

CHAPTER 5

Promotion of adherence to high professional standards in the auditing and accountancy profession and acting as a specialist source of advice to the Minister on auditing and accounting matters

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1. Promotion of adherence to high professional standards in the auditing and accountancy profession

1.1 Approach to promoting adherence to high professional standards in the auditing and accountancy profession

The promotion of adherence to high professional standards by the auditing and accountancy profession is a core element of the Authority's mission and is, therefore, embedded within, and permeates all aspects of, the Authority's activities.

In summary, during the year the Authority's approach continued to be to promote adherence to high professional standards by the auditing and accountancy profession through three principal avenues, i.e. by:

- promoting adherence to high professional standards through interaction with the auditing and accountancy profession;
- promoting adherence to high professional standards through interaction with other stakeholder groups and with the wider public; and
- co-operating with interested parties in the development of auditing and accounting standards.

1.2 Interaction with the auditing and accountancy profession

During the year the Authority sought to promote adherence to high professional standards through:

- i. continuing to provide members of the auditing and accountancy profession with an understanding of the Authority's role, functions and principal findings through, amongst other avenues, the delivery of information presentations and contributing articles to professional publications (details of presentations delivered

and articles written by Authority staff during the year are set out in the Appendix to this Report);

- ii. reviewing proposed amendments to the PABs' constitutions, bye-laws, regulations and other standards and, where considered necessary or otherwise appropriate, seeking/requiring amendments thereto;
- iii. tabling recommendations to the PABs where the Authority's ongoing review and related activities identified scope for improvement in the manner in which members and member firms are being regulated and, where applicable, monitored;
- iv. reviewing complaints received relating to members of the PABs and to the PABs themselves and, where considered necessary, initiating statutory Enquiries into such matters with a view to determining whether:
 - breaches of approved procedures have occurred; and
 - parallel regulatory responses are necessary or otherwise appropriate; and
- v. providing RABs with feedback from IFIAR inspection workshops for the purpose of enhancing RABs' inspection processes.

Further information regarding the Authority's activities in the context of (ii) to (v) above is set out in Chapter 3 of this Report.

1.3 Interaction with other stakeholder groups and with the wider public

Other avenues through which the Authority sought to promote adherence to high professional standards (on the part of the profession and in a wider context) during the year included:

- i. continuing to review, on a risk assessed basis,

selected constituent issuers' periodic financial reports for compliance with relevant reporting frameworks and, where considered necessary or otherwise appropriate, seeking further information and clarification from issuers regarding matters including apparent non-compliance with relevant aspects of accounting standards and legislative requirements;

ii. responding to queries received from members of the public, thereby providing enquirers with the information necessary to enable them to:

- understand the Authority's and PABs' respective roles in the complaints/disciplinary process;
- understand issuers' periodic financial reporting obligations under the Transparency Regulations; and
- direct complaints to other relevant authorities, where appropriate; and

iii. providing stakeholder groups and the wider public with an understanding of the Authority's role and functions through the delivery of information presentations and contributing

articles to professional publications (details of presentations delivered and articles written by Authority staff during the year are set out in the Appendix to this Report).

Further information regarding the Authority's activities in the context of (i) above can be obtained in Chapter 4 of this Report while further information regarding (ii) above can be obtained in Chapter 6.

1.4 Provision of observations on year-end financial reporting issues for stakeholders' benefit - financial years ended 31 December, 2008

In presenting their results in respect of the year ended 31 December, 2008, issuers reported against a background of continuing market uncertainty, reduced access to credit and a weak domestic and international economic environment, each of which gave rise to significant challenges in the context of financial reporting. In that context, the Authority considered it opportune to offer some commentary by way of an observations document published in January, 2009 on selected financial reporting issues for Boards' and Audit Committees' benefit⁷³. The Table below provides a brief summary of the matters addressed in the document.

