



The Faculty's Annual Report 2002

The Faculty has issued its Annual Report for 2002 and some of the key highlights are set out below.

Chairman's Statement

In his Chairman's statement, Andrew Ratcliffe says that 2002 had seen an unprecedented interest in the work of auditors. The corporate failures in the US have meant that the auditing profession came under great scrutiny from Government and the public. The Faculty commissioned an independent study of fund managers on investor confidence, which found that confidence in UK audited information remained high despite recent US corporate scandals. Notwithstanding this reassurance, Andrew Ratcliffe warns against complacency.

In 2002, the Faculty launched a publication, *Audit Quality*, which concentrates on the practical measures by which quality is maintained and enhanced in an audit practice. It has also developed interim process guidance for UK directors on preparing an OFR.

The Faculty firmly believes that quality is at the heart of every audit and has worked throughout 2002 to continue to promote the value and quality of what auditors are doing in the UK and to help enhance confidence in the profession. Andrew Ratcliffe says that audit is all about integrity, objectivity, diligence and judgement; and that forming an appropriate opinion can only be assured if the range of quality processes within the firms is in place, supported by effective regulation and monitoring.

The focus of the Faculty's work has been on providing practical guidance and support to members, helping them to effectively meet their obligations as auditors.

Review of the Faculty's Technical Work

The Faculty disseminated information to members in 2002 on various topics from pensions and charities audits, data protection, money laundering, new auditor independence requirements and the Company Law Review Process.

The Report highlights that these topics continue to remain top of the agenda for 2003 and the Faculty

will continue to consult members and provide information and guidance on practical implications thereof.

The Faculty issued practical guidance in 2002 on FRS 17 implications for auditors, bank reports for audit purposes and management representation letters.

The Report also highlights the European Commission's intention that auditors of all EU companies will be required to comply with International Standards on Auditing from 2005. The next couple of years are, therefore, likely to be very busy.

The Report highlights the work of the Special Reports of Accountants Panel (SRAP) in developing and issuing guidance for members on Special Reports (see *Making A SRAP of Difference* on page 4).

The Faculty has been working hard on public sector matters, developing a document promoting its strategic objectives in this area and commenting on a number of public sector consultation issues.

The Faculty's Internal Audit Committee continued to support and promote the Moorgate lectures and has written articles on a regular basis to be included in the Institute of Internal Auditors' magazine.

Members' Services

Significant work has also been carried out in the area of members' services in 2002. A successful roadshow

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was held at seven venues around the country in the autumn on Accounting for Tax Purposes and Money Laundering Reporting Responsibilities. There were over 700 attendees. In the light of the demand for further guidance on money laundering, the Faculty also ran another series of 13 roadshows in May 2003 which had over 1600 attendees.

Members have been kept up-to-date on audit and

assurance matters and the work of the Faculty through *True and Fair* and the *Technical Update* was launched in 2002 to provide information on international/domestic accounting and auditing developments.

The Faculty's Annual Report, which also includes the financial statements for 2002, can be viewed at: www.icaew.co.uk/auditassfac.

Solicitors' Accounts Rules: Proposed Changes

The Law Society's Regulation Review Working Party and Standards Board have been considering proposals which seek to prevent the use of solicitors' accounts for money laundering, and to protect solicitors from being targeted by criminals for this purpose.

They propose a draft rule that will, except in exceptional circumstances, prohibit the use of the solicitors' accounts where there is no underlying transaction or provision of solicitor-like services.

The Law Society are also proposing that reporting accountants check for compliance with the new rule in relation to the client and controlled trust matter files selected under rule 42 of the accounts rules. Any breach found during the course of the accountant's work should be noted in the accountant's report. There is also the option of direct reporting to the Law Society under existing rule 38 of the accounts rules if evidence of money laundering is discovered.

The Faculty has responded to the consultation document. Whilst agreeing that money laundering is a significant public interest concern and understanding that the Law Society would want to be seen to be taking this seriously, we raised fundamental concerns about the use of the Solicitors' Accounts Rules (SARs) for this purpose and the additional responsibility that this would place on reporting accountants.

We make the point that the anti-money laundering legislation is comprehensive and complex enough without the need for an additional rule to police it. We also suggest that guidance to solicitors on suitable systems to put in place is more appropriate than a rule.

We believe that the new rule as drafted, with its 12 comprehensive notes will serve to significantly extend the scope of the reporting accountants' responsibilities under the SARs, impacting on the level of work to be performed and ultimately the cost to the solicitor client. We comment that it would seem that the reporting accountant is effectively being asked to check compliance with anti-money laundering legislation.

We also raise concerns about the risk of tipping off. Rule 38 revisions suggest that reporting accountants may and will be encouraged to report evidence of money laundering to the Law Society. The reporting accountant's legal responsibility is only to report suspicions of money laundering to NCIS and the reporting accountant is in danger of tipping off if he or she was to report otherwise than as laid down under the Proceeds of Crime Act 2002.

The Faculty's response is available within the Consulting You section of the website at: www.icaew.co.uk/auditassfac.

