**Audit News**

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ICAS

## New Audit Regulations – January 2020

**New regulations came into effect on 1 January 2020. Amendments are largely to align the joint UK and Ireland regulations to the Companies Act 2014 (as amended) ('CA 2014') in Ireland following the commencement, in September 2018, of the Companies (Statutory Audits) Act 2018. A copy of the new Regulations can be found on the ICAS website at https://www.icas.com/governance/charter/icas-rules-and-regulations**

It is likely that there will be further changes to the regulations to reflect the impact of Brexit and further divergence between UK and Ireland audit arrangements.

Under the new regulations, UK firms were required to apply separately to be registered for Irish audits, and all ICAS audit firms were contacted in this regard. This deadline for registration has now passed and any firm who has not applied will not be eligible to conduct audit work in Ireland going forward. If your firm is no longer on the register, you will require to update your website and letterhead accordingly.

## Changes to the Ethical Standard and ISAs (UK)

**The FRC Board has published changes to its Ethical Standard along with select changes to ISAs and ISQC(UK)1**

**Note that the implementation date of the ISA changes is for p/c 15 December 2019, whilst the ethical standard changes take effect for p/c 15 March 2020. ICAS AM considers that some of the changes will have a significant impact on ICAS audit firms and further articles and guidance will be issued via this publication and icas.com.**

**A more detailed review of the impact of the revisions to the ISAs will be provided in a future edition of Audit News, for now we will focus on changes to the Ethical Standard, a copy of which can be found at https://www.frc.org.uk/auditors/audit-assurance/standards-and-guidance/current-ethical-standards**

The FRC has announced significant changes the UK's Ethical Standard. The FRC has set out more stringent ethical rules for auditors, in response to findings from recent audit enforcement

cases and from audit inspections.

Key changes include:

- A clearer and stronger ‘objective, reasonable and informed third party test’ which requires audit firms to consider whether a proposed action would affect their independence from the perspective of public interest stakeholders rather than another auditor.
- Enhancing the authority of the Ethics Partner function within audit firms, in order to ensure firm wide focus on ethical matters and the public interest, and to require reporting to those charged with governance where an audit firm does not follow the Ethics Partner’s advice.
- The list of prohibited non-audit services that auditors of Public Interest Entities (PIEs) can provide to audited bodies has been replaced with a much shorter list of permitted services (no other services can be provided).
- The requirement for the auditors of all UK listed entities to include in their published auditor’s reports the performance materiality threshold used in the audit.

ICAS AM also notes some key changes in relation to the safeguarding of certain ethical threats including long association, and further restrictions and prohibitions in relation to contingent fees, which will impact a number of our firms.

**More stringent non-audit service requirements**

The auditor of a public interest entity (PIE) or listed entity, will now only be able to provide non-audit services which are closely linked to the audit itself or required by law or regulation. The revised Standard contains a new section 5B “Approach to Non-audit / Additional Services Provided to Public Interest Entities” in this regard. Rather than containing a list of prohibited services this new section details the types of non-audit services that an auditor of a public interest entity and a member of its network (where applicable) can provide to that PIE, its UK parent undertaking or its worldwide controlled undertakings.

In relation to non-PIE audits, revisions mainly provide clarity on existing requirements, but reinforces the management threat issue presented by a large number of non-audit services including accountancy services. There is a greater emphasis on the auditor ensuring that no management role is undertaken by the auditor which may be difficult unless:

- Relating to the provision of a specific accounting function on an outsourced basis (for example, payroll);
- The entity maintains the accounting records, undertakes basic bookkeeping and prepares a year-end trial balance and asks the firm to assist with the preparation of the necessary adjustments and the financial statements.

Consequently, firms providing more detailed bookkeeping and management accounts services may find it difficult to reduce the management threat to an acceptable level, though it is noted that the Provisions Available for Smaller Entities are still available in section 6 of the standard and should be considered further by all firms going forward.

**Recruitment and Remuneration Services**

The Standard now prohibits auditors from providing recruitment and remuneration services or playing any part in management decision making.