Table 23: Summary of matters addressed in the observations document published in January, 2009

Subject matter	Observation
Valuation and impairment of assets	The document drew attention to the necessity for issuers' Boards and Audit Committees to critically assess management's judgements in respect of the impairment of individual assets and Cash Generating Units. It also reminded Boards that the use of models in valuations or impairment assessments of financial assets requires careful analysis as previous assumptions utilised in those models, which are based on historical experience, may no longer be applicable in the prevailing environment
Retirement benefits	The necessity for Boards and Audit Committees to question the appropriateness of historically applied assumptions in the valuation of retirement benefit asset and liabilities was also highlighted. Aspects of accounting for retirement benefits highlighted as warranting particular attention included: <ul style="list-style-type: none"> ■ determination of appropriate discount rates; ■ fair value of plan assets; and ■ the provision of a full current actuarial valuation in the context of the changed economic environment.

⁷³ This document is available at http://www.iaasa.ie/publications/FRSUobs_Jan09.pdf

Table 23: Continued

Subject matter	Observation
Going concern/ principal risks and uncertainties	Against a background of potentially falling asset values and decreased earnings, Boards and Audit Committees were advised to place appropriate emphasis on satisfying themselves that the preparation of financial reports on a going concern basis was appropriate and, in that context, the document listed several considerations that might usefully be included in Boards' and Audit Committees' evaluations. In addition, the document drew attention to the Authority's observations on the varying standard of compliance noted with the requirement to include a description of the principal risks and uncertainties facing issuers in Management Reports and noted that disclosures which are meaningful and issuer-specific are required as opposed to the provision of boilerplate statements.
Financial instruments: IFRS 7/ FRS 29 disclosures	The document drew attention to the provisions of Paragraph B3 of IFRS 7, which points to the necessity to strike a balance between overburdening financial statements with excessive detail and obscuring important information as a result of too much aggregation. Stakeholders were also advised that the Authority was likely to focus on the standard, quality and appropriateness of issuers' IFRS 7 disclosures in the course of its review activities during 2009.
Hedge effectiveness	In times of market turbulence, the measurement of the effectiveness of a hedging arrangement takes on additional importance, and in this regard Boards and Audit Committees were advised to carefully review the assumptions employed by management in their assessment of hedge effectiveness.
Judgements	Noting that, in its review activity to date, the Authority had found that periodic financial reports vary considerably in the extent to which they clearly and comprehensively disclose the judgements made in preparing financial statements, stakeholders were advised that judgements were likely to remain an area of review focus during 2009. The document highlighted, in particular, the judgements made by debt and fund issuers in respect of the classification of financial instruments between equity and financial liabilities under IAS 32 <i>Financial Instruments: Presentation</i> .
Related party disclosures	As a general observation, it was noted that the Authority had identified weaknesses and deficiencies in disclosures provided pursuant to the requirements of IAS 24 <i>Related Party Disclosures</i> . In the particular environment in which issuers were preparing to publish their 2008 financial reports, the importance of compliance with the statutory provisions governing transactions with directors was emphasised.
Deferred tax assets	Boards and Audit Committees were advised to rigorously assess the appropriateness of the recognition of deferred tax assets in circumstances where the entity had incurred losses.
Operating profit	While acknowledging that issuers differ in their presentation of items within and outside of a subtotal entitled ' <i>Operating profit</i> ' and in the level of accompanying disclosure provided, it was noted that entities should have regard to the provisions of BC13 of IAS 1 <i>Presentation of Financial Statements</i> and should also include a disclosure to explain the judgements applied in classifying items within and outside of ' <i>Operating profit</i> '.
Alternative performance measures	The Authority noted that, while many entities present alternative (non-IFRS) performance measures in periodic financial reports, such as ' <i>EBITDA</i> ' and ' <i>Alternative Earnings Per Share</i> ', the quality of narrative explanations accompanying same varies considerably. In that context, stakeholders' attention was drawn to the CESR Paper entitled ' <i>Recommendation on Alternative Performance Measures</i> ' which encourages entities who use alternative performance measures to do so in a manner that is both appropriate and useful for investors' decision making.
Business combinations	The document highlighted potential weaknesses in the financial reporting around business combinations, in particular in respect of the allocation of the cost of acquisition to identifiable assets at fair value and failure to disclose the use of provisional values.
Earnings per share (‘EPS’)	The Boards, and where applicable Audit Committees, of closed ended funds were reminded that the requirement to provide EPS is neither met nor negated by the provision of Net Asset Value (‘NAV’) disclosures.
Prior period errors	Arising from the Authority's review activities, weaknesses and deficiencies in disclosures concerning the nature and effect of restatements of comparative amounts were noted, as well as instances in which entities had corrected prior period errors on a prospective rather than retrospective basis, as required by IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> .
Recently promulgated accounting pronouncements	The requirement to disclose that a new IFRS or IFRIC Interpretation, which is not yet effective, has been issued along with reasonably estimable information relevant to assessing the possible impact of the application of that pronouncement on the entity's financial statements was highlighted for stakeholders' benefit.