IFRS1

The IASB has issued its first International Financial Reporting Standard, IFRS 1, *First-time Adoption of International Financial Reporting Standards*, which explains how an entity should make the transition to IFRSs from another basis of accounting.

The IASB indicates that it has sought to address the demand of investors to have transparent and comparable information over all periods presented, while giving reporting entities a suitable starting point for their accounting under IFRSs.

The new standard will require entities, on first adoption of IFRSs, to comply with every IASB standard in force in the first year, with some specific exceptions (based on cost considerations). Under IFRS 1 entities will also need to explain how the transition to IASB standards affects their reported financial position, financial performance and cash flows.

Further information is available from the IASB's website at: www.iasb.org.uk.

International Accounting Standards

— Do I really have to read this?

For readers with good memories, a short article was featured in the May 2002 edition of *True & Fair* on this. However, it is even more relevant now with 2005 rapidly approaching. You will undoubtedly keep reading or hearing about the EU Regulation that was published in June 2002 requiring the use of International Accounting Standards (IAS) for EU companies listed on a regulated market in 2005. The Regulation, which automatically has the force of law in each EU jurisdiction, applies for periods beginning on or after 1 January 2005.

The DTI issued a consultation at the end of August last year to establish whether the scope of IAS should be extended to unlisted companies in the UK. At the time of writing the DTI had not announced the outcome of the consultation, even though it expected to make an announcement in early 2003. The impact of extending IAS to unlisted companies in the UK is largely dependent on the audience. A subsidiary of a listed parent will have to prepare IAS figures for consolidation purposes anyway. A start-up company with ambitions of going public within a couple of years may wish to prepare financial information in both UK GAAP and IAS to enable easy comparison and conversion later on. However, a medium-sized owner-managed business may have no interest in IAS. With 2005 less than 18 months away it would seem that a compulsory switch to IAS for all UK companies is unlikely. One possible outcome is that companies will be provided with an option to move to IAS.

The ICAEW carried out a recent survey amongst its members to gauge their level of awareness of IAS. The survey highlighted that only 16 per cent of members who responded from practice were aware of the DTI consultation. Another question addressed in the survey was whether, if members were given the choice, would they move to using the 'IAS

rulebook' rather than UK GAAP. Just over a third of members in business said that they would be likely to make the switch to IAS.

Regardless of the outcome of the DTI consultation the ASB has made a commitment to align UK GAAP with international standards as far as possible. This means that it is not just listed companies, and hence the Big 4 and mid-tier accountancy practices, that will be affected by the international rules, in many cases the international rules will replace current UK GAAP. This has been overlooked by many who mistakenly believe that IAS will not affect their business. This was certainly the view taken by one respondent to the ICAEW survey who said 'I do not see how it has any relevance to normal everyday owner-managed businesses'. The survey showed that only 28 per cent of members in practice were aware of the ASB's intention to converge to IAS.

The ASB has so far issued FREDs 23-31, as well as a number of consultation papers, on the back of publications by the International Accounting Standards Board (IASB). The Exposure Drafts were originally expected to replace UK rules from 2003, however the final publication of the revised international standards were delayed due to the Norwalk Agreement (the joint agreement between the IASB and the US standard setter, FASB).

The Exposure Drafts that have been issued to date by the ASB cover areas such as inventory (that is stock to you and me), related party transactions, earnings per share and property, plant and equipment (better known as tangible fixed assets to a UK audience). Although some of the proposals will not change our current rules significantly, it is worth reading the detail, as the international standards are by no means exact copies. The best way to describe their relationship with UK standards might be as 'cousins'. The proposals on work in

progress in FRED 28, for example, make no distinction between construction and service contracts, with no apparent distinction between long and short-term contracts in this context. The effect of this is that the percentage completion method of valuation should be used. This will mean including an element of profit for part completed, unbilled work in relation to service contracts. A consequence that will not only be of importance to your clients but will almost certainly impact your own practice.

Our survey not only highlighted that there was a great deal of complacency amongst members but also that clients would be turning to their auditors for help and advice. Over 60 per cent of respondents said that they considered their auditors to be a source of information on IAS and a third said that they had already turned to their auditors for advice.

In the words of Dostoevsky 'taking a new step, is what people fear most'. This is not a time to sit back and wait and see what might hit you, it is a time to start mapping out the journey ahead.

Although we have not seen the replacement of any UK standards so far it is likely that the IASB will be publishing its 'improved' standards shortly. 19 June 2003 saw the publication of the first newly named International Financial Reporting Standard (IFRS) on the first time adoption of international standards (see page 2 for further information). This will only be of significance for those companies that move to the full set of international standards.

There is certainly plenty of activity on the horizon and it is important that auditors are passing the right messages on to their clients. International standards are a reality, they will affect all companies in the UK, even if it is by the back door. Now is not the time to sit back and say: 'Do I really need to read this?'