**The role of the Ethics Partner and further reporting requirements**

New provisions incorporated into Section 1 highlight increased reporting requirements under the remit of the Ethics Partner:

- Where the firm concludes that the opinion of the Ethics Partner is not to be followed, where it relates to an engagement on a public interest entity, the matter shall be reported to the firm's independent non-executives and to the Competent Authority. The engagement partner shall also report this matter to those charged with governance (PIE auditors ONLY); and
- Whenever a possible or actual breach of this Ethical Standard, or of policies and procedures identified, the firm shall be reported to the Competent Authority (i.e. the FRC or ICAS) on a biannual basis and to those charged with governance of an entity relevant to an engagement, where a breach relates to a specific engagement or engagements in a timely manner (ALL audit firms, not just PIEs).

**Long Association**

The FRC has made a subtle but significant change to requirements in relation to long association for non-PIE audit entities where an audit engagement partner has held that role for a continuous period of ten years. Previously, if the file documented the reasoning as to why the individual continued to participate in the engagement, and the facts were communicated formally to those charged with governance of the entity, this on its own would be an allowable safeguard.

Under the revised standard this will have to combined with an appropriate safeguard under paragraph 3.5, including either independent partner review, partner rotation or an engagement quality control review of the file.

**Fees**

The insertion of a new paragraph 4.2 represents another significant change and will require firms to be able to justify to those charged with governance where a lower than expected audit fee is charged.

Paragraph 4.5 introduces a prohibition on contingent fees for the provision of non-audit and audit-related services to an entity relevant to an audit engagement, its UK parent undertaking and any worldwide controlled undertaking. This could impact a number of non-audit services, most commonly valuation work; R&D tax credit claims; and VAT work.

**Internal audit**

Under section 5.44 of the revised standard, the firm shall not provide internal audit services to an entity relevant to an engagement or a significant affiliate of such an entity, where the firm is undertaking an engagement. This introduces a blanket prohibition on provision of internal audit services to external audit clients.

Paragraph 5.44 replaces sections 5.48 to 5.59 of the old Standard, with effective removal of any applicable scenario where this would be acceptable.

**A change to the ‘staff loan assignment’ wording**

Under the new standard, in relation to staff loan assignments / secondments, a firm shall not enter into an agreement with an entity relevant to an engagement, or with the affiliates of such an entity, to provide any partner or employee to work for a temporary period as if that individual were an employee of any such entity or its affiliates.

An exception applies in respect of staff employed by a UK national audit agency, in a role with no management responsibilities, provided the secondment is for a period of no longer than three months; and where the service to be provided would not otherwise be prohibited by this Ethical Standard.

**As noted above, the ISA changes will be considered in the next edition of audit news. Further detailed amendments to individual standards include changes to:**

- **ISA (UK) 250 - to clarify the auditor's responsibilities when considering whether the bodies they have audited are compliant with relevant laws and regulations; and**
- **ISA (UK) 720 - when checking there are no material misstatements in the 'other information' companies include in their annual financial reports (other than the financial statements which are subject to audit).**

## Brydon review on quality and effectiveness of audit published

**Sir Donald Brydon has published his Report on his Independent Review into the Quality and Effectiveness of Audit.**

**This contains a number of wide-ranging recommendations to improve audit quality and effectiveness.**

Sir Donald Brydon's final report on his Independent Review into the Quality and Effectiveness of Audit has been published. The detailed report contains a number of recommendations which are categorised in the report as follows:

- A redefinition of audit and its purpose;
- The creation of a corporate auditing profession governed by principles;
- The introduction of suspicion into the qualities of auditing;
- The extension of the concept of auditing to areas beyond financial statements;
- Mechanisms to encourage greater engagement of shareholders with audit and auditors;
- A change to the language of the opinion given by auditors;
- The introduction of a corporate Audit and Assurance Policy, a Resilience Statement and a Public Interest Statement;
- Suggestions to inform the work of BEIS on internal controls and improve clarity on capital maintenance;
- Greater clarity around the role of the audit committee;
- A package of measures around fraud detection and prevention;
- Improved auditor communication and transparency;
- Obligations to acknowledge external signals of concern;
- Extension of audit to new areas including Alternative Performance Measures; and
- The increased use of technology.

