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## COMPANIES ACT 2006 – LATEST DEVELOPMENTS

### *SI 2008 No. 393: The Companies Act 2006 (Amendment) (Accounts and Reports) Regulations 2008*

These Regulations come into force on 6th April 2008 and apply in relation to financial years beginning on or after 6th April 2008. They have the effect of amending various sections of the Companies Act 2006 (CA 2006).

The SI amends Sections 382 and 383 of CA 2006 which deal with the qualifying conditions for small companies and groups. These sections are reproduced below. The notes then provide a series of case-study examples. The SI also amends the qualifying conditions for medium-sized companies and groups.

Other matters dealt with by the SI are:

- Entitlement of small companies to directors' report exemptions – this re-instates into CA 2006 a number of exemptions contained in the 1985 Act where the company is a member of an ineligible group
- Disclosure of off-balance sheet arrangements

#### **Section 382 Companies qualifying as small: general**

- (1) A company qualifies as small in relation to its first financial year if the qualifying conditions are met in that year.
- (2) A company qualifies as small in relation to a subsequent financial year-
  - (a) if the qualifying conditions are met in that year and the preceding financial year;
  - (b) if the qualifying conditions are met in that year and the company qualified as small in relation to the preceding financial year;
  - (c) if the qualifying conditions were met in the preceding financial year and the company qualified as small in relation to that year.
- (3) The qualifying conditions are met by a company in a year in which it satisfies two or more of the following requirements-

1. Turnover	Not more than £6.5 million (previously £5.6m)
2. Balance sheet total	Not more than £3.26 million (previously £2.8m)
3. Number of employees	Not more than 50
- (4) For a period that is a company's financial year but not in fact a year the maximum figures for turnover must be proportionately adjusted.
- (5) The balance sheet total means the aggregate of the amounts shown as assets in the company's balance sheet.
- (6) The number of employees means the average number of persons employed by the company in the year, determined as follows-
  - (a) find for each month in the financial year the number of persons employed under contracts of service by the company in that month (whether throughout the month or not),
  - (b) add together the monthly totals, and
  - (c) divide by the number of months in the financial year.



**Case study examples**

Example 1

The following data applies to X Ltd for the three years ending on 31 December:

	2007	2008	2009
Turnover	£6m	£6m	£6m
Balance sheet total	£3m	£3m	£3m
Number of employees	40	40	40

Does X Ltd qualify as a small company in 2008 and/or 2009?

Example 2

The following data applies to P group Ltd for the year ended 31 December 2009:

	net	gross
Turnover	£7m	£7m
Balance sheet total	£3m	£4m
Number of employees in group	60	

Does P Ltd satisfy the qualifying conditions to be a small group in 2009?

Example 3

The following data applies to the Q group for the year ended 31 December 2009. The group consists of Q Ltd (parent) and three wholly owned subsidiaries – A Ltd, B Ltd and C Ltd.

	Q Ltd	A Ltd	B Ltd	C Ltd
Turnover	£1m	£7m	£1m	£1m
Balance sheet total	£2m	£4m	£1m	£1m
Number of employees	10	40	10	10

The figures for the years 31 December 2008 and 31 December 2007 were the same as those shown above. There is no trading within the group and no balances with other members of the group.

Which of the companies qualify as a small company in 2009 and which of them qualify for audit exemption?

**Medium-sized companies and groups**

The SI also amends sections 465 and 466 which set out the limits for medium-sized companies and groups respectively.

The qualifying conditions are met by a company in a year in which it satisfies two or more of the following requirements-

1. Turnover Not more than £25.9 million
2. Balance sheet total Not more than £12.9 million
3. Number of employees Not more than 250

The qualifying conditions are met by a group in a year in which it satisfies two or more of the following requirements-

- |                                  |  |
|----------------------------------|--|
| 1. Aggregate turnover            | Not more than £25.9 million net (or £31.1 million gross) |
| 2. Aggregate balance sheet total | Not more than £12.9 million net (or £15.5 million gross) |
| 3. Aggregate number of employees | Not more than 250  |

### **Directors' report: small companies exemption**

Regulations 6 and 7 of the SI amend various provisions in order to reinstate certain exemptions relating to the directors' report in section 247A(1A) of the Companies Act 1985 for small and medium-sized companies that would otherwise not be able to take advantage of them only because they are members of ineligible groups.

A new section 415A has been incorporated into CA 2006. This states that a company is entitled to small companies exemption in relation to the directors' report for a financial year if -

- (a) it is entitled to prepare accounts for the year in accordance with the small companies regime, or
- (b) it would be so entitled but for being or having been a member of an ineligible group.

The exemption is relevant to—

- section 416(3) (contents of report: statement of amount recommended by way of dividend),
- section 417 (contents of report: business review), and
- sections 444 to 446 (filing obligations of different descriptions of company).

### **Information about off-balance sheet arrangements**

The regulation inserts a new section 410A into the 2006 Act requiring companies to make certain disclosures about off-balance sheet arrangements in the notes to their accounts. Section 410A is reproduced below.

410A.—

- (1) In the case of a company that is not subject to the small companies regime, if in any financial year—
  - (a) the company is or has been party to arrangements that are not reflected in its balance sheet, and
  - (b) at the balance sheet date the risks or benefits arising from those arrangements are material,the information required by this section must be given in notes to the company's annual accounts.
- (2) The information required is—
  - (a) the nature and business purpose of the arrangements, and
  - (b) the financial impact of the arrangements on the company.
- (3) The information need only be given to the extent necessary for enabling the financial position of the company to be assessed.
- (4) If the company qualifies as medium-sized in relation to the financial year (see sections 465 to 467) it need not comply with subsection (2)(b).
- (5) This section applies in relation to group accounts as if the undertakings included in the consolidation were a single company.

**SI 2008 No. 497: The Companies (Late Filing Penalties) and Limited Liability Partnerships (Filing Periods and Late Filing Penalties) Regulations 2008**

These Regulations were made on 23 February 2008 and come into force on 6th April 2008.

References in these Regulations to late filing, or to a failure to comply with filing requirements, are to a failure to comply with the requirements of section 441 of the Companies Act 2006 (which apply in relation to financial years beginning on or after 6th April 2008) in relation to a company's accounts and reports before the end of the period for filing those accounts and reports.

Whether a company is a public company or a private company depends upon its status at the end of the financial year in question.

**Late filing penalties under the Companies Act 2006 as from 6th April 2008**

This regulation applies where the requirements of section 441 of the Companies Act 2006 are complied with before 1st February 2009.

The amount of the civil penalty to which a company is liable under section 453 of the Companies Act 2006 in a case of late filing is that shown in the following table:

<i>Length of period</i>	<i>Public company</i>	<i>Private company</i>
Not more than 3 months.	£500	£100
More than 3 months but not more than 6 months.	£1,000	£250
More than 6 months.	£2,000	£500

The first column of the table ("length of period") refers to the length of the period between the end of the period for filing the accounts and reports in question and the day on which the requirements of section 441 are complied with.

Note that these penalties are the same as those in CA 1985 Section 242A.

**Late filing penalties under the Companies Act 2006 as from 1st February 2009**

This regulation applies where the requirements of section 441 of the Companies Act 2006 are complied with on or after 1st February 2009.

The amount of the civil penalty to which a company is liable under section 453 of the Companies Act 2006 in a case of late filing is that shown in the following table or, if there was a failure to comply with filing requirements in relation to the previous financial year of the company and that previous financial year had begun on or after 6th April 2008, double that shown in the table:

<i>Length of period</i>	<i>Public company</i>	<i>Private company</i>
Not more than 1 month.	£750	£150
More than 1 month but not more than 3 months.	£1,500	£375
More than 3 months but not more than 6 months.	£3,000	£750
More than 6 months.	£7,500	£1,500

The first column of the table ("length of period") refers to the length of the period between the end of the period for filing the accounts and reports in question and the day on which the requirements of section 441 are complied with.

Note that there is no provision for doubling the penalty for late filing in two successive years when either year began before 6th April 2008.

### Late filing penalties under the Companies Act 1985 as from 1st February 2009

The increased penalties above also apply where a company files its accounts (or an LLP delivers its accounts and auditors' reports) on or after 1<sup>st</sup> February 2009 under Companies Act 1985 (that is for a financial year beginning before 6th April 2008).

The provision for doubling the penalty for late filing in two successive years, however, does not apply to limited liability partnerships, because section 453 of the Companies Act 2006 does not yet apply to limited liability partnerships.

The new 9-month deadline in the Companies Act 2006 for filing private company accounts and reports is applied by the SI to the delivery of the accounts and auditors' reports of limited liability partnerships for financial years beginning on or after 6th April 2008. The SI also applies the new rules in section 443 of that Act for calculating that deadline.

### What is the incidence of late filing?

From Companies House statistics for 2006/7:

The number of private companies filing late was 219,298 paying penalties of £47.4m

The number of public companies filing late was 1,506 paying penalties of £1.32m

To put this into context there were 2.3m private companies and 11.2k public companies.

In the same period there were 4,084 prosecutions with 1,484 convictions. The number of prosecutions was down on previous years.

### Examples

#### *Alpha Ltd*

Year end 31 December 2007

If accounts filed on:	Lateness:	Fine:
3 October 2008	Not late – deadline 31 October	Nil
28 January 2009	Up to 3 months but before 1 February	£100
2 February 2009	Over 3 months, up to 6 months and after 1 February	£750

#### *Bravo Ltd*

Year end 30 April 2008

If accounts filed on:	Lateness:	Fine:
30 January 2009	Not late – deadline 28 February	Nil
10 March 2009	Up to 1 month but after 1 February	£150
20 May 2009	Over 1 month, up to 3 months and after 1 February	£375

### Doubling

Assuming both companies were late in filing their accounts for the previous year, what would the fines be in the following situations?

#### *Alpha Ltd*

Year end 31 December 2008

Accounts filed on 5 January 2010



Filing deadline 31 October 2009. Therefore over 1 month but up to 3 months - £375. There is no doubling as the previous period commenced before 6 April 2008. If the company is late for 31 December 2009 then the penalty will still not be doubled since the previous year commenced before 6 April 2008. If the company files late for both 2009 and 2010 then the penalty will be doubled for 2010 as this will be the second consecutive period. Therefore if the company was one day late for 2009 but 7 months late for 2010 then penalty for that year would be £3,000.

*Bravo Ltd*

Year end 30 April 2009

Accounts filed on 25 March 2009.

Filing deadline 31 January (9 months not 10 and note the removal of the corresponding date rule). Therefore over 1 month but up to 3 months - £375. There is no doubling as the previous period started before 6 April 2008. If the company is late for 30 April 2010 then the penalty will be doubled for that year.

***Statutory Auditors (Transparency) Instrument 2008***

The Professional Oversight Board (POB) has published this instrument under powers conferred on the Secretary of State by section 1240 of the Companies Act 2006 which have been delegated to the POB.

The Instrument comes into force on 6 April 2008 and applies in respect of financial years commencing on or after 6 April 2008.