Making a SRAP of Difference

Some of the most difficult and important technical work of the Faculty is being undertaken by the Special Reports of Accountants Panel (SRAP) and its sub-group, the Public Sector Special Reports of Accountants Panel (PSSRAP). SRAP is a sub-committee of the Technical & Practical Auditing Committee (TPAC). Chris Cantwell reports on progress to date.

Introduction

The Special Reports of Accountants Panel was formed in 2000. The Institute has long acknowledged the need to provide guidance on assurance reports but the emergence of SRAP was a recognition of the increasingly litigious environment faced by accountants and auditors and the challenges facing firms in managing their risk in such a difficult area. Since 2000 SRAP has worked hard to, where possible, meet expectations for guidance both from auditors and accountants and from third parties.



SRAP activity

In seeking to establish and clarify the boundaries of assurance that can be provided by accountants and auditors, and provide guidance to practitioners to meet their professional needs, SRAP has had, and continues to hold, discussions with various regulators, professional bodies and trade associations. SRAP has so far produced the following technical releases:

■ Audit 1/01: *Reporting to third parties* providing the following:

- examples of types of wording and opinions that are unacceptable to accountants providing special reports;
- words for inclusion in engagement letters; and
- an indication of the pitfalls to avoid.

■ Audit 2/01: *Requests for reference on clients financial status and their ability to service loans* provides accountants with guidance in cases where third parties, such as lenders and letting agents, ask for references from accountants on the financial status of their clients where these clients have applied for a loan or about to enter some other obligation.

■ Audit 2/02: *New arrangements for reporting to the Association of British Travel Agents (ABTA)*. The 'package' comprises of three elements:

- a) a model tripartite agreement;
- b) guidance notes for reporting accountants; and
- c) reports/confirmations to ABTA.

Audit 2/02 is an example of a specific agreement that SRAP is able to reach with a trade association.

■ Audit 1/03: *The Audit Report and Auditors' Duty of Care to Third Parties*. This Technical Release – based on advice the Institute received from Leading Counsel – was published in the light of the Scottish Case of the Royal Bank of Scotland and Bannerman Johnstone Maclay and deals with the duty of care to third parties in relation to audit reports.

As well as the above work, the Audit Bureau of Circulation (ABC) and the Faculty are working together to improve the quality of circulation auditing through the ABC/Institute Forum. The aim of the Forum is to raise standards, improve training and improve communication between ABC and external auditors.

Other areas where SRAP are currently involved include regulatory accounts reporting such as Solicitors' Accounts Rules (SARs), Civil Aviation Authority (CAA) reporting and an update of Audit 3/95: *Access to Working Papers by Investigating Accountants*. The Faculty hopes to issue guidance on CAA reporting shortly.

The public sector

The Public Sector Special Reports of Accountants Panel was established to develop guidance on reporting to public sector third parties. It aims to assist accountants to communicate appropriately with clients and public sector third parties and to help them manage their risks more effectively. Firms of all sizes are being asked to provide reports on grant claims by their private sector clients for specific funding received from central government departments and agencies. The Faculty has been receiving requests from members in this area. The amount of liability assumed may not be appropriate for the size of firm involved and the matters specified can be difficult to report on. In addition the level of assurance requested may not be warranted by the work actually expected. The intention is to issue guidance in 2003 that reflects good practice for sponsoring departments and grant paying bodies in relation to requests for accountants' reports on grants used for specific purposes. The guidance will seek to improve the consis-

tency of reporting by auditors and accountants to public sector bodies.

Conclusion

In the past, special reports and other assurance engagements have been regarded as almost an after thought by many firms. Over the last few years there has been, however, a much greater realisation of the risks involved and the importance of good risk management. Members of SRAP know that work remains to be done. For instance, we are aware that some lenders and other bodies have refused to accept references provided in line with Audit 2/01. These types of issues will continue to be addressed. However, we hope that the work of SRAP over the past three years

has raised the level of awareness about assurance engagements, helped firms manage their risk and helped to improve the quality of the service provided to clients.

To discuss any aspect of the work of SRAP, in the first instance please contact Chris Cantwell at: chris.cantwell@icaew.co.uk

The Technical Releases can be viewed by Faculty members on our website at www.icaew.co.uk/auditassfac. They are also mailed to Faculty members when they are issued. Members are also reminded that a copy of the publication, *Reporting Engagements* can be purchased from the Faculty for £5 by contacting 020 7920 8493.

Background

SRAP was set up in late 2000 (see below for terms of reference) and in Spring 2002, the Public Sector

Terms of Reference

- To develop detailed practical guidance on special reporting engagements, specifically:
 - the advantages and limitations of these reports and the level of assurance they provide, including the types of report that accountants are able and unable to give;
 - the confirming of responsibilities, including the different types of engagement and limitations on the reporting accountant's liability and duty of care owed to third parties;
 - the wording of reports i.e. words and phrases that might be appropriate to use and those that would not be, and the types of opinion that can be given;
 - the qualifications that the reporting accountant must have, in particular whether Registered Auditor status is required.

Special Reports of Accountants Panel (PSSRAP) was also established.