1.5 Provision of observations on year-end financial reporting issues for stakeholders' benefit - financial years ended 31 December, 2009

At year end, work on a similar document dealing with issuers' financial statements in respect of the year ended 31 December, 2009 was at an advanced stage⁷⁴. In summary, matters addressed in that document include the topics of:

- impairment of goodwill;
- hedging instruments;
- bank covenants;
- related party transactions and balances;
- accounting for Government grants and disclosure of Government assistance;
- materiality;
- financial instruments – risk disclosures;
- operating profit; and
- key performance indicators.

1.6 Co-operation with interested parties in the development of accounting standards and practice notes

The background to the Authority's observer status at the Accounting Standards Board ('ASB') was set out in the Authority's 2006 Annual Report⁷⁵ and is not, therefore, reproduced in this Report. In summary, the Authority sought, and was granted, ASB observer status in the context of its statutory mandate (as

provided for by section 9(2)(k) of the Act) to co-operate with interested parties in the development of accounting standards and practice notes.

As well as facilitating contribution to ASB discussions and outputs generally (which comprise mainly of revised Standards, Exposure Drafts and discussion papers), ASB observer status facilitates the early identification by the Authority of issues that are, or might be, of particular interest or relevance in an Irish context.

While the ASB published a number of documents during the year that were of interest in an Irish context, one issue of particular relevance to Irish preparers of financial statements was the publication, in August 2009, of the ASB's policy proposal entitled '*The Future of UK GAAP*'. This was a particularly important development in that, if implemented as proposed, this policy proposal would impact the vast majority of Irish (as well as UK) companies and would lead to major changes to the financial reporting regime currently operating in Ireland. Specifically, the separate body of accounting literature currently referred to as Irish/UK GAAP would cease to exist. While, under its policy proposal, the ASB would not relinquish the right to set Irish/UK GAAP in the future, if implemented, all existing literature would be superseded.

The ASB's proposal sets out a differential reporting regime based on the concept of '*public accountability*'. The proposed approach, and its effect on the various categories of companies operating in Ireland, can be summarised as follows:

⁷⁴ This document, which was published in January 2010, is available at http://www.iaasa.ie/publications/Obsdoc_Jan10.pdf

⁷⁵ Section 5 of Chapter 2 of the Authority's 2006 Annual Report refers (available at http://www.iaasa.eu/publications/Annual_Report_2006.pdf).

Table 24: Effects of the ASB’s proposal on ‘The Future of UK GAAP’

Type/Nature of Entities	Current Accounting Regime	Proposed Accounting Regime	Potential implications for:
EU listed entities’ consolidated financial statements IEX listed entities’ consolidated financial statements	IFRS (EU endorsed)	IFRS (EU endorsed)	n/a
‘Publicly Accountable’ entities, including 100% publicly accountable subsidiaries	Converged Irish/UK GAAP	IFRS (EU endorsed) [Tier 1 – see narrative below]	Irish listed debt and fund entities Building societies Credit unions Friendly societies
Large and medium ‘Non-publicly Accountable’ entities (‘NPAs’)	Converged Irish/UK GAAP	IFRS for Small and medium-sized entities (SMEs) [Tier 2 – see narrative below]	NPA groups NPA entities NPA subsidiaries
Small companies	Converged Irish/UK GAAP	FRSSE [Tier 3 – see narrative below]	Small companies

In essence, and as referred to in the Table above, the ASB proposals would see a three tier approach to future financial reporting by Irish (and UK) entities. Set out below is a brief summary of each Tier.