The instrument requires a transparency reporting auditor to prepare a transparency report in respect of each financial year. A transparency reporting auditor is a statutory auditor that has made an audit report on the annual accounts of one or more public interest entities at any time during the financial year of that statutory auditor.

The transparency report must contain at least the information shown in the schedule to the instrument and must be approved by the transparency reporting auditor and signed on its behalf. The report must be made available on a website within three months of the financial year-end of the auditor to which it relates and must remain available for a period of two years after the end of the three month period referred to above. The transparency report must be sent to the POB at the same time that it is made available on the website with an indication of where the website can be found.

The schedule requires the following disclosures:

- A description of the legal structure and ownership of the transparency reporting auditor.
- Where the transparency reporting auditor belongs to a network, a description of the network and the legal and structural arrangements of the network.
- A description of the governance structure of the transparency reporting auditor.
- A description of the internal quality control system of the transparency reporting auditor and a statement by the administrative or management body on the effectiveness of its functioning.
- A statement of when the last monitoring of the performance by the transparency reporting auditor of statutory audit functions within the meaning of paragraph 13 of Schedule 10 to the Act (as amended by regulation 23 of the Statutory
- Auditors and Third Country Auditors Regulations 2007 (S.I. 2007/3494)) took place.
- A list of public interest entities in respect of which an audit report has been made by the transparency reporting auditor in the financial year of the auditor; and any such list may be made available elsewhere on the website specified in regulation 4 provided that a clear link is established between the transparency report and such a list.

- A description of the transparency reporting auditor's independence procedures and practices including a confirmation that an internal review of independence practices has been conducted.
- A statement on the policies and practices of the transparency reporting auditor designed to ensure that persons eligible for appointment as a statutory auditor continue to maintain their theoretical knowledge, professional skills and values at a sufficiently high level.
- Financial information for the financial year of the transparency reporting auditor to which he report relates, including the showing of the importance of the transparency reporting auditor's statutory audit work.
- Information about the basis for the remuneration of partners.

#### ***Statutory Auditors (Registration) Instrument 2008***

The Professional Oversight Board (POB) has published this instrument under powers conferred on the Secretary of State by section 1239 of the Companies Act 2006 which have been delegated to the POB.

The Instrument comes into force on 6 April 2008 (subject to transitional provisions) and requires the recognised supervisory bodies (RSBs) to keep a register in electronic form of persons eligible for appointment as a statutory auditor. One of the RSBs shall be the body responsible for keeping the register and making it available for inspection by electronic means.

The instrument goes on to set out the details of how the register is to be maintained, the obligations of the RSBs with respect to maintenance of the register and their duty to provide access to the register.

The instrument also requires that any person eligible for appointment as a statutory auditor must take all reasonable steps to notify their RSB without undue delay of any updated information. The schedules to the instrument set out the information which the register must contain.

#### ***Statutory Auditors (Examinations) Instrument 2008***

The Professional Oversight Board (POB) has published this instrument under powers conferred on the Secretary of State by paragraph 8(1)(a) of schedule 11 to the Companies Act 2006 which have been delegated to the POB.

The Instrument comes into force on 6 April 2008 and sets out the list of subjects for which a statutory auditor is required to have theoretical knowledge. The list is as follows:

1. General accounting theory and principles.
2. Legal requirements and standards relating to the preparation of annual and consolidated accounts.
3. International accounting standards.
4. Financial analysis.
5. Cost and management accounting.
6. Risk management and internal control.
7. Auditing and professional skills.
8. Legal requirements and professional standards relating to statutory audit and statutory auditors.
9. International auditing standards.
10. Professional ethics and independence.
11. Those aspects of the following which are relevant to auditing -
  - a) company law and corporate governance;
  - b) the law of insolvency and similar procedures;
  - c) tax law;
  - d) civil and commercial law;
  - e) social security law and employment law;
  - f) information technology and computer systems;
  - g) business, general and financial economics;
  - h) mathematics and statistics;
  - i) basic principles of the financial management of undertakings.

*Frequently asked questions - Companies House website*

**Reference to Companies Act 2006**

Q: The software that we use (for small companies), in providing accounting services to our clients, refers to the Companies Act 1985 in a number of places in the accounting reports. Our understanding is that the Companies Act 1985 has been superseded and the valid act is the Companies Act 2006. Should our software therefore refer to the 2006 Act and not 1985?

A. The section of the Companies Act 2006 relating to the new requirements for accounts does not come into force until 6th April 2008, and will apply to accounting reference dates beginning on or after that date. For earlier accounting reference dates, you should continue to refer to the 1985 Act.

**Statements appearing on the accounts of small and medium-sized companies**

Q: What statements should be included on accounts prepared in accordance with the Companies Act 2006 and the related regulations?

*Small companies that prepare abbreviated accounts*

The special auditor's report should state that in the auditor's opinion the company is entitled to deliver abbreviated accounts in accordance with section 444(1) or (3) of the Companies Act 2006 and that they have been properly prepared in accordance with the regulations made by the Secretary of State; as the case may be.

*Audit exempt small companies*

Audit exempt small companies with accounting periods starting on or after 06/04/2008 must include the following statements on the balance sheet:

For the year ending..... the company was entitled to exemption from audit under section 477 of the Companies Act 2006 relating to small companies.

Director's responsibilities:

- The members have not required the company to obtain an audit of its accounts for the year in question in accordance with section 476,
- The directors acknowledge their responsibilities for complying with the requirements of the Act with respect to accounting records and the preparation of accounts

These accounts have been prepared in accordance with the provisions applicable to companies subject to the small companies regime.

Note: Small companies that do not deliver abbreviated accounts may also choose not to include a copy of the Directors report and/or a copy of the profit and loss account. In this case the balance sheet must also contain the following statement:

‘The accounts have been delivered in accordance with the provisions applicable to companies subject to the small companies regime.’

*Dormant audit exempt companies*

Dormant audit exempt companies with accounting periods starting on or after 06/04/2008 must include the following statements on the balance sheet;

For the year ending ..... the company was entitled to exemption from audit under section 480 of the Companies Act 2006 relating to dormant companies.

Director's responsibilities:

- The members have not required the company to obtain an audit of its accounts for the year in question in accordance with section 476,
- The directors acknowledge their responsibilities for complying with the requirements of the Act with respect to accounting records and the preparation of accounts

A private company that qualifies as small should also include the following statement on the balance sheet:

‘These accounts have been prepared in accordance with the provisions applicable to companies subject to the small companies regime.’

### *Medium-sized companies*

Medium-sized companies with accounting periods starting on or after 06/04/2008;

- The balance sheet (and if appropriate, the directors' report) must contain a statement that the accounts are prepared in accordance with the special provisions in section 445(3) of the Companies Act in regards to medium-sized companies.
- The special auditor's report should state that in the auditor's opinion the company is entitled to deliver abbreviated accounts in accordance with section 445(3) of the Companies Act 2006 and that they have been properly prepared in accordance with the regulations made by the Secretary of State; as the case may be.

### *Accounts that include an auditor's report or special auditor's report*

If a company feels that the auditor or any other person is at risk of serious violence or intimidation as a result of the auditors' name being stated they may pass a resolution to omit the name. A copy of this resolution must not be submitted to Companies House but the auditor's report would need to contain the following statement ‘In accordance with section 506 Companies Act 2006 a resolution has been passed and notified to the Secretary of State.’

### **Limited liability partnerships**

Q: Can LLPs take advantage of the higher small/medium thresholds?

A: Yes. However, the higher thresholds for qualifying as small or medium will only apply to LLPs with accounting periods starting on or after 1st October 2008.

**Lecture A237 (8.20 Minutes)**

**Lecture A238 (17.31 Minutes)**

## **BULLETIN 2008/06 THE "SENIOR STATUTORY AUDITOR" UNDER COMPANIES ACT 2006**

### ***Introduction***

The Auditing Practices Board has issued Bulletin 2008/06 as guidance on Section 503(3) of the Companies Act 2006 which requires, where the auditor is a firm, that the auditor's report must be signed by the senior statutory auditor in his own name for and on behalf of the auditor.

The requirement for the senior statutory auditor to sign in his own name applies to auditor's reports for financial years beginning on or after 6 April 2008 and includes reports:

- prepared in accordance with the requirements of sections 495 (report on the company's annual accounts), 496 (report on whether the directors' report is consistent with the accounts) and 497 of CA 2006 (report on the auditable parts of the directors' remuneration report);
- in respect of voluntary revisions of annual accounts and reports made in accordance with section 454 of CA 2006; and
- on the special auditor's report where abbreviated accounts are delivered to the Registrar (section 449 CA 2006),

### ***Eligibility for appointment as "senior statutory auditor"***

Section 504(2) of CA 2006 requires that the person identified as senior statutory auditor of a company must be eligible for appointment as auditor of the company in question. Eligibility for appointment is dealt with in sections 1212 to 1225 of CA 2006.

### ***Meaning Of "senior statutory auditor"***

Subject to meeting the CA 2006 requirement described above, the APB have decided that the term "senior statutory auditor" has the same meaning as the term "engagement partner" when used in International Standards on Auditing (UK and Ireland).

ISA (UK and Ireland) 220 Quality Control for Audits of Historical Financial Information contains the following definition of "engagement partner":

*The partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.*

Where more than one partner is involved in the conduct of an audit engagement, it is important that the responsibilities of the respective partners are clearly defined and understood by the engagement team. In particular, it is necessary for it to be clearly understood which partner is designated as the engagement partner and is, therefore, the senior statutory auditor identified by the firm in accordance with section 504(1) of CA 2006.

### ***Meaning of "signing" the auditor's report***

Section 503 of CA 2006 requires that where the auditor is a firm, the auditor's report must be signed by the senior statutory auditor in his own name, for and on behalf of the auditor (i.e. the firm). The signature of the senior statutory auditor is also required to be dated. Section 505(1) further requires that the name of the senior statutory auditor must be stated in copies of the auditor's report published by, or on behalf of, the company.

The references in the above paragraph to "the auditor's report" refer to the report provided to the company by the auditor upon completion of the audit. The paragraph does not apply to the authentication of the copy auditor's reports required to be delivered to the Registrar. The senior statutory auditor does not necessarily need to sign copy auditor's reports that are required to be delivered to the Registrar. While such reports must show the name of the senior statutory auditor, they can, in fact, be signed by any person authorised to sign on behalf of the firm.

### ***Questions and answers on problem areas***

Question 1: What are the requirements if the audit firm changes the senior statutory auditor during the engagement?

Answer: The new senior statutory auditor must review the audit work performed to the date of the change. The review procedures must be sufficient to satisfy the new senior statutory auditor that the audit work performed to the date of the review has been planned and performed in accordance with professional standards and regulatory and legal requirements.

Question 2: What will be the implications if the senior statutory auditor is unable to be present to sign the auditor's report?

Answer: Under section 503(3) of CA 2006, the senior statutory auditor must sign the auditor's report. Another partner, or responsible individual, is not able to sign for and on behalf of the senior statutory auditor.