- In developing this guidance, the Panel will liaise with other professional bodies, government departments and regulatory/trade bodies, as appropriate. The Panel will also liaise with the Auditing Practices Board.
- To promote this guidance to members, users of reports, government departments, regulatory bodies and standard setters so as to ensure their widespread adoption.
- To consider specific problematic examples as they come to light and negotiate with trade bodies and others as appropriate, in situations where members would benefit from Institute-wide representation to agree the wording of the reports and the details of the reporting engagements.

SRAP Committee Membership

Martyn Jones, Deloitte & Touche, Chairman
 David Atkinson, Gerald Edelman
 John Chastney, Mazars
 Ian Dewar, KPMG
 Andy Harris, Deloitte & Touche
 Kim Hurst, Mazars
 Keith Jones, BDO Stoy Hayward
 Ian Joslin, Deloitte & Touche
 Simon Judd, Pricewaterhouse-Coopers
 Matty Yates, Ernst & Young

PSSRAP Committee Membership

John Chastney, Mazars, Chairman
 James Barbour, ICAS
 Don Bawtree, BDO Stoy Hayward
 Nick Carroll, District Audit
 Ken Davies, PKF
 Richard Gillin, Deloitte & Touche
 Lynn Hine, Pricewaterhouse-Coopers
 Phillip Little, CIPFA
 John Owens, Pricewaterhouse-Coopers
 Paul Spinks, RSM Robson Rhodes
 Mike Suffield, National Audit Office
 David Ward, KPMG

Money Laundering Regulations Delay

There has been a further delay in the implementation of the new Money Laundering Regulations. It was initially anticipated that the Regulations would take effect from the start of June. Following the close of the consultation process

HM Treasury deferred the implementation date to mid-September. The latest position is that the Regulations will take effect three months after the date that the final Regulations are tabled in Parliament. At the time of writing

the Regulations had not been tabled. At the earliest we would expect an implementation date of mid-October. Watch out for further information over the forthcoming months.

Bannerman Wording – Application to Other Public Reports

The March issue of True & Fair carried a Q&A on this subject. This article provides further suggestions for members on the process they might follow when determining appropriate wording for other public reports.

The Q&A in March drew attention to para. 12 of Audit 1/03 *The Audit Report and Auditors' Duty of Care to Third Parties*, the second sentence of which refers to possible application of the guidance to public reports other than audit reports under s.235 of the Companies Act. A key message of the Q&A is that such application elsewhere needs to be done in a thinking way and this will not necessarily be straightforward.

The purpose of the guidance in Audit 1/03 is to provide firms with a process to follow to determine appropriate language in the specific circumstances of each report. The example language for s.235 audit reports contained in Audit 1/03 is of some assistance but accountants need to follow the Audit 1/03 thought process in order to develop appropriate language for a particular case rather than simply trying to fit different situations into the example s.235 language. Unfortunately, it is not therefore possible to provide standard words for other public reports to cover all circumstances which firms might encounter - each situation is different for different types of reports (e.g. different types of pension scheme reports and different classes of charities).

Box 1: Process for Accountants applying Audit 1/03 Principles to Other Public Reports

1. Consider:
 - Specific reporting requirements, including the legal framework
2. Determine:
 - Who is the report for?
 - What is its purpose?
 - What is driving the report's preparation?
 - The specific risks associated with this report
3. Decide appropriate wording in the light of the answers to 1 and 2 based on the appropriate structure
4. Where appropriate seek specific legal/professional advice

Box 1 attempts to describe the process needed and Box 2 (page 7) shows how the process might be applied to a specific example, i.e. the special auditors' report on abbreviated accounts.

Process needed (Box 1)

Step 1

Firms need to ascertain the specific reporting requirements as set out in the appropriate legislation, other regulations or agreements which are relevant to the report.

Step 2

Any disclaimer wording needs to address who the report is for and its purpose. In simple terms, the first sentence of para. 4 of Audit 1/03 addresses who the report is made to and for what purpose, the second explains the limit of that purpose (as set out in s.235), and the third disclaims responsibility to any party other than the party for whom the report is produced.

How this applies in practice will be determined by reference to the requirements of the relevant legislation/regulations/agreements. The question of what is driving the preparation of the report reinforces the need to step back and understand the overall context of the report. Establishing this is fundamental.

Step 3

Determination of appropriate wording should then flow from Steps 1 and 2. The three sentence structure illustrated by para. 4 of Audit 1/03 (explained under Step 2 above) is likely to remain appropriate in most situations and it is likely to be sensible, to the extent possible, to retain a structure and language which are consistent with the wording recommended in Audit 1/03 (particularly where that wording has been adopted for Companies Act 1985 audit reports).

The following aspects of the wording are worth considering:

- Where legislation or regulation is silent on the report requirement, reference should be made to the engagement terms or other relevant agreement (such as a trust deed).
- Where the addressees are a group (such as members or trustees or directors), the report should refer to them as 'a body' (to avoid assuming responsibility to each individually where it is inappropriate to do so).
- Reference is retained in the second sentence to matters that the auditors are required to 'state' to retain consistency with the Companies Act language,

unless the relevant reporting requirement identified in *Step 1* uses clear alternative language.