Tier 1 – ‘Publicly Accountable’ entities (including 100% publicly accountable subsidiaries)

All publicly accountable entities would be required to apply EU endorsed IFRS. This requirement would apply to publicly accountable entities irrespective of their size. By way of example, in an Irish context, this would have implications for:

- approximately 500 Credit Unions and Friendly Societies operating in the State;
- fund and debt issuers listed on the ISE; and
- publicly accountable wholly-owned subsidiaries.

This was an issue discussed at considerable length by the ASB and, given that Ireland differs from the UK considerably in that Ireland has a higher proportion of fund and debt issuers listed on the ISE than is the case on the London Stock Exchange (and that certain of these issuers are wholly owned subsidiaries), this was a subject in which the Authority took a keen

interest. Having considered the matter in detail, the ASB decided to expose the following proposals for stakeholder comment:

- IFRS (EU endorsed) should be used by all publicly accountable entities (including publicly accountable subsidiaries);
- subsidiaries not meeting the criteria for being considered as being publicly accountable should be regarded as part of Tier 2 and should be allowed to use the IFRS for SMEs; and
- there should be no disclosure exemptions for subsidiaries (as there are so few that this option was not considered to be worth pursuing). Stakeholders were, however, invited to make the case if they disagreed with this assessment.

Tier 2 – Large and medium Non-publicly Accountable entities

The ASB considers that the IFRS for SMEs standard, recently published by the IASB, should be used by Tier 2 entities. The IFRS for SMEs is a self-contained Standard which has been developed by the IASB to cater for the needs of entities that publish general purpose financial statements for external users but which do not have public accountability. Many of

the principles for recognition and measurement in 'full' IFRS have been simplified, some topics omitted altogether, and the number of required disclosures has been significantly reduced. Under the proposed approach, therefore, the IFRS for SMEs standard would require to be adopted by:

- those entities not deemed to be publicly accountable (Tier 1 entities), who would be required to apply EU endorsed IFRS;
- those entities not permitted to use the FRSSSE (only Tier 3 entities would be permitted to apply the FRSSSE).

In practice the proposals mean that most large and medium sized Irish companies would be required to switch from using existing 'full' Irish/UK GAAP to using the IFRS for SMEs Standard. Affected entities could, of course, elect to apply 'full' EU endorsed IFRS should they so wish.

Tier 3 – Small companies

The ASB considers that the existing Financial Reporting Standard for Smaller Entities ('FRSSE') should remain in force for the foreseeable future, on the grounds that the cost of change to the IFRS for SMEs Standard in its current form would not be justified in the context of the entities concerned. The FRSSSE is a self-contained standard based on Irish/UK GAAP for use by small companies. The measurement requirements in the FRSSSE are the same as those in 'full' Irish/UK GAAP but many of the disclosure and presentation requirements of 'full' Irish/UK GAAP have not been included.

This option is currently available for small companies as defined in Irish law, i.e. companies that do not exceed two or more of the following criteria:

- i. turnover: €3,809,214;
- ii. balance sheet total: €1,904,607;
- iii. average number of employees: 50.

While the FRSSSE is widely used by small companies in the UK, it is not as widely used in Ireland and many small companies prepare their financial statements using 'full' Irish/UK GAAP. In the event that the ASB implements its proposals, these entities would have to change their existing practice and use the FRSSSE (or, alternatively, elect to apply the IFRS for SMEs or 'full' IFRS).

In view of the significance of the ASB's proposals for Irish entities, the Consultative Committee of Accountancy Bodies in Ireland (CCAB-I) hosted a public event on 9 December, 2009 to discuss and debate the proposals and the role of IFRS therein. The Authority's Head of Financial Reporting Supervision spoke at the event, which was attended by over 400 people.