If the senior statutory auditor is unable to continue to take responsibility for the direction, supervision and performance of the audit the audit firm must appoint a replacement senior statutory auditor. The answer to Question 1 sets out the work that is then required.

If the senior statutory auditor is absent but is still able to, and does, take responsibility for the direction, supervision and performance of the audit the senior statutory auditor may sign the auditor's report using electronic means (e.g. e-mail or fax).

Question 3: What will be the implications if the auditor's report needs to be signed on a particular date and the senior statutory auditor is unable to be present to sign the auditor's report on that date?

Answer: The APB suggests that it would be pragmatic for the audit firm to have a contingency plan as to who would succeed as senior statutory auditor in the event that the audit is at an advanced stage but the senior statutory auditor is unable to sign the auditor's report.

If another audit partner is actively involved in the audit engagement, a suitable contingency plan may be for that other partner to work in parallel with the senior statutory auditor and be able to take over as senior statutory auditor if the need arises.

If no other partner has worked in parallel with the senior statutory auditor, then the APB is of the view that in such exceptional circumstances it is permissible for the engagement quality control reviewer to be appointed as the replacement senior statutory auditor where:

- (a) the engagement quality control reviewer has completed his or her review; and
- (b) the audit is at an "advanced stage" as defined by Bulletin 2008/2 which deals with the auditor's association with preliminary announcements.

This is subject to the condition that the engagement quality control reviewer is eligible to be appointed as the senior statutory auditor.

Once an engagement quality control reviewer has been appointed as a replacement senior statutory auditor he or she can no longer act as the engagement quality control reviewer because his or her objectivity may have been impaired through assuming the role of senior statutory auditor.

Question 4: Where a company appoints joint auditors, are there two senior statutory auditors?

Answer: Yes. Each of the auditing firms appoints a senior statutory auditor and both are required to sign the auditors' report in accordance with the requirements of section 503 of CA 2006.

**Lecture A234 (12.01 Minutes)**

## **NOTIFICATION OF CHANGE OF AUDITOR**

The Professional Oversight Board (POB) has published a press release giving more information concerning notification of changes of auditors to the appropriate audit authority.

Sections 522 to 525 of the Companies Act 2006 set new requirements on auditors and on companies to notify the “appropriate audit authority” when an auditor ceases to hold office. It is important to stress that both auditors and companies need to notify the “appropriate audit authority” and that there are significant differences in the detailed requirements on auditors and on companies.

These requirements came into force on 6 April 2008.

The POB have given guidance on the circumstances in which the Professional Oversight Board is the appropriate audit authority, how the notification to the POB should be made, and what it must cover. This is done by means of two flowcharts (one for audit firms and one for companies), with links to explanatory notes.

### ***Major Audit***

The audits of the following UK companies should be considered as “major audits” for the purposes of determining the notification requirements. For the avoidance of doubt, companies incorporated in the Crown Dependencies (Guernsey, Isle of Man, Jersey) are not UK incorporated companies.

1. All UK incorporated companies with equity and /or debt securities admitted to the official list (within the meaning of part 6 of the Financial Services and Markets Act 2000) on the date on which the auditors cease to hold office. Where the listed equity or listed debt has been issued by a separate entity within a group structure, the audit of any group accounts including the entity should be considered as a major audit. This includes PLUS-listed companies.
2. All UK incorporated AIM or PLUS-quoted companies
3. Unquoted companies, which have either:
  - a) Group turnover in excess of £500million; or
  - b) Group long term debt in excess of £250million and turnover in excess of £100million.

This category is intended to include companies or groups of companies that are privately owned, whether directly or through another UK or overseas investment vehicle, or trust. It is also intended to include those companies owned by private equity funds or other institutions. It is not intended to include subsidiaries of any other category in this list.

4. Unquoted companies or groups which are subsidiaries of foreign parent companies where the turnover of the UK group or company is in excess of £1,000 million.

This category is intended to cover major subsidiaries of overseas groups. If there are a number of separate subsidiaries trading in the UK and no UK group consolidated accounts are produced, this measure should be applied on an individual company basis.

5. Charitable companies with income exceeding £100million
6. Subsidiary companies of the above.

A subsidiary company of any of the above companies may be treated as a “major audit”. This avoids the need in the case of groups to notify different audit authorities in respect of different companies in the group.

***Notification to the POB***

The notification by the auditors or by the company should be sent to the POB either in hard copy or by E-mail, as follows:

In hard copy to:

Change of Auditor Notifications  
Professional Oversight Board  
5th Floor, Aldwych House  
71 - 91 Aldwych  
London  
WC2B 4HN

By E-mail to [auditorchange@frc-pob.org.uk](mailto:auditorchange@frc-pob.org.uk)

The auditors must notify the POB at the same time as they deposit the section 519 statement at the company's registered office.

The company must notify the POB not later than 14 days after the date on which the auditor's statement has been deposited at the company's registered office.

There is no statutory format for notifying change of auditor to the POB. However, it should be clear, whether this is sent electronically or by post, who has signed the notification, and in what capacity, giving contact details in case of a query. The notification should include the year end of the company's last audited accounts, the company number and the address of the registered office.

If the notification is by E-mail this should be in the form of an electronic copy of a letter.

The notification must be accompanied by a statement as indicated below.

In the case of a group of companies, where the auditor of the parent company and of subsidiary companies are the same and cease their appointment at the same time, the auditors and the company can meet their obligations by a single statement accompanied by a list of the companies to which it applies, which should also, if appropriate, set out different reasons for the cessation in respect of different companies in the group.

***Notification to the Recognised Supervisory Body***

For audits other than major audits the appropriate audit authority is not the Professional Oversight Board but the auditor's Recognised Supervisory Body (RSB). The RSB is the body with which the audit firm is registered and which is responsible for the direct regulation of that audit firm.

The ICAEW have issued guidance on this subject. This guidance is largely repetitive of the POB guidance and, where that is the case, the guidance is not repeated here.

The ICAEW say that notification should be made to the following address:

Change of Auditor Notifications  
Quality Assurance Department  
ICAEW  
Metropolitan House  
321 Avebury Boulevard  
Milton Keynes  
MK9 2FZ  
e-mail: [auditorchange@icaew.com](mailto:auditorchange@icaew.com)

The ICAEW state that they assume that the auditors will want to notify the Institute at the same time they deposit the S519 statement at the company's registered office, so that the matter is dealt with. Otherwise,



notification can be made at any time but at the latest, it must be made with the annual return covering the period in which the cessation took place.

By contrast, the company must notify by 14 days after the date on which the auditor's statement has been deposited at the company's registered office.

#### ***Accompanying Statement by Auditor***

Section 522(2) requires that the notice by the auditor to the POB (or the RSB) that he has ceased to hold office in respect of a major audit is accompanied by

- (i) the statement they have deposited at the company's registered office in accordance with section 519, and
- (ii) where the statement is to the effect that there are no circumstances in connection with ceasing to hold office, a statement of the reasons for ceasing to hold office.

#### ***Accompanying Statement by Company***

Section 523(2)(b) requires that the notice by the company to the POB that the auditor has ceased to hold office in respect of a major audit is accompanied by

- (i) a statement by the company of the reasons for the auditor ceasing to hold office  
or
- (ii) if the statement by the auditor deposited at the company's registered office in accordance with section 519 contains a statement of circumstances in connection with the auditor's ceasing to hold office that need to be brought to the attention of members or creditors, a copy of that statement.

#### ***Other comments***

1. The auditor must notify the appropriate audit authority:
  - For major audits: where an auditor ceases to hold office for any reason
  - For an audit which is not a major audit: where an auditor ceases to hold office before the end of his term of office
2. The company must notify the appropriate audit authority where an auditor ceases to hold office before the end of his term of office.
3. For a company other than a quoted company, if the auditor considers there are no circumstances in connection with his ceasing to hold office that need to be brought to the attention of members or creditors of the company, he must deposit at the company's registered office a statement to that effect. (S519(2))
4. For auditors of quoted companies, there is no facility for there to be a statement of no circumstances.
5. The auditor therefore needs to ask the following four questions in deciding what action is required:
  - i. Is the company quoted?
  - ii. Is the audit a major audit?
  - iii. Did the auditor cease to hold office before the end of his term of office?
  - iv. Does the statement of circumstances refer to any circumstances or is it a statement of no circumstances?

**Lecture A236 (9.11 Minutes)**

## ISA 600 (REVISED): USING THE WORK OF ANOTHER AUDITOR

### *Introduction*

The APB has issued a revision of ISA (UK and Ireland) 600, 'Using the work of another auditor'. This is effective for audits of financial statements for periods commencing on or after 6 April 2008.

The main effect of the revision is to add a new paragraph 14-1:

**In the UK and Ireland, the principal auditor should document any review that it undertakes, for the purpose of the group audit, of the audit work conducted by other auditors.**

This change has been made to reflect a new requirement in Schedule 10, paragraph 10A, of the Companies Act 2006, implementing a provision of the European Statutory Audit Directive.

In these notes, we will take the opportunity to remind readers of the other "bold print" requirements of the ISA. Note that the ISA has not, at this stage, been amended to reflect the changes in the clarity project – that will come later.

The purpose of the ISA is to establish standards and provide guidance when an auditor, reporting on the financial statements of an entity, uses the work of another auditor on the financial information of one or more components included in the financial statements of the entity.

**When the principal auditor uses the work of another auditor, the principal auditor should determine how the work of the other auditor will affect the audit.**

The ISA provides the following definitions:

"Principal auditor" means the auditor with responsibility for reporting on the financial statements of an entity when those financial statements include financial information of one or more components audited by another auditor.

"Other auditor" means an auditor, other than the principal auditor, with responsibility for reporting on the financial information of a component which is included in the financial statements audited by the principal auditor. Other auditors include affiliated firms, whether using the same name or not, and correspondents, as well as unrelated auditors.

"Component" means a division, branch, subsidiary, joint venture, associated company or other entity whose financial information is included in financial statements audited by the principal auditor.

### *Acceptance as Principal Auditor*

**The auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor.**

The issues to consider include the materiality of the part of the group audited by the principal auditor and the risk of material misstatements in the financial statements of components audited by other auditors. The relationship of the principal auditor with other auditors will also be relevant.

### **The Principal Auditor's Procedures**

**When planning to use the work of another auditor, the principal auditor should consider the professional competence of the other auditor in the context of the specific assignment.**

If the principal auditor and the other auditor are affiliated, then this will be relevant in considering competence.

**In the UK and Ireland, when planning to use the work of another auditor, the principal auditor's consideration of the professional competence of the other auditor should include consideration of the**

**professional qualifications, experience and resources of the other auditor in the context of the specific assignment.**

**The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment.**

The principal auditor would advise the other auditor of:

- Independence requirements - and obtain written representation as to compliance with them
- The use that is to be made of the other auditor's work and report - which would include areas requiring special consideration and the timetable for completion of the audit
- The accounting, auditing and reporting requirements - and obtain written representation as to compliance with them.