■ The description of the report is tailored to the particular reporting requirement so that for example it might simply refer to 'this report' rather than 'this auditor's report'.

Firms are also reminded that the wording should appear in the report so as to be sufficiently prominent to readers of it, e.g. in the first or second paragraph.

Step 4

It should be emphasised that the advice the Institute received from Leading Counsel on Audit 1/03 was limited to s.235 audit reports and whilst it is likely that similar legal considerations will apply for other public reports, members are reminded that they may need to take specific legal and professional advice on their particular reporting engagements.

Box 2: Suggested Report on Abbreviated Accounts

For this example the directors of a company propose to deliver to the registrar copies of abbreviated accounts prepared in accordance with s.246(5) or (6) or 246A(3) of the Companies Act. It is assumed that there is an unqualified opinion in the s. 235 audit report on the financial statements.

Step 1

Firms will consider the requirements of s.247B of the Companies Act 1985 which governs the auditor's reporting requirement (as opposed to s.246 which governs the preparation and delivery of abbreviated accounts) and will refer to relevant guidance, in particular the Bulletin issued by the APB (1997/1).

Step 2

Question 1: the report is for the company (para.9 of the APB Bulletin) and included in the abbreviated accounts delivered to the registrar of companies. The report is not to the members of the company or other third parties.

Question 2: the purpose is to fulfil the requirements of s.247B that the abbreviated accounts delivered to the registrar be accompanied by a copy of a 'special report of the auditors'. The report is not prepared to assist

with the company's borrowing arrangements or for any purpose other than to meet the requirements of s.247B.

Step 3

Appropriate wording in the light of Steps 1 and 2 might be as follows:

'This report is made solely to the company, in accordance with s.247B of the Companies Act 1985. Our work has been undertaken so that we might state to the company those matters we are required to state to it in a special auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our work, for this report, or for the opinions we have formed.'

Regarding placement, this wording might sensibly be included as a new second paragraph in the example reports provided in APB Bulletin 1997/1 'Special auditors' report on abbreviated accounts'.

Step 4

For this example, it is unlikely that firms will take specific legal or other professional advice.

DTI consultations

The DTI has issued a consultation document on the use of fair value accounting for certain financial instruments and disclosure of dividends by companies and other undertakings. The document includes draft Regulations to make

the proposed changes to the Companies Act 1985. The consultation document is available on the website at: www.dti.gov.uk/cld/con-docs.htm. Comments are requested by 5 September 2003.

The DTI has also issued a consul-

tation document entitled *Directors' Remuneration – Contracts, Performance and Severance*.

Comments are sought by 30 September 2003. The document can be viewed at: www.dti.gov.uk/cld/con-docs.htm.

European Commission's Agenda on Audit

In its recent Communication, Reinforcing the statutory audit in the EU, the European Commission puts forward its ten priorities to improve and harmonise the quality of statutory audits throughout the European Union.

This comes in the aftermath of financial reporting scandals such as Enron and the subsequent erosion of investor confidence in capital markets worldwide and impact on the credibility of the audit profession. Despite the achievements of the EU Committee on Auditing to date (which include Recommendations on quality assurance and statutory auditors' independence), the Commission believes that further initiatives are required to reinforce confidence in the capital markets and to safeguard the reputation of the audit profession.

The Commission states that these proposals, once adopted, will provide a comprehensive set of EU rules on how audits should be conducted and on the audit infrastructure needed to safeguard audit quality.

The plan has been divided into short and medium-term priorities, which are set out below. These priorities on audit complement the Commission's wider action plan on company law and corporate governance, which was published simultaneously.

Short-term priorities for 2003/2004

Modernising the 8th Company Law Directive

The current 8th Directive is outdated and lacks key elements needed to support an effective audit infrastructure. Proposals will be put forward to modernise the 1984 8th Company Law Directive to provide a comprehensive, principles-based Directive applicable to all statutory audits conducted in the EU. The modernised Directive would have principles on:

- public oversight;
- external quality assurance;
- auditor independence;
- code of ethics;
- auditing standards;
- disciplinary sanctions; and
- appointment and dismissal of statutory auditors.

Reinforcing the EU's Regulatory Infrastructure

To ensure the independence of EU policy making, the proposals for a modernised 8th Directive will also include the creation of an Audit Regulatory Committee. The new Audit Regulatory Committee will be a separate regulatory committee of Member State representatives only, chaired by the Commission.

The EU Committee on Auditing comprising

Member States and the audit profession will be renamed the Audit Advisory Committee and will continue its work as an advisory committee.

Strengthening of EU public oversight of the audit profession

The Commission, together with the Audit Advisory Committee will analyse the existing public oversight systems with the objective of developing minimum requirements, by way of principles, for public oversight for inclusion in the 8th Directive. The Commission intends to define a co-ordination mechanism at EU level to link up national systems of public oversight into an efficient EU network.