ICAS will be giving due consideration to these wide ranging recommendations which also cover areas beyond audit. A series of articles will be featured on icas.com providing greater detail on the above proposals, and we would direct you to the first of these by Anne Adrain, ICAS Head of Sustainability and Assurance at https://www.icas.com/professional-resources/audit-and-assurance/information-and-support/brydon-recommendations-a-redefinition-of-audit-and-its-purpose

**A copy of the report can be found at https://www.gov.uk/government/publications/the-quality-and-effectiveness-of-audit-independent-review**

## Revisions to ISA 570 (UK) Going Concern

**The Financial Reporting Council (FRC) has issued a revised going concern standard in response to recent enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after these reports were issued.**

**The revised standard will require greater work on the part of the auditor to challenge management's assessment of going concern and is applicable for accounting periods commencing on or after 15 December 2019.**

**ICAS AM would stress that the new standard imposes significant additional requirements on the auditor, and we will be discussing and covering the new standard at our monitoring visits in 2020.**

The revised standard follows concerns about the quality and rigour of audit and increases the work auditors are required to do when assessing whether an entity is a going concern. The changes mean that UK auditors will follow significantly stronger requirements than those required by current international standards.

The revised standard requires:

- Greater work on the part of the auditor to more robustly challenge management's assessment of going concern, incorporating thorough testing of the adequacy of supporting evidence, evaluation of the risk of management bias, and greater use of the viability statement (where applicable for entities who comply with the UK Corporate Governance Code);

- New reporting requirements for the auditors of public interest entities (PIEs), listed and large private companies, including provision of a clear, positive conclusion on whether management's assessment is appropriate, and setting out the work performed in this respect; and
- A stand back requirement when the auditor draws their conclusions on going concern in consideration of all evidence obtained, whether corroborative or contradictory.

**Responsibilities of the auditor**

In considering the requirements of the new standard, it is important to revisit the auditor's responsibilities as regards going concern. As stated in the standard the auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on:

- Whether a material uncertainty related to going concern exists; and
- The appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

These responsibilities exist even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern

Key to understanding these responsibilities, is an understanding of the term 'material uncertainty related to going concern' which along with 'management bias' has been specifically defined within the new standard at section 9-2:

a. Management bias – A lack of neutrality by management in the preparation of information;
b. Material uncertainty related to going concern – An uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern, where the magnitude of its potential impact and likelihood of occurrence is such that appropriate disclosure of the nature and implications of the uncertainty is necessary for:
    i) In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements; or
    ii) In the case of a compliance framework, the financial statements not to be misleading.

These terms are used frequently in the new standard and underpin the additional consideration, work effort and documentation required on audit files from the risk assessment stage forwards.

**Greater work effort for the auditor**

It is important to note that a lot of the additional work effort and documentation was required under the previous version of the standard, however, only crystallised when events or conditions were identified which cast doubt on the entity's ability to trade as a going concern (for example when challenging management's assessment of going concern).

Under the new standard, there are no such steps to ascertain whether 'additional work' should be performed – the work is required in all cases - and the revised standard includes further detail as to the types of procedures and testing that might be required in following areas:

- The risk assessment process and related activities at the planning stage;
- The auditor's evaluation of management's assessment of going concern;
- The auditor's evaluation of the sufficiency and adequacy of evidence obtained in support of the auditor's conclusion; and
- Consideration of the impact on disclosures in the audit report in relation to going concern.

**Documentation**

The increase in the auditor's work over going concern under the revised standard will of course increase the amount of documentation required in support the evaluation of management's going concern assessment and the auditor's conclusion. In a key addition to the standard, section 26-1 sets out the audit documentation required on the file and specifies that the auditor shall include:

a. Key elements of the auditor's understanding of the entity and its environment, including the entity's internal control related to going concern;
b. Indicators of possible management bias related to going concern, if any, and the auditor's evaluation of the implications for the audit.
c. Significant judgments relating to the auditor's determination of:
    i) Whether or not a material uncertainty related to going concern exists;
    ii) The appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements; and
    iii) The appropriateness of management's disclosures in the financial statements.

As noted above, there is also a new stand back requirement in the revised standard which requires the auditor to consider all evidence obtained before forming their conclusion, and firms will also have to consider how this stand back step of the audit process is documented.