Depending on the principal auditor's knowledge of the professional competence of the other auditor, the principal auditor might:

- Discuss with the other auditor the audit procedures applied, or
- Review a written summary of the other auditor's procedures (which may be in the form of a questionnaire or checklist), or
- Review working papers of the other auditor, or
- Conclude that such procedures are unnecessary because of previous knowledge concerning the quality of the work of the other auditor.

**The principal auditor should consider the significant findings of the other auditor.**

This may involve discussion with the other auditor and the management of the component or the principal auditor may decide that additional audit work is required.

The principal auditor would document in the audit working papers:

- The components whose financial information was audited by other auditors and their significance to the financial statements of the entity as a whole
- The names of the other auditors
- Any conclusions reached that individual components are immaterial.
- Procedures performed and conclusions reached. This would include identification of the working papers of the other auditor that have been reviewed and a record of the results of discussions with the other auditor.

**In the UK and Ireland, the principal auditor should document any review that it undertakes, for the purpose of the group audit, of the audit work conducted by other auditors.**

#### *Co-operation Between Auditors*

**The other auditor, knowing the context in which the principal auditor will use the other auditor's work, should co-operate with the principal auditor.**

There are a number of “plus” paragraphs which deal with the statutory requirements relating to companies incorporated in the UK and Ireland. These refer to the following issues:

- Whether there is a statutory obligation on the other auditor, and the component, to provide the principal auditor with information and explanations – and the implications if there is no such statutory obligation
- Communication with the principal auditor by the other auditor
- The other auditor's sole responsibility for the audit opinion on the financial statements of the component and therefore the need for the other auditor to plan and perform the audit without placing reliance on the principal auditor

- There is no obligation on the principal auditor to provide information to the other auditor. If the principal auditor identifies matters which may be relevant to the other auditor's work, they will discuss and agree an appropriate course of action with those charged with governance of the entity which they audit.

### *Reporting Considerations*

**When the principal auditor concludes that the work of the other auditor cannot be used and the principal auditor has not been able to perform sufficient additional procedures regarding the financial information of the component audited by the other auditor, the principal auditor should express a qualified opinion or disclaimer of opinion because there is a limitation in the scope of the audit.**

If the other auditor issues, or intends to issue, a modified auditor's report, the principal auditor would consider the impact of this on the principal auditor's report.

When the principal auditor is satisfied that the work of the other auditors is adequate for the purposes of the audit, no reference to the other auditors is made in the principal auditor's report.

### *Division of Responsibility*

The ISA refers to the situation where local regulations permit a principal auditor to base the audit opinion on the financial statements taken as a whole solely upon the report of another auditor regarding the audit of one or more components. The ISA includes the following bold-print paragraph:

**When the principal auditor does so, the principal auditor's report should state this fact clearly and should indicate the magnitude of the portion of the financial statements audited by the other auditor.**

However, in the UK and Ireland the principal auditor has sole responsibility for the principal auditor's audit opinion and a reference to the other auditor in the principal auditor's report may be misunderstood and interpreted as a qualification of the principal auditor's opinion or a division of responsibility, which is not acceptable.

### *Effective Date*

The ISA is effective for audits of financial statements for periods commencing on or after 15 December 2004. The requirement in paragraph 14-1 is effective for audits of financial statements for periods commencing on or after 6 April 2008.

## ACCESS TO WORKING PAPERS

An amendment has been made to Schedule 10 of the Companies Act 2006. This requires that Recognised Supervisory Bodies must have adequate rules and practices designed to ensure that a person ceasing to hold office as a statutory auditor makes available to his successor in that office all relevant information which he holds in relation to that office. (CA 2006 Schedule 10 (9)(3)(c)).

The audit regulations and guidance have now been amended to give effect to this requirement. Matters arising include:

- The new regulation applies in respect of appointments for the audits of financial years starting on or after 6 April 2008.
- Information is for the purposes of the successor's audit and must not be disclosed to a third party unless the successor is required to do so by a legal or professional obligation. Third party includes the client – although the successor may discuss the information with the client where to do so is a necessary part of the audit work.
- BERR has confirmed its view that the Act does not alter the existing liability of each auditor in relation to its respective audit.
- The request by the successor auditor can only be made after formal appointment. The provision of information should be on a timely basis.
- The request must be in writing.
- The successor should consider the need for a request and the extent of that request. The successor should not request unnecessary information. There are references to reviewing the predecessor's audit work in ISA 510 (opening balances), ISA 710 (comparatives) and ISA 300 (planning) so information is likely to be necessary for these purposes.
- The successor should try to be as specific as possible in making a request and should avoid, wherever possible, a request for "all relevant information".
- Where the audit is an audit of financial statements, then ISAs will indicate the working papers to be prepared. It does not matter whether those working papers are filed on the current audit file, a permanent file or a systems file.
- The predecessor should be prepared to assist the successor by providing oral or written explanations on a timely basis.
- The period for which information is requested would normally be the period in respect of the last audit report signed by the predecessor and would include any subsequent interim review. If the successor considers that it needs information from a previous period then they should be prepared to provide a list of precisely what information is required and give reasons which demonstrate why such additional information is "relevant" in accordance with the regulations.
- It would be usual for the basis on which the information is to be provided to be documented in writing by an exchange of letters between the two auditors, copied to the audited entity. Guidance on suitable letters is to be provided in a technical release (see below).
- There is no obligation to allow copying of working papers but it would be usual to allow copying of extracts of the books and records of the audit client that are contained in the audit working papers.

- A request for information under the Regulation should not be made other than in connection with the successor's audit. The successor should refuse to accept an additional engagement, such as to act as an expert witness or to review the quality of the predecessor's audit work, where the engagement would involve the use of the information obtained by it under the Regulation. In any event, the successor should not comment on the quality of the predecessor's audit work unless required to do so by a legal or professional obligation.

The Audit and Assurance Faculty of the ICAEW will issue further guidance on this topic in due course.

**Lecture A235 (16.40 Minutes)**

## **OTHER CHANGES TO AUDIT REGULATIONS**

Audit news (Issue 43) draws attention to a number of changes in the audit regulations concerning conduct of audit work. These include:

- A UK monitoring unit may ask to see audit working papers of subsidiaries of UK companies where those subsidiaries are based outside the EEA. This means that firms need arrangements in place with the overseas firm to access its papers if requested.
- If requested by an oversight body from outside the EEA, a registered auditor must provide a copy of its own working papers. Such a request would come via the UK oversight authorities.
- Firms must inform their RSB if they acquire a major audit client or if an existing client becomes a major audit client. This is because such audits are subject to review by the Audit Inspection Unit. The term “major audit” is defined on the website of the Professional Oversight Board. Large firms can seek a dispensation from this requirement on the grounds that the AIU is already closely involved with such firms.
- Firms should take prompt action to deal with any issues arising from their annual compliance review.

## APB ETHICAL STANDARDS: KEY CHANGES

### *Introduction*

The Auditing Practices Board (APB) has published revised Ethical Standards for Auditors (ESs), which become effective for audits of financial statements for periods commencing on or after 6 April 2008. This follows a review of the ESs by the APB which concluded that there is currently no need to make major changes to the standards, except for amendments which:

- are needed to comply with UK and Irish legislation that implements the EU Statutory Audit Directive;
- are required in order that the ESs continue to adhere to the principles of international ethical standards;
- add clarity to the existing standards and assist their implementation in practice.

One of the particular issues on which the APB requested views in its consultation paper related to the period for rotation of the audit engagement partner on listed company audits. Responses demonstrate that there is not yet a consensus between auditors, corporates and investors on whether this should be extended from five years to seven years. The APB believes that a further period of dialogue with interested parties is needed on this topic. Accordingly the APB has decided to undertake further work on rotation periods together with addressing a small number of additional issues as a separate exercise later in 2008 and will consult on any resulting changes to the ESs.

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

#### **Main amendments**

1. The revised ES1 adopts the definition of network firms included in the IFAC code of ethics. The IFAC code requires all network firms to be independent of the entities audited by other network firms. ES1 indicates that international audit networks commonly meet this requirement through global independence policies and procedures. These procedures are then monitored across the network.
2. The discussion in ES1 of management responsibility is extended and the standard clarifies that partners and employees of the firm, including those providing non-audit services to the client, must not take decisions that are the responsibility of management.
3. Ethical standards contain some requirements that only apply to listed entities. There is a cross-reference to these requirements in paragraph 41 of ES1. The standard then goes on to say that the firm should establish policies and procedures which set out the circumstances in which these additional requirements apply to other clients for example on the grounds of size, nature of the business or number of stakeholders.

#### **Practical problem areas in applying ES1**

- Most firms will have a set of fully documented procedures but this does not guarantee that partners and staff will be aware of those procedures.
- Partners and staff may not understand how the threats identified by the APB relate to their day to day work. In particular, staff not involved in audit work may either be unaware of the requirements of ethical standards or assume that the standards are only concerned with audit work and therefore do not apply to them.
- Partners providing non-audit services to clients may be unwilling to accept the need to inform the engagement partner that they are providing such services.
- Many firms do not inform the client of “all significant facts and matters that bear on the auditor’s independence and objectivity”



**ES2 Financial, business, employment and personal relationships**

**Main amendments**

1. Generally, the prohibition from holding a financial interest in the audit client applies to the firm, any partner in the firm, a person in a position to influence the conduct and outcome of the audit or an immediate family member of such a person. The revised ES2 relaxes this requirement for a family member of a partner who is not involved in the audit where the interests of the family member arise from their employment or a contractual business arrangement.
2. Only short term loan staff assignments are permitted and these should not be for prohibited non-audit services. The rules also state that the audit firm should not enter into an agreement with an audit client to provide a partner or employee to work for a temporary period unless the audit client:
  - (a) agrees that the individual concerned will not hold a management position, and
  - (b) acknowledges its responsibility for directing and supervising the work to be performed, which will not include such matters as:
    - making management decisions; or
    - exercising discretionary authority to commit the audit client to a particular position or accounting treatment.
3. ES2 has been changed slightly in the standard dealing with the situation where a partner (ie audit engagement partner, engagement quality control reviewer, key partner involved in the audit or partner in the chain of command) joins the audit client as a director or in a key management position. As before, the audit firm must resign as auditor and not accept re-appointment for a period of at least two years or, if sooner, when the former partner ceases employment with the former client. The start of the two year period is now measured from the date when the former partner ceased to have an ability to influence the conduct and outcome of the audit.
4. In dealing with the above situation, the standard also cross-refers to the requirement in UK legislation that RSB's must have adequate rules and practices to ensure that a key audit partner is prohibited from being appointed as a director or other officer to a public interest audit client for a period of two years commencing on the date on which his work as key audit partner ended.

**Practical problem areas in applying ES2**

- Partners and staff do sometimes acquire interests in clients as a result of inheritance or trusteeships. The requirements of ES2 must be considered very carefully and there may be no alternative to either disposal of the interest or resignation as auditor.
- Firms have had problems in the past in deciding whether it is acceptable to trade with clients. ES2 has now been clarified by permitting such situations where the business relationship is clearly inconsequential to both parties (in the opinion of a reasonable and informed third party).
- It is now very difficult to second partners or staff to the audit client without infringing the rules of the standard.
- ES2 continues to require that partners or senior staff should notify the audit firm of any situation involving their potential employment with an audit client. (for other staff this requirement only takes effect when employment is "probable"). Partners and staff may be unaware of this requirement or may be unwilling to comply with it.