Requiring International Standards on Auditing (ISAs) for all EU statutory audits

The Communications states that a key element to help support a uniform high-level of audit quality across the EU is the use of common auditing standards. The Commission and the Audit Advisory Committee will work towards the implementation of ISAs from 2005, including analysing EU and Member State audit requirements not covered by ISAs and the development of an endorsement procedure, common audit report, and high-quality translations. The Commission intends introducing the principle of compliance with ISAs in the 8th Directive. Assuming satisfactory progress is made, the Commission will then propose to require the use of ISAs from 2005.

Medium-term priorities for 2004-2006

Improving Disciplinary Sanctions

National systems of disciplinary sanctions will be assessed by the Commission and the Audit Advisory Committee to determine common approaches. An obligation to co-operate in cross-border cases will be introduced. The Commission will also reinforce these existing requirements by introducing a principle for appropriate and effective systems of sanctions in the modernised 8th Directive.

Making audit firms and their networks transparent

The Commission proposes to develop disclosure requirements for audit firms that will cover, among other things, international networks.

Corporate governance: Strengthening audit committees and internal control

The Commission and the Audit Advisory Committee will work on the appointment, dis-

missal and remuneration of statutory auditors, and on communication between the statutory auditor and the company being audited. The Commission and the Committee will also examine statutory auditors' involvement in assessing and reporting on internal control systems to identify the need for further appropriate actions.

Auditor independence and code of ethics

A study on the impact of a more restrictive approach on additional services provided to the audit client will be carried out. The Commission will continue the EU-US dialogue on auditor independence, with the aim of obtaining US recognition of the equivalence of the EU approach. Existing national codes and the International Federation of Accountants (IFAC) code of ethics will be reviewed to consider whether there is a need for further action in this respect.

Deepen the Internal Market for audit services

The Commission intends to introduce proposals to

make it easier to establish EU audit firms, through the removal of restrictions currently in the present 8th Directive on ownership and management. The provision of audit services will be exempted from the Commission's proposal on the recognition of professional qualifications by amending the 8th Directive to include a principle for mutual recognition subject to an aptitude test. The Commission will also carry out a study on the EU audit market structure and access to the EU audit market.

Examining auditor liability

The Commission will carry out a study analysing the economic impact of auditor liability regimes.

A full copy of the text can be viewed at: www.europa.eu.int/comm/internal_market/en/company/audit/docs/2003-05-comm-reinforcement_en.pdf.

The Institute has recently issued comments on the Communication which can be viewed at: www.icaew.co.uk/index.cfm?AUB=TB2I_37814.

Political Donations

If you go to www.electoralcommission.gov.uk and do a little rummaging around, you will discover that among the several hundred political parties registered in the UK, there exist the Wessex Regionalists, the Morecambe Bay Independents and the Fancy Dress Party, as well as more mainstream parties such as the Official Monster Raving Loonies. You may also discover that the late Sir Paul Getty gave £5m to the Conservative Party on 11 June 2001 and that Lord Sainsbury gave £2m to the Labour party on 13 January 2002, and then gave a further £2.5m on 1 March 2003. Interesting though all of this may be, what relevance is it to auditors?

The March and April 2001 editions of *True & Fair* carried articles on the implications of the Political Parties and Referendums Act 2000 for accountants and auditors. The legislation deals with *inter alia* the registration of political parties, accounting requirements for political parties, the control and reporting of donations to political parties, the control of campaign and election

expenditure and referendums.

The main *new* issues for most auditors and accountants dealt with by the Act involve:

- the need for both individuals and companies to *report donations* to the Electoral Commission which provides details of donations on its web-site;
- the need for donations to come from *permissible donors*;
- the need for political parties and their 'accounting units' (such as constituency associations, MPs and office-holders) to *check donations* over £200 to ensure that they come from permissible donors;
- additional disclosures which will be required for the first time in 31 December 2003 financial statements.

There are many other provisions of this legislation which may affect practitioners such as the need for shareholder approval for donations over £5,000. But the provisions with the potential for the most embarrassment if they have not been complied with are those listed above.

We reproduce below (with minor amendments), an article on the legislation by Katharine Bagshaw originally appearing in the June 2001 edition of *Accountancy* under the title *Caps and Controls*. The legislation has not been widely publicised and we reproduce the article as a reminder, with the 31 December 2003 disclosures in mind.

Caps and Controls

Until relatively recently, substantial political donations made by wealthy private individuals to political parties in the UK were, at least in theory, private arrangements. A number of high-profile cases in the late 1990s involved individuals 'admitting' to having made such donations, despite there being no legal requirement to do so, reflecting the changing political climate that now favours transparency in these matters. The recommendations of the report of the Neill Committee on Standards in Public Life were translated into legislation

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in the form of the Political Parties and Referendums Act 2000. The Act covers much more than political donations – it also deals with the registration of political parties, referendums, charitable donations, the approval of donations by shareholders, the disclosure of donations in company accounts, accounting for political parties and the capping of campaign expenditure.