**Reporting**

The new standard brings further auditor reporting requirements. If the auditor concludes that the going concern basis is appropriate, audit reports for all entities will include:

- A statement that the auditor has not identified a material uncertainty that may cast doubt on the entity's ability to continue as a going concern for a period not less than twelve months from the date of approval of the financial statements; and
- A conclusion that management's use of the going concern basis of accounting in the preparation of the entity's financial statements is appropriate.

If the auditor considers that a 'material uncertainty related to going concern' should be included in the auditor's report, or that it is necessary to issue a qualified, adverse or disclaimer of opinion in respect of matters related to going concern, the auditor is required to determine whether law, regulation or relevant ethical requirements:

a) require a report to an appropriate authority outside the entity; and/or
b) establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.

The revised ISA has also incorporated enhanced auditor reporting requirements for PIEs, listed entities and those entities applying the UK Corporate Governance Code. These are:

- A new requirement for the auditor to explain how he/she evaluated management's assessment of the entity's ability to continue as a going concern.
- A statement that the auditor has nothing to add or draw attention to what management has reported in relation to their assessment of the entity's ability to continue as a going concern.

**Conclusion**

The new standard requires a greater consideration of the auditor's conclusions around going concern, including consideration of managements evaluation, the evidence obtained in support of the conclusion and the appropriateness of documentation on the audit file to ensure compliance with the standard.

It is noted from our monitoring visits in 2018/19, that some firms struggle with the requirements of the current standard, in particular when documenting the auditor's judgments and conclusions where there are indications of material uncertainty but a clean audit report has been signed; and in challenging management's evaluation of going concern and obtaining evidence in support of the overall conclusion.

Firms are advised to review the requirements of the new standard in detail, and to ensure appropriate coverage in audit staff and RI training in advance of the adoption date.

A copy of the new standard can be downloaded from the FRC website at https://www.frc.org.uk/news/september-2019/frc-strengthens-going-concern-audit-standard

As a consequence of introducing the new standard, the FRC has withdrawn Bulletin 2008/01 'Audit issues when financial market conditions are difficult and credit facilities may be restricted' and Bulletin 2008/10 'Going concern issues during the current economic conditions'.

## FRC announces its audit areas of focus and thematic reviews for corporate reporting for 2020/21

**The FRC has announced its 2020/21 corporate reporting and audit quality review programme. In selecting corporate reports and audits for review, priority will be given to certain higher risk sectors.**

The FRC's Corporate Reporting Review team will supplement its routine corporate reporting reviews with four thematic reviews. In particular, the FRC will follow-up its recent report on IFRS 16 in interim reports by considering how a sample of companies apply IFRS 16 to their annual report and accounts. A 'deep dive' will also be carried out into findings from the recent report into the application IFRS 15. The full list of reviews is as follows:

- IFRS 16: review of disclosures in the first year of implementation
- Cash flows and liquidity disclosures
- IFRS 15: a deeper dive
- The effects of the decision to leave the EU on companies' disclosures.

### Areas of focus for audit monitoring

The FRC's Audit Quality Review team has also signalled its areas of focus for audit monitoring. The AQR team expect to pay particular attention to the auditor's work on:

- Going concern and the viability statement
- The Other Information in the Annual Report
- Long-term contracts

- The impairment of non-financial assets
- Fraud risk
- Application of new accounting standards (IFRS 15 & 16)

**Priority sectors**

Priority sectors are those considered by the FRC to be particularly high risk virtue of particular economic or other pressures. The corporate reports and audits selected for review by the FRC will have regard to the following priority sectors:

- Financial Services
- Retail, including Retail Property and Travel & Leisure
- Construction and Materials
- Manufacturing

**FRC Developments in Audit - report for 2019**

**In November 2019 the FRC released its Developments in Audit report for 2019.**

**The Developments in Audit report was first produced in 2015/16 and was the first of its kind for the FRC as the UK's Competent Authority for audit.**

**The report summarises the current 'state of play' as seen by the FRC and its stakeholders, supplemented by a more detailed report of the FRC's audit related and monitoring activities. This article will focus on the key findings and observations from the FRC's Audit Quality Review team (AQR) in its 2018/19 inspection cycle.**

The most common weaknesses across the 2018/19 inspection cycle were in relation to:

- the sufficiency of challenge of management;
- the audit of revenue; and
- the audit of long-term contracts.

There were further notable findings in relation to the audit of controls and the audit of fair value.