1.7 Co-operation with interested parties in the development of auditing standards and practice notes

During the year the Authority continued to act as an observer at APB meetings, an activity that assists the Authority to discharge its role of co-operation in the development of auditing and ethical standards and to identify at an early stage developments that may have a particular relevance to, or bearing on, Ireland.

Some of the APB's more significant activities during the year included the publication of:

- a revised Ethical Standard on long association with the audit engagement;
- Practice Notes on the audit of complex financial instruments and smaller audit entity documentation respectively;
- an Exposure Draft Practice Note on the audit of pension schemes in Ireland; and

- a Consultation Paper on the topic of audit firms providing non-audit services to audit clients.

2. Acting as a specialist source of advice to the Minister on auditing and accounting matters

2.1 Transposition of the Statutory Audit Directive

During the year the Authority continued to devote considerable resources towards providing the Department of Enterprise, Trade & Employment with advice and assistance in the context of its responsibility to transpose the Directive into national law. Specific Directive related issues on which the Authority provided assistance and advice are elaborated upon in sections 2.2 to 2.4 below.

2.2 European Commission Decision on transitional arrangements for certain third country auditors and audit entities

In July 2008, the European Commission issued a Decision, the effect of which was to permit auditors and audit entities from certain named third countries to continue to issue audit opinions valid in the EU for a specified time period, provided that they furnish certain specified information to Member States' designated authorities. The Authority provided the Department with assistance and advice in giving effect to the Decision in national law, which was done in June, 2009 by Statutory Instrument 229 of 2009⁷⁶. Further information regarding the Authority's role as competent authority for the above purpose is provided in Chapter 3 of this Report.

2.3 European Commission Recommendation on External Quality Assurance of Auditors of Public Interest Entities⁷⁷

Following publication by the European Commission of the Recommendation in May 2008, the Department of Enterprise, Trade & Employment, with the Authority's assistance, issued a Consultation Paper in March 2009 for the purpose of garnering stakeholders' views as to whether the

Recommendation should be implemented in Ireland. In seeking stakeholders' views, the Consultation Paper set forth three principal options, namely:

- retain the *status quo*, i.e. whereby responsibility for monitoring the quality of the audits of listed entities would remain the responsibility of the RABs;
- move to a direct inspections model, i.e. whereby responsibility for monitoring the quality of the audits of listed entities would become the responsibility of the Authority; or
- move to a delegation model, i.e. whereby responsibility for monitoring the quality of the audits of listed entities would become the responsibility of the Authority, which would, in turn, be permitted to delegate certain of these responsibilities to the RABs.

In its response dated 9 April, 2009, the Authority expressed the view that:

- implementation of the Recommendation is necessary from a public interest perspective;
- Ireland's current quality assurance arrangements in respect the audits of listed entities are increasingly out of step with EU and internationally accepted best practice; and
- implementation would be likely to result in reduced duplication of audit inspection activities, thereby creating scope for associated benefits deriving from reduced costs and regulatory burdens.

Based on the foregoing, and having regard to cost and other considerations associated with a move to a direct inspections model, the Authority expressed the view that the most appropriate manner in which to implement the Recommendation would be through a

move to a delegation model (i.e. option iii).

Of those parties who responded to the Consultation Paper (and whose responses have been published on the Department's website⁷⁶), the results were as follows:

In favour of retaining the status quo	In favour of moving to a direct inspections model	In favour of a move to a delegation model
CIMA	ACCA	AIA
Ernst & Young	Deloitte	IAASA
KPMG	Financial Regulator	ICAEW
ICAI/CARB	Grant Thornton	Institute of Internal Auditors
ICAS	ICPAI	Revenue Commissioners
PricewaterhouseCoopers	Office of the Director of Corporate Enforcement	

