each subsidiary. This could create a requirement for an audit in cases where a material subsidiary is small and would otherwise qualify for an audit exemption. Committee members did not necessarily disagree that such note disclosures should be audited, but observed that the cost savings anticipated by the legislation may not be forthcoming in practice. Jon Grant agreed to investigate this matter more fully.

3. ISA 315 – Understanding the Entity: update on IAASB Clarity project

Jon Grant described the input that the sub-committee had had to crafting the additional guidance in ISA 315 on ‘Considerations Specific to Smaller Entities’. Sub-committee members thought that the current version of this redrafted ISA was much improved.

It was unclear how paragraph A122 would be applied as a result of different interpretations of ‘experience’. It was suggested that either the paragraph be removed, or it could be turned around so that it states that there is a basic requirement for compliance with ISA 230 (sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing, extent and results of the audit procedures performed, the audit evidence obtained, the significant matters arising and the conclusions reached thereon), but that a team of relatively inexperienced auditors may need a greater level of documentation.

It was thought that the use of heading formats within the application material could be improved.

4. ISA implementation

Jon Grant reported that an ICAEW article on this topic had been published in *Accountancy*. A draft ICAEW questionnaire, originally designed to gather information on further improvements that could be made to ISAs and to the support for their implementation, including training, was reviewed by the sub-committee. It was understood that ICAEW are planning to use this questionnaire at its roadshows and elsewhere.

The sub-committee recommended that APB consider carrying out a direct review of implementation of ISAs (UK and Ireland) as valuable information could be gained. It was thought that, if the focus of the research was the first year implementation experience, this should be done in late 2006 before practitioners forgot their experiences. The following points were made about any such study:

- It would be worthwhile returning to practitioners with questions in 2007 to ascertain what changes are experienced after the first year.

- If a quantitative study of a large number of practitioners is desired, it should be preceded by a small number of qualitative interviews, to help design the questionnaire.
- Questions related to costs should be included.

It was agreed that APB staff would formulate a methodology for carrying out research for further discussion within APB. It was hoped that the sub-committee would be involved in this work and once agreed, CCAB bodies would be advised. It was also noted that an academic was carrying out some research for ICAS on the APB Ethical Standards; it will be important that the two issues are not confused in any research.

5. Smaller Entity Audit Documentation Guidance

Hazel O'Sullivan outlined the background to the development of this guidance and the content of the draft document.

The use of a qualitative description of smaller entities was agreed. It would be useful to explain why such an approach is followed. The bullet points used in footnote 2 might be amended to reflect the special considerations of section 3 more closely.

It was suggested that something on related parties and the blurring of the line between business and personal expenses, etc. might be added to the special considerations. The informality of decision making and the fact that there is little documentation (e.g. no directors meeting notes) might also be worthwhile including.

The approach to the documentation requirements and related guidance was agreed. Some suggestions were offered on formatting the table.

On the example documentation in the Appendix, it was suggested that this could be linked back to the specific documentation requirements. An approach based on a series of questions would be worthwhile including and Dries Schockaert suggested one particular format that might be appropriate. It was agreed that another example entity might complicate the document, but further examples relating to the company already used would be included. Additionally, it was agreed that the size of the example company would be reduced.

The following additional points were made on the document:

- More focus could be given to the section on the purpose of documentation. This might include something on what is required from an inspection viewpoint and clarifying what is required where an ISA requirement is not relevant.
- Something could be included in paragraph 3.9 on fraud.

- It should be emphasised that the example documentation is provided for illustrative purposes only.
- The example documentation might include extracts from a concluding memorandum.

It was agreed that the working group would continue with the development of the document which would be circulated to the sub-committee for review during August. A further draft would be available for discussion at the next sub-committee meeting in October and a recommendation then made for approval at the October APB meeting.

6. Any other business

Jon Grant explained that CCAB representatives were currently in discussion with the BBA regarding bank confirmations. The sub-committee took the view that bank confirmations were an important source of audit evidence (especially in relation to the fraud risk) and was concerned that auditors should stop requesting them just because of the poor quality of the bank's response. The view was taken that CCAB should strive to get the banks to improve the accuracy and timeliness of their responses. In this context it was thought that consideration should be given to:

- Auditors paying for bank confirmations and penalty clauses being introduced for inaccurate responses.
- The need for timely and accurate bank confirmations being recognised in the banks' agreements with their clients.
- CCAB complaining to the Banking Ombudsman.

7. Next meeting date

The next meeting is due to be held on Wednesday 4th October, starting at 11am. Dates for 2007 meetings will be set before this date.