### ***ES3 Long association with the audit engagement***

#### **Main amendments**

1. The requirement for rotation time-out has been amended to specify that the individual should have no participation in the audit during that period.

#### **Practical problem areas in applying ES3**

- Some firms do not monitor the length of time they have acted for a client. Similarly, long service by a partner or senior staff member is often not recorded.
- The standard says that once an audit engagement partner has held this role for a continuous period of ten years, careful consideration is given as to whether a reasonable and informed third party would consider the audit firm's objectivity and independence to be impaired. The standard does not demand rotation of the partner at this point but, in the absence of rotation, requires either safeguards to be applied or, in the absence of safeguards, the audit firm must document the reasons why the partner continues to participate in the audit engagement without safeguards and these facts are communicated to those charged with governance of the client.

### ***ES4 Fees, remuneration and evaluation policies, litigation, gifts and hospitality***

#### **Main amendments**

1. ES4 now includes the requirement that the audit engagement partner shall ensure that audit fees are not influenced by the provision of non-audit services to the audited entity.
2. There is clarification that, in the fee dependency calculation, a sole practitioner can include all earned income.

#### **Practical problem areas in applying ES4**

- The fees from an individual client comprise the total of audit and non-audit fees from the client and its subsidiaries. These are calculated as a percentage of the annual fee income of the audit firm or the part of the firm by reference to which the audit engagement partner's profit share is calculated.
- The quality control review where this percentage exceeds 10% is required to be an external independent quality control review.
- The 15% fee limit cannot be broken, but this only refers to recurring fees. It is still possible to undertake one-off assignments for a client which would push the fee income from that client above the 15% limit.
- The objectives of the members of the audit team must not include selling non-audit services to the audited entity. Similarly, remuneration and promotion must not be based on success in selling non-audit services to the audit client. It is permitted, however, to encourage staff to identify areas where clients may benefit from non-audit services.

### ***ES5 Non-audit services provided to audited entities***

#### **Main amendments**

1. There is clarification about the meaning of the term "informed management". As before, there must be a member of the client's management that has been designated to receive the results of the non-audit service and has been given the authority to make any necessary decision; the auditor must be satisfied that this individual has the capability to make such decisions. The new element of informed management is that the results of the non-audit service are communicated to management with an objective analysis of the issues, and management makes those decisions.

2. The requirement concerning valuations provided to listed companies has been strengthened. Whereas, in the previous version of ES5, the prohibition related to services involving both a significant degree of subjective judgment and a material effect on the financial statements. The new requirement (applying only to listed companies) contains only the condition relating to materiality.

### **Practical problem areas in applying ES5**

- ES5 covers a wide range of non-audit services including information technology, valuation, litigation support, tax, recruitment services and corporate finance as well as accounting services. It is this wide range of services that can cause problems since staff providing such services are not necessarily aware of the requirements of the standards.
- As mentioned above, there is often a failure to notify the audit engagement partner.
- If a safeguard cannot be put in place then either the non-audit work must be refused or the firm must resign from the audit.
- Where there is a management threat, the audit firm must document its assessment of whether there is informed management.
- For entities other than listed companies, the auditor may provide accounting services as long as such services do not involve initiating transactions or taking management decisions and are of a technical, mechanical or informative nature. Appropriate safeguards must then be applied to reduce the self-review threat to an acceptable level. Many firms will use the safeguard whereby the accounting work is performed by staff not involved in the audit. If this safeguard is not available then ES5 suggests that an alternative is for a suitable person not involved in the audit to perform a review of the accounting services or the audit.

### ***ES Provisions available for small entities (ES PASE)***

#### **Main amendments**

1. The exemption now applies to small companies and groups as defined in the Companies Act. Previously, the rule in ES PASE had not matched with the Companies Act in the application of the years rule.
2. A charity is a small entity if its income is less than the turnover limit for small companies.
3. A pension fund is a small entity if it has less than 100 members (previously 1,000).

#### **Reminder of the relaxations available under ESPASE**

- There is no need for an external quality control review where the client is expected to regularly provide more than 10% of the firm's or partner's fee income.
- When undertaking non-audit services, the audit firm is not required to apply safeguards to address a self review threat provided:
  - (a) the audit client has 'informed management'; and
  - (b) the audit firm extends the cyclical inspection of completed engagements that is performed for quality control purposes.
- The audit firm is not prohibited from providing non-audit services that involve the audit firm undertaking part of the role of management, provided that:

- (a) it discusses objectivity and independence issues related to the provision of non-audit services with those charged with governance confirming that management accept responsibility for any decisions taken; and
  - (b) it discloses the fact that it has applied this Standard as indicated below.
- The audit firm is not prohibited from providing tax services to an audit client where this would involve acting as an advocate for the audit client, before an appeals tribunal or court in the resolution of an issue provided that it discloses the fact that it has applied this Standard as indicated below.
  - In a situation where a former partner is appointed as a director or to a key management position with an audit client, having acted as audit engagement partner (or as an independent partner, key audit partner or a partner in the chain of command) at any time in the two years prior to this appointment, the firm is not required to resign as auditors provided that:
    - (a) it takes appropriate steps to determine that there has been no significant threat to the audit team's integrity, objectivity and independence; and
    - (b) it discloses the fact that it has applied this Standard as indicated below.
  - The drawback in taking advantage of some of the reliefs provided by ES-PASE is that the auditors' report must disclose that relief has been taken and either the financial statements, or the auditors' report, must disclose the type of non-audit services provided to the audit client or the fact that a former audit engagement partner has joined the client.

### *Glossary of terms*

#### **Main amendments**

1. The definition of “Key partner involved in the audit” has been changed to meet the requirements of the Statutory Audit Directive.

The new definition is:

“A partner, or other person in the engagement team (other than the audit engagement partner or engagement quality control reviewer) who either:

- is involved at the group level and is responsible for key decisions or judgments on significant matters or risk factors that relate to the audit of that audited entity, or
- is primarily responsible for the audit of a significant affiliate or division of the audited entity.”

2. Listed company is now defined to include AIM and PLUS markets.
3. The definition of network firm has been amended to bring it into line with SAD and IFAC. The new definition is:

Any entity which is part of a larger structure that is aimed at cooperation and which is:

- I. Controlled by the audit firm; or
- II. Under common control, ownership or management; or
- III. Part of a larger structure that is clearly aimed at profit or cost sharing; or
- IV. Otherwise affiliated or associated with the audit firm through common quality control policies and procedures, common business strategy, the use of a common name or through the sharing of significant common professional resources.

#### **Lecture A240 (32.58 Minutes)**

## **UPDATE ON CURRENT ASB PROJECTS (INSIDE TRACK 55)**

### ***FRED 40: Heritage Assets***

The ASB has accepted that it is difficult to find a better accounting solution than that contained in the current FRS 15. We can conclude from this statement that the ASB will not be pursuing their plans to require heritage assets to be included in the balance sheet at valuation. They will be issuing a new exposure draft requiring enhanced disclosures.

### ***Proposed FRSSE Update***

The ASB will be issuing an updated version of FRSSE to reflect changes arising from Companies Act 2006. The new FRSSE will apply for accounting periods beginning on or after 6 April 2008 and cannot be adopted early.

The following are reported to be the most important changes:

- An increase in the thresholds for qualifying as a small company
- A requirement to report separately political donations and charitable donations and an increase in the threshold for reporting these donations to £2,000.

There are no changes in FRSSE 2008 arising from accounting standards.

### ***The future application of UK GAAP***

In Inside Track, Issue No 54, Ian Mackintosh, the chairman of the ASB, expressed the view that there was no longer a case for retaining two sets of GAAP. He said that the debate had now moved on to whether there should be a three-tier or two tier system of reporting.

A three-tier system would see listed companies, and perhaps other large or important entities, applying full IFRS; unlisted companies other than the smallest would apply the IFRS for SMEs; and the smallest layer would continue to apply the FRSSE, amended to align with IFRS. A two-tier system would apply the IFRS for SMEs to both those last two categories.

An article in Inside Track 55 updates this position and reports that the ASB will be issuing a discussion paper later this year which will propose a three tier reporting structure. The ASB are still considering which entities would fall within each tier.

One comment that might be significant is that, according to the article, the smallest tier would follow the Board's FRSSE – there is no mention in this new article of aligning the FRSSE with IFRS.

## **CHANGES FOR CHARITABLE COMPANIES**

### ***Introduction***

The following regulations have been brought in for financial years commencing on or after 1 April 2008:

- The Companies Act 2006 (Commencement Order No. 6) – SI2008/674
- The Charities Act 2006 (Charitable Companies Audit and Group Accounts Provisions) – SI2008/527

31 March is a popular year end for charities and therefore the commencement date of 1 April 2008 is significant.  
***SI 674***

This SI brings into force s1175 and Part I of Schedule 9 Companies Act 2006 (CA 06) and applies for financial years of charitable companies commencing on or after 1 April 2008.

The effect of the Regulations is to remove the special provisions concerning charitable companies from Companies Act 1985 (CA 85). CA 06 does not contain any special provisions applicable to charitable companies. The CA 06 provisions concerning accounts and audit are applicable for financial years commencing on or after 6 April 2008. Therefore the change to the CA 85 only affects financial years commencing in a small time frame, from the 1st to 5th April.

Therefore the following are removed from CA 85:

S249A – the requirement for a reporting accountant’s report, any reference to report conditions, and reference to charitable companies;

S249B – reference to charities in the section concerning group turnover when assessing whether the companies in a small group are entitled to audit exemption;

S249E – the requirement to file the reporting accountants report with the Registrar of Companies (regardless of the format filed, i.e. shareholder accounts or abbreviated accounts), the right of a member to receive a copy of the report with the accounts;

S240 – the requirement to include the reporting accountant’s report when a charitable company publishes its accounts.

Therefore under companies’ legislation a charitable company has the same criteria for audit exemption as any other company. However, for those that satisfy the requirements for audit exemption they will need to comply with the changes to s43 Charities Act 93 (Ch A 93). For those that are not entitled to audit exemption under companies’ legislation an audit will be required in accordance with either the CA 85 or CA 06.

### ***SI 527***

The elements of this SI which are considered in these notes apply to financial years commencing on or after 1 April 2008.

Charitable companies subject to audit under companies’ legislation are not required to comply with s43 Ch A 93. This is a change from the previous 43(9) which exempted all charitable companies from the provisions of s43.

It is interesting to note that all of the references in the SI are to the requirements under Part VII CA 85. There are no references to the CA 06 despite the fact that Part VII CA 85 is being replaced by Parts 15 and 16 CA 06 from 6 April 2008.

The assumption, therefore, is that in due course, further amendments will be made to apply s43(9) to the new regime.