Permissible donors and the disclosure of donations

Provisions in force as of 16 February 2001 restrict political parties, both locally and nationally, to donations from 'permissible donors'. Permissible donors include UK voters, EU registered companies doing business in the UK, LLPs, unincorporated associations, registered political parties and trade unions. Political parties and 'accounting units' are required to check that any donation over £200 comes from a permissible donor - donations from impermissible donors must be returned and there are provisions dealing with the return of anonymous donations. 'Accounting units' include constituency associations, individual MPs and other holders of elected office.

Any donation of over £5,000 (in total) to central political organisations and any donation over £1,000 to accounting units must now be reported to the Electoral Commission. The Commission will make the names of donors (but not the addresses of private individuals) and the amount donated available for public inspection. The Commission's web-site at: www.electoralcommission.gov.uk has guidance, forms and returns that can be downloaded as well as the registers of donations themselves. Reports of donations must be made on a quarterly basis, except in the run-up to general elections when reports must be made weekly. Anti-avoidance provisions are intended to ensure that the identities of those making dona-

tions are not concealed, including provisions requiring donors to report small multiple donations to the Commission.

Shareholder approval of political donations and expenditure

Until now, provided there was no impediment in a company's constitution, directors were able to make political donations and incur political expenditure more or less as they saw fit. Section 139 of the legislation requires shareholder approval for donations and expenditure to both political parties and EU political organisations of any amount exceeding £5,000. Non-wholly owned subsidiaries must also obtain the approval of the holding company. An ordinary resolution is required as a minimum, the authority to make donations and incur expenditure cannot extend beyond four years and there must be monetary limit on the donations and expenditure approved. Companies are required to obtain this approval as of the first AGM after 16 February 2001, provided that an AGM is held within one year of that date. Where no such AGM is held (as in the case of the many private companies that take advantage of the elective regime), approval was required from 16 February 2002. Directors are required to repay unauthorised donations to the company.

Disclosure of political donations and expenditure

Companies must disclose political donations and expenditure in Directors' Reports under s.140 of the legislation, for amounts exceeding £200. Disclosure is required for financial years beginning on or after the first anniversary of the date on which authorisation of expenditure is first required (i.e. one year after the date of the first AGM after 16 February 2001, or 16 February 2002 where no AGM is held). So, for example, for companies with December year-ends

and a May 2001 AGM (and therefore a first anniversary date of May 2002), this means that information must be collected from 1 January 2003 for disclosure in 31 December 2003 financial statements, despite the fact that approval of donations will be required from the May 2001 AGM. There are, of course, existing Companies Act provisions in relation to the disclosure of political donations and these will continue to apply until the new provisions take effect. But whereas the existing legislation only applies to UK expenditure, the new requirements will include donations and expenditure made within the EU. Disclosure is also required for total contributions to non-EU political organisations.

Campaign expenditure and donations to candidates

Part V of the legislation deals with caps on campaign expenditure and came into force on 16 February 2001. It limits political parties to general election expenditure of £30,000 per constituency and companies and third parties such as trade unions to expenditure of £10,000 in England, and £5,000 in Scotland, Wales and Northern Ireland. Auditors' reports on returns to the Commission are required where expenditure exceeds £250,000. Tighter controls over donations to candidates came into force on 1 July 2001. Time will tell if these new provisions have a substantive effect on the funding of political parties and if the capping of election expenditure will be more effective than it appears to be in the US, where 'soft' money makes something of a mockery of the legal limits. The legislation should, at the very least, have the effect of making political funding more transparent and the atmosphere in which donations are made less secretive and suspicious. The accounting and auditing requirements for political parties in Part III of the legislation should also further this process.

Registration of Foreign Audit Firms in the US: will it affect you?

The Sarbanes-Oxley Act that was introduced in the US last year as a result of the recent US corporate scandals, established amongst other things, the Public Company Accounting Oversight Board. The PCAOB, or 'Peekaboo' as the Americans are calling it, has just finalised a set of rules requiring registration with it of firms that audit US listed companies. Tony Bromell reports.

Why is this of interest to auditors in the UK? First, the rule is not restricted to US audit firms. Also, it covers not only firms with clients who have shares directly listed on US stock exchanges, but also those who play a substantial role in the audit of the group results. This is defined as being responsible for 20 per cent or more of total audit hours, audit fees or the client's consolidated revenues or consolidated assets. Thus, any firm auditing an unlisted UK subsidiary of a listed US company (or of a UK company with a secondary US listing) could be required to register if the subsidiary is fairly large relative to the group as a whole. If in doubt, it may be advisable to contact the primary group auditor for clarification.

If registration is required, it covers the whole audit firm. Individual offices do not need to register, but international affiliations which comprise a series of legally separate national or regional firms will have to register separately if they are included in the scope.