2.4 PCAOB proposals to conduct inspections of Irish audit firms

In the context of the PCAOB's proposals to perform inspections of Irish PCAOB-registered audit firms, the Authority continued to provide the Department with its perspective and advice on these matters during the year. One of the more significant developments on this issue during the year was the issuing of a letter from EU Commissioner McCreevy to the Acting PCAOB Chairman in September. In his letter, the Commissioner:

- i. noted that certain amendments to the Sarbanes Oxley Act necessary to facilitate the mutual exchange of audit working papers between EU and US audit oversight bodies were still some way off;
- ii. expressed concerns regarding the PCAOB's desire to perform inspections in EU Member States in circumstances where the aforementioned legislative amendments had yet to be made;
- iii. drew attention to the legal consequences that PCAOB inspections would have for Member States and EU audit firms (i.e. on the basis of such inspections taking place outside the provisions of Article 47 of the Directive);
- iv. confirmed that, until such time as the Commission has taken an adequacy decision in respect of the US, Member States cannot accept PCAOB inspections of EU audit firms and Member States' oversight bodies and audit firms cannot send audit working papers to the PCAOB;
- v. emphasised that, were Member States to fail to comply with (iii) above, the Commission would have to initiate infringement proceedings against the Member State(s) concerned; and
- vi. indicated that the PCAOB should not, therefore, impose sanctions on EU audit firms that are not in a position to comply with the PCAOB's information/inspection requests.

⁷⁶ The text of the S.I. may be accessed at http://www.iaasa.ie/legislation/si229_2009.pdf

⁷⁷ This document may be accessed at http://www.iaasa.ie/publications/EU_QA_Recs080508.pdf

⁷⁸ <http://www.deti.ie/commerce/companylawlegislation/eqaconresponses.htm>

In the context of the foregoing, and in the context of the issue of proposed third country inspections of Irish audit firms generally, the Authority continued to share its analysis on these matters with the Department of Enterprise, Trade & Employment during the course of the year.

3. Other advisory inputs

3.1 Provision of advice/assistance to the Department of Enterprise, Trade & Employment and to the Minister for Trade & Commerce

During the year the Authority also provided assistance and/or advice to the Department of Enterprise, Trade & Employment in respect of:

- the Companies (Miscellaneous Provisions) Bill 2009 ('the Bill'), which provided for the use, on a transitional basis, of US GAAP by certain parent undertakings, to the extent that the use of those principles in the preparation of relevant undertakings' financial statements does not contravene any of the provisions of the Companies Acts or any Regulations made thereunder. The Bill was subsequently enacted as the Companies (Miscellaneous Provisions) Act 2009;
- the commencement of section 36 of the Companies (Auditing and Accounting) Act 2003, which provides statutory backing for the PABs' disciplinary processes⁷⁹ (this matter is discussed in further detail in Chapter 3 of this Report);
- possible alternative means of funding investigations under section 24 of the Act;

- the formulation of a revised list of entities for Ministerial prescription under section 48(1) of the Act (i.e. for the purpose of section 31 of the Act);
- certain proposed amendments to the Transparency (Directive 2004/109/EC) Regulations, 2007; and
- how the term '*auditor*' should be defined in the Criminal Justice (Money Laundering) Bill, 2008. This Bill seeks to consolidate the existing law on money laundering and to enact new provisions giving effect to the Third Money Laundering Directive (Directive 2005/60/EC).

3.2 Company Law Review Group

The Company Law Review Group ('CLRG') is a statutory body established by the Company Law Enforcement Act, 2001 (CLEA) for the purpose of advising the Minister on company law related matters⁸⁰. The Authority is a body entitled to nominate a member to the CLRG and, through its nominee's membership⁸¹, the Authority contributed to the CLRG's ongoing provision of advice to the Minister during the year.

⁷⁹ Section 36 was commenced by S.I. 13 of 2009 (Companies (Auditing and Accounting) Act 2003 (Commencement) Order 2009).

⁸⁰ Further information on the CLRG can be obtained at <http://www.clrg.org>

⁸¹ The Authority has nominated its Chief Executive as a member of the CLRG.