From financial years commencing on or after 1 April charitable companies not required to be audited under CA 85 will apply the same requirements as other charities under s43. This is summarised in the following tables:

**Audit**

	<i>Periods commencing before 27/2/07</i>	<i>Periods commencing on or after 27/2/07 but before 1/4/08</i>	<i>Periods commencing on or after 1/4/08</i>
<b>Unincorporated charity</b>	Gross income or expenditure >£250k in current or 2 preceding years	Gross income >£500k in current year or Gross assets >£2.8m and Gross income >£100k in current year	
<b>Incorporated charity</b>	Gross income >£250k or Gross Assets >£2.8m or does not qualify as small	Gross income >£500k or Gross Assets >£2.8m or does not qualify as small	As unincorporated charity as long as company qualifies for audit exemption

**Independent Examination**

	<i>Periods commencing before 27/2/07</i>	<i>Periods commencing on or after 27/2/07 but before 1/4/08</i>	<i>Periods commencing on or after 1/4/08</i>
<b>Unincorporated charity</b>	Gross income >£10k but <£250k and not >£250k in current or 2 preceding years	Gross income >£10k but <£500k Qualified independent examiner if gross income >£250k	
<b>Incorporated charity</b>	Gross income >£90k but <£250k and meets other criteria for audit exemption (s249D report)	Gross income >£90k but <£500k and meets other criteria for audit exemption (s249D report)	As unincorporated charity as long as company qualifies for audit exemption

The following should be noted in respect of the above:

- Where the income is up to £250,000 the independent examiner is not required by law to have qualifications or to be a member of any particular body. The requirement is that they should be independent. The Charity Commission comments as follows in CC63a:

*Whilst not all examiners have to hold a professional accountancy qualification, the trustees must always appoint a person suitable for the circumstances of the charity. Where the accounts are prepared on the accruals basis in accordance with the 2005 Regulations, a commensurate understanding of accountancy principles and accounting standards will still be needed. Experience of charity administration and accounting is desirable.*

*It is the responsibility of the trustees to satisfy themselves that their independent examiner is appropriately experienced or qualified to undertake the independent examination,*

- Where the income exceeds £250,000, the examiner must be a member of a professional body. These are now listed in s43(3A) as follows:



Institute of Chartered Accountants in England and Wales	Institute of Chartered Accountants of Scotland
Institute of Chartered Accountants in Ireland	Association of Chartered Certified Accountants
Association of Authorised Public Accountants	Association of Accounting Technicians
Association of International Accountants	Chartered Institute of Management Accountants
Institute of Chartered Secretaries and Administrators	Chartered Institute of Public Finance and Accountancy; or
A Fellow of the Association of Charity Independent Examiners.	

3. All auditors have to be qualified to act as an auditor of a company.
4. The Ch A 93 has two measures to determine whether the charity is required to be audited. One based only on income, the other if both the income and balance sheet criteria are exceeded.

**Questions concerning the above changes**

*What happens to the reporting accountant’s report?*

For financial years commencing on or after 1 April 2008 it no longer applies. Practitioners will need to update procedures accordingly. Engagement letters referring to the report conditions will need to be revised to reflect the new requirements. Practitioners will need to apply the procedures for an independent examination in future periods. There is information available in CC63a, on the Charity Commission website. This includes directions issued by the Charity Commission on what work should be completed by the examiner.

*Who receives the examiner’s report?*

There is no specific reference to the situation regarding charitable companies. No distinction has been made so the publication requirements of the report are the same as would apply to other charities.

No specific consideration has been given to the different nature of charitable companies and the fact that members of such organisations have a statutory right to receive certain information.

As noted above a member was entitled to receive the reporting accountants report under s238 (in place of the audit report, reference s249E). In addition the company was required to file the reporting accountants report with the Registrar (s242 as required by s249E). Members will still be entitled to receive the accounts but since there is no reference to the examiner’s report this does not have to be provided.

Ch A 93 s45 requires the examiner’s report to be sent to the Charity Commission. Ch A 93 s47 requires it to be included should a person request a copy of the charity accounts. However, s47 also allows the trustees to charge a fee for this whilst members would receive the accounts as of right. It appears that the distinct difference between charitable companies and other charities - the fact they have members who are entitled to receive information - has been overlooked at this stage.

*How will the changes be reflected when the CA 06 provisions are in force?*

At the present time all the references are to CA 85. Presumably, in time, further Regulations will be issued which will refer to the CA 06.

*If the company is above the audit threshold of the Ch A 93 but within the audit exemption criteria of the CA 85/06 what is the basis of the auditors’ appointment?*

This issue is important to the auditor. The audit report normally refers to the basis of the appointment as would the engagement letter. In addition audits under the CA85/06 require the auditor to give an opinion on the directors’ report. Ch A 93 does not include any equivalent requirement.

The Regulations as passed are far from clear on this issue.

Changes made to s45(5) imply the following. By way of information s45(5) states the requirements in respect of documents to be delivered to the Commission. The requirement to send accounts prepared under Part VII CA 85 are not changed. However, what accompanies those accounts has been amended. Previously the requirement was to attach either the audit report or reporting accountant's report. This has been changed to:

- An audit report under Part VII CA 85, no change to previous;
- If the accounts have been audited under s43 Ch A 93, a copy of that report;
- If the accounts have been examined under s43, a copy of the examiner's report.

The first and last above are straight forward. It is the middle requirement that raises some issues. This implies that the auditors' appointment will be in accordance with the Ch A 93 and not CA 85 (unless the charity exceeds the exemption thresholds in CA 85). This would imply the company has taken advantage of audit exemption under the CA 85, otherwise there would be no reason to include this reference. If the company has taken advantage of audit exemption then s249B(4) requires a balance sheet statement, as is the case for any company taking advantage of audit exemption. It appears illogical for the balance sheet statement to be included, which refers to audit exemption under CA 85, and for an audit to be completed under Ch A 93. Having a disclosure in one place that indicates audit exemption, with an audit report attached is likely to be misleading.

If the auditor is reporting in accordance with Ch A 93 then there is no requirement to include an opinion on the directors' report.

Section 235 requires the auditors to give a report on all accounts during their tenure of office. It makes no reference to the basis of their appointment. On this basis the auditor is still appointed under CA 85 provisions but the requirement for the audit is under Ch A 93. If this is correct then this middle aspect would never arise.

### ***Group accounting***

There are changes for charitable companies which are parent undertakings for financial years commencing on or after 1 April 2008. Schedule 5A Ch A 93 as included in the Ch A 06 did not apply to charitable companies. This has been amended to include charitable companies within these provisions.

The threshold for the preparation of group accounts is aggregate gross income exceeding £500,000 (SI 2008/629). Although the term gross is used Regulation 9 states that all group transactions are eliminated in calculating the value. The income of all subsidiaries are included, whether they are charities or not.

**Lecture A241 (10.38 Minutes)**

## INTRODUCTION TO CLARITY – THE NEW AUDITING STANDARDS

### *Background*

Clarity is coming! The International Auditing and Assurance Standards Board (IAASB) have announced that they plan to adopt the new clarified International Standards in Auditing (Clarified ISAs) from periods commencing 14 December 2009. It is more than likely (although it is yet to be confirmed) that the UK Auditing Practices Board (APB) will adopt these standards at the same time.

### *What is Clarity?*

On 31 October 2005 the IAASB announced that it intended 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.

Clarification of the standards is not the same as revision of the standards, although some standards have also been revised as well as clarified. However, clarity might mean auditors doing things differently and will almost certainly require fuller documentation to demonstrate compliance with the standards. In essence the changes are driven by a new drafting convention:

- introduction – i.e. scope, effective date
- objective – brief explanation of purpose
- definitions – key words that undefined may confuse
- requirements – regulators will expect these to be done
- application and other explanatory material

### *Requirements*

One of the most spoken about changes is the use of the word “shall”. This word is used throughout the clarified Standards and indicates a requirement of the Standards. It replaces the paragraphs previously using the present tense which confused many auditors because it was unclear how imperative it was to follow such requirements. The Exposure Draft of ISA 200 (Revised and Redrafted) “Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing” issued by IAASB in May 2007 says:

“20. The ISAs, taken together, are designed to support the achievement of the overall objective of the auditor. Accordingly, the auditor shall comply with all ISAs relevant to the audit. An ISA is relevant to the audit when the ISA is in effect and the circumstances addressed by the ISA exist.”

### *Requirements and guidance*

The auditing standards currently applicable (ISAs UK and Ireland) contain bold text indicating a requirement and grey text indicating guidance. Under clarity this distinction is no longer relevant. The auditor has to read the whole standard in order to understand/interpret the requirements. See again the clarified ISA 200:

“21. The auditor shall consider the entire text of an ISA to understand its requirements. The nature of the ISAs requires the auditor to exercise professional judgment in applying them.”

### ***Current status of the project in the UK***

The UK APB has not yet announced its intentions regarding adoption of clarity but it is currently consulting upon clarified standards.

What seems most likely is that the UK will adopt the clarified standards at the same time as the IAASB (pc 15 December 2009). Also, the current arrangement of “pluses” is likely to end. The APB currently enhance the ISAs in the UK by the addition of more onerous UK and Ireland only additional requirements. It is believed that the APB will only amend the clarified standards where necessary to comply with UK only legislation such as Companies Act 2006.

### ***What will audit clients see?***

Under clarity, audit clients might notice changes to:

- engagement letters
- reports to those charged with governance
- content of discussions with management and board
- representation letters
- form of report

In addition, clarified ISAs may alter nature and extent of audit work and documentation. This will affect the cost of audits.

### ***Implementation issues***

- The clarified Standards will require auditors to have a complete command of the requirements of the standards so that audit documentation can record not just how the audit was done but how the work complied with requirements of the standards. The clarified standards might be very similar to the current ISAs but did all UK auditors read the current standards?
- Because of the above there will be significant training requirements and the correct timing of this will be crucial to good implementation
- As the Clarified ISAs contain much more detail it will be necessary to redraft audit methodologies and standard working paper systems.
- The revised and clarified standards are more onerous. There is a significant one-off cost in the first year of adoption followed by a smaller ongoing increase in audit costs. Audit fees will go up again. (See April 2008 Accountancy Age for a good scare story)

### ***Examples of the changes resulting from Clarity***

It is easy to talk about Clarity in abstract terms but sometimes this does not convey the substance of the changes that are coming. In this section we will look at a few examples of how the standards might change under clarity. This is by no means an exhaustive list of the changes. In fact these represent a small fraction of the new requirements.

#### **Exposure Draft ISA 220 Quality Control for an Audit of Financial Statements**

The current ISA 220 is not specific on the requirements for the form of an Engagement Quality Control Review (EQCR), unless it is a listed client. The clarified ISA has increased specificity regarding the EQCR. It shall include:

- Discussion with engagement partner.
- Review of financial statements, proposed auditor’s report and selected working papers.
- For listed entities, consider the firm’s independence, consultations on difficult matters, whether documentation reviewed reflects the work done re significant judgments and conclusions reached.

- Matters to be documented by the reviewer.

Most audit firms will have been doing this sort of work already when conducting an EQCR but the new requirements mean that it is vital to document properly the work that has been performed.