Registration involves the payment of an as-yet unspecified fee (which will not be refunded even if registration is refused) and completion of a lengthy form which will be available on the PCAOB website (www.pcaobus.org). Information requested includes details of: the audit firm and its offices; the relevant clients it is responsible for; individuals at manager

level or above who take part in the relevant audits; the total number of partners and employees; pending and past legal and other proceedings relating to audits; and consents to be subject to oversight. During the initial consultation period the Institute pointed out that there are major legal constraints in disclosing data relating to individuals, particularly outside of the EU. Summarising the Data Protection Act 1998 would require an article in itself, but in essence the only safe course of action is likely to be to obtain the informed and freely given consent of all those involved. The PCAOB has recognised that there are legal issues outside the US and allows non-disclosure provided the relevant law is annexed to the form, along with a legal opinion confirming that disclosure is not permitted, and details of any efforts to obtain consents where these were not given.

The PCAOB is still setting up the detail of its ongoing procedures, but registered firms will need to keep the information up to date, will be subject to monitoring by an inspection unit the PCAOB is setting up and will have to co-operate with any investigations it carries out.

Fortunately, this regulatory tidal wave does not arrive all at once. Registration for non-US firms does not have to be completed until 19 April 2004, though as the information to be provided is more extensive than that routinely collected by the Institute, any firms affected might like to start thinking about it now. Also, not envisaging exemptions, the PCAOB has undertaken to work with foreign regulators, such as ourselves, to minimise 'unnecessary burdens and conflicting requirements'. The Institute expects to be involved in this process over the next few months. We will keep you posted.

Data Protection

The Business Law Committee of the Institute has issued guidance on the implications of the Data Protection Act 1998 for the major practice streams of accountancy practices. Technical Release 16/03: Data Protection Act 1998 and its Application to the Major Practice Streams of Accountancy Practices can be viewed on the website at: www.icaew.co.uk/policy.

Audit Exemption – Watching Brief

The Government is set to open the audit exemption debate again this summer with the publication of the DTI's consultation paper. There will be a three-month consultation period and the DTI looks set to announce its results in the pre-budget report in November. Further information is available at: www.dti.gov.uk.

The Faculty will be responding to the consultation. Comments may be directed to Louise Maslen at: louise.maslen@icaew.co.uk.

Faculty update

IAASB Consultations

The IAASB has issued an exposure draft on a proposed International Standard on Quality Control (ISQC) 1 *Quality Control for Audit, Assurance and Related Services Practices* and a proposed revised ISA 220 *Quality Control for Audit Engagements*.

The proposed ISQC 1 requires a firm to establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements. The proposed revised ISA 220 establishes basic principles and essential procedures, and provides guidance on quality control procedures for audit engagements. The deadline for submitting comments to IAASB is 31 August 2003.

The IAASB has also issued an exposure draft containing a proposed standard on the *Review of interim financial information performed by the auditor of the entity*. The deadline for comment is 30 September 2003.

The Faculty will be responding to both consultation documents. The exposure drafts can be viewed at: www.ifac.org/eds.

Library & Information Service

The Library & Information Service will be closed from Monday 4 August until Tuesday 26 August 2003. During this time LIS staff will be working on essential development projects to ensure they can

continue to improve the high quality service they provide to members.

While the Library is closed you can still:

- Use the extensive online information services on the LIS website at: www.icaew.co.uk/library.
- Return books by post or leave them with the Security staff at the Copthall Avenue entrance to Chartered Accountants Hall.
- Get help with urgent information needs by leaving a message on 020 7920 8620 or emailing library@icaew.co.uk. These will be checked twice daily by LIS staff.

For more information about alternative business information services you can use while the Library is closed visit www.icaew.co.uk/library.

CCH Courses

Financial Framework of Charities
London 14 October
£299 plus VAT

Acting as an Executor
Huddersfield 18 November
£109 plus VAT

Accounting Standards and Reporting Requirements
Birmingham 9 October
£458 plus VAT

Audit of Pension Schemes
Birmingham 8 October
£109 plus VAT

Faculty members receive a 10 per cent discount on the prices list-

ed above for these courses. For further information, please contact CCH Customer Services on 020 8247 1646.

The Operating and Financial Review (OFR)

The Operating and Financial Review Working Group on Materiality, set up in December 2002 as a result of the proposals for an OFR in the White Paper on Modernising Company Law, has issued a consultation document. It addresses the concept of materiality, the principles to be applied in arriving at a judgement on materiality and the process directors should go through, as part of good governance, in deciding what should be included in their OFR. The document can be viewed at: www.dti.gov.uk/cld/financialreview.htm. The deadline for comments is 19 September 2003.

Moorgate Internal Audit Lecture

The next Moorgate Lecture entitled 'Risk-Based Internal Auditing' will take place on Monday 15 September at 6.00pm.

The lecture will be held at Chartered Accountants Hall in Moorgate. The Speaker to be confirmed.

Tickets cost £30.00 plus VAT and are available from Lucille Good on tel: 020 7920 8493.

true & fair EDITORIAL INFORMATION

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If you have enjoyed reading *True & Fair*, please pass this copy to one of your colleagues or associates who may be interested in joining the Audit and Assurance Faculty. All enquiries should be directed to the Faculty address above.

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