**Challenge of management**

AQR inspection reports show that auditors continue to struggle most with challenging management sufficiently, especially in more judgemental areas, such as long-term contracts, goodwill impairment or the valuation of financial instruments. This is an issue common to findings on ICAS AM visits in 2018/19, and we see similar issues and lack of professional scepticism arising from:

- Over familiarity with audited entities leading to the same audit approach being followed even when changes in the business or trading environment (for example, economic difficulties) demand a different approach;
- Confirmation not challenge - audit teams accepting what management tells them rather than questioning its plausibility;
- Discussions with the audit client on accounting judgements becoming a fact gathering exercise for presentation as audit evidence, rather than a starting point for challenge and corroboration; and
- Audit teams too regularly accepting unrealistic deadlines resulting in inadequate work.

The importance of management challenge cannot be understated. Often a lack of scepticism and challenge on an audit file is in relation to a specific balance or assertion, and prominently in areas of judgement which by their nature have a high potential financial impact.

Other shortcomings were identified by the AQR team in more routine audit procedures - notably in relation to revenue recognition.

**Revenue**

Revenue is an area in which ICAS AM continues to raise issues and has also been a key finding in the FRC report. In the current inspections cycle, AQR highlighted concerns at five of the largest seven firms inspected, with many of the findings relating to more routine audit procedures. This included:

- Poorly performed substantive analytical procedures (comparing actual and estimated revenue);
- Insufficient work over key sales reconciliations; and
- A lack of evidence obtained over the occurrence of transactions.

In relation to the first two bullet points, ICAS AM note an increase in the use of substantive analytical review and key sales reconciliations to provide audit evidence in support of (and

sometimes in place of) detailed testing. Often, the work performed is no more than a variance analysis or basic analytical review with uncorroborated explanations from management, and therefore not sufficient to meet the ISA requirements over evidence.

**Long-term contracts**

As accounting for long-term contracts requires significant estimation, for example estimating future costs to completion and forecasting revenues, there is a great degree of judgement.

Issues have been identified on ICAS AM visits in 2019 in relation to testing future costs to completion on construction contracts, in particular where the estimate provided by management has not been tested or corroborated on the audit file.

Often estimates can be difficult to substantiate, especially when they relate to contracts for which corroborating and comparative information is not as readily available, and therefore extremely challenging to audit. The FRC found that audit teams often struggled to challenge management appropriately in key areas of judgement and in obtaining sufficient evidence to support the judgements made, including estimates of future costs and margins, forecast revenues for onerous contracts and revenue recognition for multiple-element and complex contracts.

**Fair value**

Fair value accounting can involve significant management judgement, and for auditors, the combination of high financial statement impact and high judgement can make auditing of fair value items challenging. This is especially the case where there is limited access to reliable information or the information used in ascertaining fair value is subjective, for example when valuing investment property, shares in unlisted entities or assessing impairment of goodwill and intangibles.

Issues raised on ICAS AM visits in 2019 include lack of consideration of the impairment of goodwill and intangibles in the balance sheet, in particular where there have been changes to the business or trading environment of the client, and a lack of challenge over expected future cashflows and discount rates applied.

A large number of inspection findings by the AQR team in this area also concerned audit work on the fair value of financial instruments, which management typically calculate using complex models based on assumptions and other inputs.

**Internal controls**

Audit work performed over internal controls was a focus area during the AQRs most recent

recent inspection cycle, and reviews identified the following themes:

- Understanding and evaluation of the design and implementation of controls - Some of the audits reviewed lacked sufficient evidence of the audit team's understanding of processes and controls and/or evaluation of the design and implementation of controls relevant to the audit risks. The AQR team also observed cases where the audit team had not identified any relevant controls which mitigate certain significant risks, which auditors are required to do irrespective of whether they intend to rely on them.

  ICAS AM notes that there have been a number of instances in 2019 monitoring visits where this work had not been completed in the current year, or the auditor had placed undue reliance on other work, for example substantive testing to be performed at the execution stage, or in a previous year's audit.

- Responding to identified control deficiencies – The AQR team found insufficient evidence of the audit team's response to control deficiencies, including the audit team's testing of whether the control deficiencies had been exploited (i.e. ensuring that they had not been used to commit fraud). Consequent issues were noted in relation to the sufficiency of changes to the audit plan and approach to address any related increase in risk.