### **Exposure Draft ISA 265 – Communicating deficiencies in internal control**

Proposed ISA 265 will be a new ISA – there is no current stand-alone equivalent, although the subject matter is addressed in a number of current ISAs

See the extracts from the standard below to see the extended requirements on communications:

#### *“Communication of Deficiencies in Internal Control*

9. The auditor shall communicate all deficiencies in internal control (other than those that are clearly trivial) identified during the audit to management at an appropriate level of responsibility on a timely basis, unless: (Ref: Para. A9-A11, A22)

(a) The auditor has obtained sufficient appropriate audit evidence about the operating effectiveness of other controls that would prevent, or detect and correct, misstatements arising from the identified deficiencies; or (Ref: Para. A3, A12)

(b) It would be inappropriate to communicate directly to management in the circumstances. (Ref: Para. A13)

10. The auditor shall communicate significant deficiencies identified during the audit to those charged with governance in writing and on a timely basis. (Ref: Para. A14-A18, A22)”

### **Exposure Draft ISA 550 - Related parties**

One of the changes in the standard extends the requirements for what business must be conducted at the audit team planning meeting. See the extract below:

“13. The discussion among members of the engagement team required by ISAs 315 (Redrafted) and 240 (Redrafted) shall include specific consideration of the susceptibility of the financial statements to material misstatements due to fraud or error that could result from the entity’s related party relationships and transactions.”

“17. The auditor shall share relevant information obtained about the entity’s related parties with the other members of the engagement team.”

In paragraph 21 of the standard an additional significant risk is identified:

“21. In identifying and assessing the risks of material misstatement as required by ISA 315 (Redrafted), the auditor shall treat at least the following as circumstances giving rise to significant risks:

- Identified significant related party transactions outside the normal course of business.
- Management has made an assertion in the financial statements stating that a related party transaction was conducted on terms equivalent or similar to those prevailing in an arm’s length or market transaction.”

### **Exposure Draft ISA 501 Audit evidence regarding specific financial statement account balances and disclosures**

It remains mandatory for the auditor to attend the physical stock take but clarity is more specific as to what the auditor does at stock attendance:

“4. When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding its existence and condition by, unless impracticable, attendance at the entity’s physical inventory count (or counts) and: (Ref: Para. A1-A3)

- (a) Evaluating management’s instructions and procedures for recording and controlling the results of the entity’s physical inventory count; (Ref: Para. A4)
- (b) Observing management’s count procedures, inspecting the inventory, and performing test counts; and (Ref: Para. A5-A7)
- (c) Performing audit procedures over the entity’s final inventory records to determine whether they accurately reflect actual inventory count results. (Ref: Para. A8)”

Here are new requirements in relation to litigation:

“10. When the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when the auditor believes that other litigation or claims may exist, the auditor shall, in addition to the procedures required by other ISAs:

- (a) Seek direct communication with the entity’s external legal counsel through a letter of general inquiry or specific inquiry, prepared by management and sent by the auditor, requesting the entity’s external legal counsel to communicate directly with the auditor; and (Ref: Para. A19-A21)
- (b) When considered necessary, meet with the entity’s external legal counsel to discuss the likely outcome of the litigation or claims. (Ref: Para. A22)”

### **Exposure Draft ISA 240 - The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements**

There are some significant new requirements in this standard. The clarified standard is more specific about testing journal entries and other adjustments, accounting estimates and unusual transactions, including:

- Making inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
- Testing journal entries and other adjustments made at the period end, and considering the need to test journal entries and other adjustments throughout the period;
- Reviewing accounting estimates for bias, even if individually reasonable;
- Performing retrospective review of management judgements and assumptions;
- Evaluating the business rationale of significant transactions outside the normal course of business or that otherwise appear unusual.

### **Exposure Draft ISA 560 - Subsequent Events**

In this clarified standard there are new requirements on what the auditor must do when considering post balance sheet events:

- Obtain understanding of management’s process to ensure events identified.
- Read minutes of meetings of owners, management and those charged with governance.
- Read latest interim financial statements / management accounts.
- Inquire of management.

### **Lecture A239 (18.54 Minutes)**

## **SUMMARY OF DEVELOPMENTS**

This section of the notes is designed to give you an overview of all recent developments announced by the various bodies under the control of the Financial Reporting Council (FRC). The bodies concerned are:

Accounting Standards Board (ASB)  
Urgent Issues Task Force (UITF)  
Financial Reporting Review Panel (FRRP)  
Auditing Practices Board (APB)

### ***FRC publishes Discussion Paper on Cost-effective Regulation***

The Financial Reporting Council (FRC), the UK's independent regulator responsible for promoting confidence in corporate reporting and governance, has today published a discussion paper which aims to stimulate an on-going dialogue with its stakeholders about ways to improve the cost-effectiveness of FRC regulation without compromising the achievement of high standards of corporate reporting and governance.

In line with its commitment to the principles of good regulation, the FRC has in the past few years taken or proposed a range of actions to reduce the costs to market participants of the regulation for which it has responsibility. This document highlights some of the most significant of these actions and invites stakeholders to comment on further opportunities to reduce regulatory costs whilst preserving confidence in corporate reporting and governance.

The main focus of the discussion paper is on opportunities to reduce the costs associated with FRC regulation rather than on its internal costs.

Proposals highlighted in the paper include:

- a major project to review the relevance and complexity of corporate reporting
- the FRC's continuing work to promote cost-effectiveness in the development of international accounting and auditing standards.

The paper also identifies further initiatives on which it might consult in the future, including a proposal to provide a summary of FRC regulatory requirements which apply to SMEs.

*10 March 2008*

### ***Findings of the Financial Reporting Review Panel in respect of the accounts of Cambrian Mining Plc for the year ended 30 June 2006***

The Financial Reporting Review Panel has had under review the report and accounts of Cambrian Mining Plc for the year ended 30 June 2006.

In the Panel's view the accounts in question did not comply with the Companies Act 1985 ('the Act') as they contained a number of errors and failed to comply with International Financial Reporting Standards in significant respects.

The directors have today acknowledged that the original accounts failed to comply with the Act in significant respects and have accordingly issued revised accounts for the year ended 30 June 2006.

The principal adjustments made in the revised accounts are:

- Revision of the accounting in respect of the 2005 acquisitions of Deepgreen Minerals Corporation Ltd and AGD Mining Ltd to reflect the existing interests already held by the company and revisions to the fair values of net assets acquired.
- Revisions to the accounting for interests in associates, including the impact of dilutions, foreign currency translation and alignment of the results of associates with group accounting policies.

- Revisions to the accounting for associate interests to reflect the fair value of options held in associates upon exercise of those options in exchange for shares.
- Revised accounting for investments in convertible notes and debentures including separate reflection of the conversion option.
- Revisions to the accounting for convertible notes issued.
- Reclassification of profit on the sale of associates, subsidiaries and other investments in the income statement from revenue and operating profit to gains on disposal of interests in associates, gain on disposal of subsidiaries and other gains and losses.
- Recognition by the group of foreign exchange gains of the company arising from intra-group loans as part of movements in equity instead of gains in the income statement.
- Amendment of the statement of changes in equity to reflect the payment of dividends in the year and other movements previously omitted, in addition to the effect of the above.

In addition, the company has made substantial, consequential amendments and additions to the supporting notes reflecting the changes in accounting treatment and improving the clarity of its disclosures.

The Panel welcomes the corrective action taken by the directors and regards its enquiries into the company's accounts for the year under review, initiated on 14 March 2007, as concluded.

18 February 2008

#### ***APB issues new SIR on Reporting on GAAP Reconciliations***

The Auditing Practices Board (APB) today issued:

- SIR 5000 'Investment Reporting Standards applicable to Public Reporting Engagements on financial information reconciliations under the Listing Rules'
- A paper providing feedback on the actions taken by APB in response to comments received on the exposure draft issued in June 2007.

SIR 5000 establishes specific Investment Reporting Standards and guidance for reporting accountants 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. Such reconciliations are often referred to as 'GAAP reconciliations'.

Under the Listing Rules a reporting accountant is required to express an opinion as to whether:

- the financial information reconciliation has been properly compiled on the basis stated; and
- the adjustments are appropriate for the purpose of presenting the adjusted financial information on a basis consistent with the issuer's accounting policies.

27 February 2008

#### ***FRC consults on changes to Audit Committee Guidance relating to Audit Choice Project***

The Financial Reporting Council today began consultation on proposed changes to the Smith Guidance on Audit Committees as part of the implementation phase of its Choice in the UK Audit Market project.



## **Background**

The Guidance on Audit Committees (The Smith Guidance) was first published in 2003. It is intended to assist company boards when implementing the sections of the Combined Code on Corporate Governance dealing with audit committees and to assist directors serving on audit committees in carrying out their role. The FRC is responsible for keeping the Combined Code on Corporate Governance under review together with associated guidance including the Smith Guidance.

The Market Participants Group (MPG) was established in October 2006 to provide advice to the Financial Reporting Council on market-led actions to mitigate the risks that could arise in the event of one or more of the Big Four audit firms leaving the market. The Group's final report, containing 15 recommendations to enhance the efficiency of the UK audit market, was published last October.

## **Changes to audit committee guidance**

A number of the MPG's recommendations were targeted at companies. Four of these have particular relevance to audit committees and, therefore, the Smith Guidance. The recommendations called for:

- Company boards to provide information to shareholders relevant to their auditor selection decision.
- Company boards to disclose any contractual obligations (such as loan agreements) to appoint certain types of audit firms.
- Large companies to consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning.
- Sections of the Smith Guidance dealing with auditor independence to be reviewed for consistency with the relevant ethical standards for auditors.

*07 March 2008*

### ***APB updates Interim Guidance for Auditors on Anti-Money Laundering Legislation***

The Auditing Practices Board (APB) today issued an update to Practice Note 12 (Revised), 'Money Laundering - Interim guidance for auditors in the United Kingdom' which replaces the version issued in January 2007. The APB plans to publish Practice Note 12 (Revised) in final form once approval under the Proceeds of Crime Act 2002 has been received from HM Treasury.

The guidance in Practice Note 12 (Revised) has been updated to reflect the implementation of the Money Laundering Regulations 2007 and a recent update to the Proceeds of Crime Act 2002, both of which have come into force since the last version of the guidance was issued.

*19 March 2008*

### ***ASB issues further proposals on Amendment to the Liability/Equity Classification Requirements of FRS 25 'Financial Instruments: Presentation'***

The Accounting Standards Board (ASB) has today issued an exposure draft ("ED") of an amendment to Financial Reporting Standard (FRS) 25 (IAS 32) 'Financial Instruments: Presentation', to change the classification from liabilities to equity of certain financial instruments, following a final amendment to International Accounting Standard (IAS) 32 'Financial Instruments: Presentation' issued by the International Accounting Standards Board (IASB) in February 2008.

The IASB originally issued an ED proposing an amendment to IAS 32 in June 2006. These proposals made limited amendments to the IAS 32 classification of financial instruments puttable at fair value and obligations arising on liquidation. FRS 25 is the converged UK standard that corresponds to IAS 32. The ASB published an exposure draft in July 2006 proposing amendments to FRS 25 to ensure the standard's continued convergence with IAS 32.

The IASB subsequently refined the proposals in the ED in response to comments from respondents. The IASB's final amendment is wider in scope than the original proposals. In particular, the original criterion in the ED for a puttable financial instrument to be classified as equity if it was puttable at 'fair value' has been removed. The final amendment to the standard was published in February 2008 without a further formal consultation with constituents.

Despite this widening of scope, the ASB's view is that the impact of the amendment in the UK will not be major. To date, the ASB has not identified particular situations where the amendment would result in misleading accounting, but believes it would be especially relevant to the funds industry, LLPs, and mutual and co-operative entities. However, it is concerned to ensure that there are no unintended consequences in the UK that have not been identified and is thus consulting constituents on this point.

As the ASB wants the amendments to apply from the same time as those of the IASB it is allowing a shorter than normal consultation period. Comments on any aspect of the Exposure Draft are requested by 16 May 2008.  
*20 March 2008*

***The Professional Oversight Board announces the Scope of the AIU's work for 2008/9***

The Professional Oversight Board ('the Oversight Board'), part of the Financial Reporting Council, today announced the scope of the work of its independent Audit Inspection Unit (AIU) for 2008/9. The Board has determined that the small number of very large entities constituted as industrial and provident societies should be brought within scope but that no other changes of substance should be made at this time.

*26 March 2008*

***ASB issues Amendment to FRS 20 'Share-based Payment - Vesting Conditions and Cancellations'***

The Accounting Standards Board (ASB) has today issued an amendment to Financial Reporting Standard (FRS) 20 (IFRS 2) 'Share-based Payment – Vesting Conditions and Cancellations'. The amendment clarifies the treatment of certain cancellations of options granted to employees, following similar amendments issued in January 2008 by the IASB.

Under FRS 20 and IFRS 2, where share options are granted to employees, the value of the option (at the grant date) is treated as an expense over the period in which services are received from the employees in exchange for the options – normally the period until the options can be exercised. Where an option is unable to be exercised because vesting conditions are not met (for example, if a performance target is not met, or the employee leaves the employment) the cost of the options is reversed. However, if the employer cancels the options, the full value of the options is charged to the profit and loss account.

The IASB has now issued an amendment which would clarify that, where options are cancelled by the employee (other than on leaving employment), such cancellations should be treated in the same way as cancellations by the employer.

FRS 20, effective for accounting periods beginning on or after 1 January 2005 for listed entities, and 1 January 2006 for unlisted entities, is in most respects identical to IFRS 2. The ASB is therefore making corresponding changes to FRS 20 to keep it in line with the international standard. The amendment will apply for accounting periods beginning on or after 1 January 2009, with earlier application permitted.

*27 March 2008*

***ASB welcomes IASB Discussion Paper on Post-retirement benefits***

The Accounting Standards Board (ASB) welcomes the publication by the International Accounting Standards Board (IASB) of its discussion paper (DP) on accounting for post-employment benefits (including pensions) as a step towards improving International Financial Reporting Standards (IFRS) in this important area.

The IASB's project will involve a fundamental review of all aspects of post-employment benefit accounting. The DP is the first output of the project and addresses more urgent issues with the aim of significantly improving accounting for pensions by 2011.

The DP considers a number of topics, including:

- the classification of pension promises as either defined benefit or contribution-based, which is intended to cater for arrangements that contain defined return promises; and
- the elimination of options to avoid or defer recognising deficits or surpluses in defined benefit pension plans.

As the IASB's DP covers initially the more urgent issues, the proposals are narrower than those set out in the ASB DP 'The Financial Reporting of Pensions', which was published on 31 January under the Pro-active Accounting Activities in Europe (PAAinE) initiative. The ASB looks forward to the later phase of the IASB's project and believes that the proposals in the PAAinE DP will stimulate debate and provide input to the IASB in its longer-term thinking.

The ASB encourages UK and Irish constituents to consider the IASB's proposals as well as those set out in the PAAinE DP, and to comment directly to the IASB on its proposals. The IASB is seeking comments by 26 September 2008 and responses to the PAAinE DP are requested by 14 July 2008.

*27 March 2008*

#### ***APB issues Draft Revised Guidance on the Audit of Charities***

The Auditing Practices Board (APB) has published a consultation draft of a revision of Practice Note (PN) 11: "The Audit of Charities in the United Kingdom". The consultation period ends on 10 July 2008.

The current version of PN 11 was issued in 2002 and has since been supplemented by Bulletin 2005/1: Audit risk and fraud – supplementary guidance for auditors of charities.

The update to PN 11 reflects:

- the replacement of Statements of Auditing Standards by ISAs (UK and Ireland);
- changes to the Charities Act 1993 (which apply to charities in England and Wales) as a result of the implementation of the Charities Act 2006 on 1 April 2008;
- changes to the legal and regulatory arrangements for charities in Scotland, including the establishment of the Office of the Scottish Charity Regulator (OSCR) which apply to accounting periods commencing on or after 1 April 2006;
- changes to the guidance on the Charity Commission's interpretation of 'material significance' in the context of whistleblowing responsibilities.

Changes to the legal and regulatory arrangements for charities in Northern Ireland have been proposed but, as these are not yet in a sufficiently final form, they have not been referred to in the consultation draft. If new legislation is approved before PN 11 is finalised, reference will be made to it.

*10 April 2008*

#### ***APB issues four Bulletins to provide guidance on certain aspects of the Companies Act 2006 that affect auditors***

The Auditing Practices Board (APB) today issued the following four Bulletins:

- 2008/3 'The auditor's statement on the summary financial statements in the United Kingdom'.
- 2008/4 'The special auditor's report on abbreviated accounts in the United Kingdom'.
- 2008/5 'Auditor's reports on revised accounts and reports, in the United Kingdom'.
- 2008/6 'The "Senior Statutory Auditor" under the United Kingdom Companies Act 2006'.

The majority of the accounting and auditing requirements of the Companies Act 2006 came into force for periods commencing on or after 6 April 2008. These requirements include various Regulations which specify the detailed requirements of auditors with respect to Summary Financial Statements, Abbreviated Accounts and Revised Accounts and Reports. Three of the Bulletins provide up to date guidance on these aspects of the Companies Act 2006.

The Companies Act 2006 requires that the auditor's report should be signed by the 'senior statutory auditor' in his or her own name. This is a new requirement and Bulletin 2008/6 provides guidance with respect to the meaning of the term 'senior statutory auditor'.

*21 April 2008*

## **SOLUTIONS TO CASE STUDY EXAMPLES**

### *Example 1*

2008: The company has failed to meet the conditions in both 2007 and 2008 and so cannot be a small company in 2008.

2009: The new limits are now applied and the company satisfies those limits in both 2008 and 2009. Therefore the company does qualify as a small company in 2009.

### *Example 2*

Yes, the P group does satisfy the qualifying conditions to be a small group. The turnover condition is satisfied on a gross basis and the balance sheet condition is satisfied on a net basis. It is acceptable to “mix and match” the net/gross limits.

### *Example 3*

B Ltd and C Ltd are small companies.

A Ltd is not. Q Ltd is also not a small company because the group it heads up is not a small group.

None of the companies are audit exempt because the group is not small.

**FURTHER REFERENCE MATERIAL**

<b>Reference to course material</b>	<b>Web references to obtain further detail</b> Note that what appear to be gaps in any of these addresses are in fact underscores ( _ )
SI 2008 No 393: Amendments to small company limits etc	<a href="http://www.opsi.gov.uk/si/si2008/pdf/uksi_20080393_en.pdf">http://www.opsi.gov.uk/si/si2008/pdf/uksi_20080393_en.pdf</a>
SI 2008 No 497: Late filing penalties etc	<a href="http://www.opsi.gov.uk/si/si2008/pdf/uksi_20080497_en.pdf">http://www.opsi.gov.uk/si/si2008/pdf/uksi_20080497_en.pdf</a>
POB instruments re requirements for statutory auditors	<a href="http://www.frc.org.uk/pob/regulation/oversight.cfm">http://www.frc.org.uk/pob/regulation/oversight.cfm</a>
Companies House: Frequently asked questions	<a href="http://www.companieshouse.gov.uk/companiesAct/faq.shtml">http://www.companieshouse.gov.uk/companiesAct/faq.shtml</a>
Bulletin 2008/06: Senior Statutory Auditor	<a href="http://www.frc.org.uk/apb/publications/pub1592.html">http://www.frc.org.uk/apb/publications/pub1592.html</a>
POB press release re notification of change of auditor – this has links to two flowcharts to assist audit firms and companies in applying the requirements:	<a href="http://www.frc.org.uk/pob/regulation/notification.cfm">http://www.frc.org.uk/pob/regulation/notification.cfm</a>
ICAEW guidance re auditor cessation statements:	<a href="http://www.icaew.com/index.cfm?route=155861">http://www.icaew.com/index.cfm?route=155861</a>
ISA 600 (Revised): Using the work of another auditor	<a href="http://www.frc.org.uk/apb/publications/pub0706.html">http://www.frc.org.uk/apb/publications/pub0706.html</a>
Audit News Issue 43: Access to working papers and other changes to audit regulations	<a href="http://www.icaew.com/index.cfm?route=155221">http://www.icaew.com/index.cfm?route=155221</a>
APB Ethical Standards: The revised standards can be accessed by links at the foot of the page	<a href="http://www.frc.org.uk/apb/publications/ethical.cfm">http://www.frc.org.uk/apb/publications/ethical.cfm</a>
ICAEW paper on changes to ethical standards	<a href="http://www.frc.org.uk/apb/publications/ethical.cfm">http://www.frc.org.uk/apb/publications/ethical.cfm</a>
Inside Track – the magazine of the Accounting Standards Board	<a href="http://www.frc.org.uk/asb/publications/insidetrack.cfm">http://www.frc.org.uk/asb/publications/insidetrack.cfm</a>
SI 674: Companies Act Sixth commencement order re small companies which are also charities	<a href="http://www.opsi.gov.uk/si/si2008/pdf/uksi_20080674_en.pdf">http://www.opsi.gov.uk/si/si2008/pdf/uksi_20080674_en.pdf</a>
SI 527: Requirements for audit and independent examination for charities	<a href="http://www.opsi.gov.uk/si/si2008/pdf/uksi_20080527_en.pdf">http://www.opsi.gov.uk/si/si2008/pdf/uksi_20080527_en.pdf</a>
Clarity project	<a href="http://www.frc.org.uk/apb/publications/iaasb.cfm">http://www.frc.org.uk/apb/publications/iaasb.cfm</a>
Summary of developments: more details may be accessed from the list of press releases on the FRC website using this address Or more conveniently, go to the FRC homepage and follow the links to the body you are interested in	<a href="http://www.frc.org.uk/press/">http://www.frc.org.uk/press/</a> <a href="http://www.frc.org.uk/index.cfm">http://www.frc.org.uk/index.cfm</a>