  Firms are reminded that, while substantive testing may demonstrate that the financial statements are free from material error, identified control deficiencies must be resolved by management in a timely manner and this should be reflected in the financial statement disclosures regarding the effectiveness of the control environment.

> Firms are encouraged to review the full 2019 report, which includes more detail on the FRC's monitoring activities, firms visited and results. A copy can be downloaded from the FRC website:
>
> https://www.frc.org.uk/auditors/report-on-developments-in-audit

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## Results of FRC Corporate Reporting Thematic Reviews

**In October 2019, the FRC released the results of four thematic reviews, to analyse companies' disclosures for new requirements under IFRSs 9 and 15; adoption of IFRS 16; and existing requirements on the Impairment of Non-financial Assets.**

**Audit firms with clients reporting under IFRS should be aware of the outcome of these reviews when considering and challenging the adequacy of financial statement disclosures.**

### IFRS 15 'Revenue from Contracts with Customers'

The implementation of IFRSs 9 and 15, which applied for the first time to 2018 year-ends, represented significant challenge and change for many companies, following a period of relative stability in terms of financial reporting requirements.

The FRC found that, in general, companies provided helpful and meaningful explanation of the impact of the new standard, however, there was still scope for improvement including:

- improving the descriptions and tailoring of accounting policies to the specific requirements of company; and
- providing more detailed information about judgements which significantly affect the amount and timing of revenue.

### IFRS 9 'Financial Instruments'

The FRC identified instances of better practice across the sample of companies reviewed. However, it also identified that there was still room for companies to improve disclosures, including analysing the credit quality of trade receivables by non-banking companies.

### Impairment of non-financial assets

Impairment is a matter of particular interest to investors in sectors that are experiencing structural change and across all sectors in periods of heightened macroeconomic uncertainty.

The review identified a number of common disclosure omissions and opportunities to clarify and enhance disclosures. Specifically, in relation to:

- Provision of relevant information around significant judgements and key assumptions made in estimating the recoverable amount of assets and cash-generating units.
- Explanation of the sensitivity to changes in key assumptions, where reasonably possible changes could give rise to impairment of goodwill or material further adjustments to already-impaired assets.

**IFRS 16 'Leases'**

The implementation of IFRS 16 applies for the first time to 2019 year ends. As already required by IFRS, companies are expected to provide more information in their annual reports and accounts to help stakeholders better understand the effect of a new standard. In relation to IFRS 16, per the FRC this should include:

- information around key accounting judgments made, which will include the identification of the lease, and assessing its length;
- clearer explanations any specific transition choices made;
- a detailed reconciliation between the operating lease commitment disclosed under the previous standard and the new lease liability. This should include clear explanations for any adjustments or reconciling items; and
- where alternative performance measures are used to help users of the accounts to understand the effect, these should be properly disclosed, reconciled and explained.

In addition, where the adoption of IFRS 16 has a significant impact, the FRC expects management to consider the requirements of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, as well as the transition disclosure requirements of IFRS 16.

| Copies of the 2019 corporate thematic reviews can be downloaded from the FRC website at: https://www.frc.org.uk/accountants/corporate-reporting-review/corporate-reporting-thematic-reviews |
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**The audit of dividends and distributable reserves**

Under company law, companies can only make distributions out of distributable profits available for that purpose. In practice, prior to declaring and paying a dividend, directors will look to the level of

retained profits in the last set of signed accounts or interim management information to determine profit available for distribution.

The retained profit and loss reserve, however, is not always a reliable indicator of distributable profits, as it may be subject to accounting adjustments, including identified audit errors, or may contain unrealised gains. There is therefore a risk that directors declare a dividend which is not supported by distributable profits – an illegal dividend. In examples from recent monitoring recent visits:

- a client of a firm had declared and paid a dividend at the year end, based on information from its bookkeeping software. When the firm posted the client's trial balance into a statutory format making adjustments for prepayments, accruals and depreciation, the company had made a loss for the year and had negative distributable reserves at the time of the dividend;
- a client of the firm paid dividends during the year based on interim management accounts which were prepared in house. During the planning of the audit it was identified that the client had not made appropriate adjustments to a deferred income balance, and on further investigation would have had a negative distributable reserves at the time of the dividend.

Illegal dividends can have implications for the audit report, disclosures in the financial statements and shareholders, who can be liable to repay an illegal dividend. All too often on monitoring visits, however, the audit of dividends and distributable reserves has not been covered by the audit team. This is of particular concern where the dividend paid is material, or when it is paid to the director or directors who declared the dividend at the time when there were insufficient reserves.

Audit teams should consider on the audit file:

- when dividends have been declared and paid;
- whether the dividend is reflected in the correct period; and
- whether there is evidence that the company did not have had sufficient distributable reserves at the time of the dividend.

If a dividend has been declared and there were insufficient distributable profits to support it, the auditor will have to consider whether additional disclosures are required in the financial statements. Where reserves are in deficit and going concern becomes an additional consideration, there may be a further impact on the audit report.

**Director's disclosures**

In relation to potentially illegal dividends, directors may make additional disclosures in the financial statements, for example, we have reviewed financial statements which included wording such as:

- The dividend paid in the year was based on interim accounts which showed, at the time the dividend was paid, that there were sufficient profits available for distribution. Consequently, the directors do not consider that the dividend was illegal.
- Illegal dividends were declared and paid during the year. No further dividends have been declared or paid and the directors are seeking to recover monies from the shareholders.
- Illegal dividends were declared and paid during the year. At the time the dividend was paid the directors were not aware that there were insufficient profits available for distribution. No further distributions will be made until there are sufficient profits available.

While these notes are disclosed to explain the situation to readers of the accounts, the auditor must consider whether the disclosure is accurate and, where there is a material uncertainty or disagreement of disclosure, consider the implications for the audit report.

Note that retained reserves and distributable profits will be affected by different accounting treatments. Consequently, there may be an impact on companies' distributable profits as a result of transitional FRS 102 arrangements from the recent triennial review.

The FRC has released staff factsheets covering the triennial review and adjustments, which can be downloaded from https://www.frc.org.uk/accountants/accounting-and-reporting-policy/uk-accounting-standards/staff-factsheets

## Client Asset Assurance Standard - Revised November 2019

The FRC has issued a revised standard for the audit of client assets.

This Standard is effective for reports to the FCA with respect to Client Assets for periods commencing on or after 1 January 2020.

A link to the revised standard can be viewed at https://www.frc.org.uk/auditors/audit-assurance/standards-and-guidance/other-standards-and-statements

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**Mandatory course: Keeping Audit on the Right Track**

This course aims to educate Audit Compliance Principals (ACPs) and Responsible Individuals (RIs) in developing a strong compliance function and preventing some of the recurring issues identified on audit monitoring visits. It lasts three hours and is presented across various locations each year. The ICAS Authorisation Committee has imposed, since the inception of the course in 2010/11, a mandatory aspect for ACPs and RIs, where each ACP is required to attend once within a three-year cycle; and RIs are required to attend once within a five-year cycle.

For clarification, the current requirements are:

- The current cycle for ACPs commenced on 1 January 2019. As such, each ACP will be required to attend at least once in the three-year period from 1 January 2019 to 31 December 2021.
- The current cycle for RIs commenced on 1 January 2016. As such, each RI will be required to attend at least once in the five-year period from 1 January 2016 to 31 December 2020.
- Newly approved RIs will be required to attend the course within 12 months of approval; and
- Previously inactive RIs (i.e. approved RIs who are not signing audit reports), who have recommenced the role, will be required to attend the course within 12 months of becoming active.

The course is presented by the ICAS Audit Monitoring team and has been created to educate and support ACPs and RIs and covers all areas of audit compliance responsibilities, key regulatory issues, common compliance failings, and key findings from ICAS audit monitoring visits. The course is open to all audit professionals and many attend yearly to maintain audit CPD, however there is a mandatory requirement, as noted above. Detailed materials are provided during the course, and this is useful reference material for all firms.

Full details of dates and times for this course can be found on CA Connect, however courses for 2020 are scheduled as follows:

- 22nd April: Aberdeen
- 13th May: Edinburgh
- 10th June: Ayr
- 25th August: Dundee
- 9th September: Glasgow
- 6th October: Inverness