

Audit regime in the UK to be transformed with new regulator

The Financial Reporting Council (FRC) is to be replaced with a new regulator following review by Sir John Kingman.

The Business Secretary Greg Clark has announced a new enhanced regulator in response to the comprehensive Independent Review led by Sir John Kingman. As per the review's recommendations, the Financial Reporting Council (FRC) will be replaced with a new regulator called the Audit, Reporting and Governance Authority (ARGA).

The government has welcomed the Review's vision for a new regulator with a new mandate, new leadership and stronger statutory powers and has published a [consultation on implementing these reforms](#). The government intends to move swiftly to implement these reforms and overhaul the sector.

Specifically, the new regulator will for the first time:

- be a statutory body with powers such as those to make direct changes to accounts rather than apply to court to do so, and more comprehensive, visible reviews for greater transparency;
- have strategic direction and duties to protect the interests of customers and the public by setting high standards of statutory audit, corporate reporting and corporate governance, and by holding companies and professional advisors to account;
- regulate the biggest audit firms directly (rather than those being delegated);
- have a new, diverse board and strong leadership to change the culture and rebuild respect of those it regulates

There will also be greater sanctions available in cases of corporate failure, including new powers to require rapid explanations from companies and in the most serious cases publish a report about the company's conduct and management.

Further information can be found on the BEIS [website](#).

Potential audit implications for Brexit

The UK currently follows EU rules and regulations under the areas of accounting, corporate reporting and audit. This is reflected in UK law mainly through the Companies Act 2006 and regulations made under that Act.

Following Brexit, regulatory changes will be required given the UK will no longer be a Member State, and firms should consider the impact on preparation and audit of financial statements.

Potential issues for the audit of financial statements

Brexit will have ramifications for a large number of entities, in particular those who operate in industries sensitive to any impact on imports and exports, financial markets; EU licensing; and access to EU labour.



Consequently, in industries such as retail, hospitality, automotive, airline, and financial services, this impact will be more pronounced. Whilst Boards need to consider whether specific issues will impact financial reporting; Auditors will have to be aware of increased uncertainty in these sectors, in particular when considering fair value; corporate reporting; management judgements and estimates' post balance sheet events; and going concern.

Risk assessment

At the planning stage, auditors should identify any implications of Brexit and the extent to which they will have an impact on audit risk and a material effect on the financial statements. As noted above, the industry in which a business operates will determine the extent to which Brexit may impact the financial statements, however, outside of these sectors businesses can still be affected by issues such as foreign exchange, pricing and disruption to supply chains, and general decline in economic activity, and therefore any risk should not be rebutted simply on the basis that the entity does not operate in a perceived 'high risk' sector.

At the risk assessment stage, auditors should consider the potential impacts of Brexit, including:

- The extent of new risks as a result of Brexit and how the entity has attempted to mitigate these risks;
- Any impact on funding and capital;
- Any impact on the entity's supply chain or a key market;
- Any impact on the cost or resourcing of employees;
- Any impact as a result of currency fluctuation;
- Whether the extent of any impact is short, medium or long term;
- Whether the outcome of Brexit been considered as part of the preliminary going concern assessment.

The Auditor should also ensure that consideration of laws and regulations (ISA (UK) 250A) reflects the appropriate legal and regulatory framework having a direct or indirect effect on the financial statements, and potential issues have already been noted as regards EU laws around data protection; intellectual property; licensing & trademarks; and insolvency.

Impairment and recoverability of assets

The assumptions used to determine the recoverability of assets are impacted by economic uncertainty including, but not limited to: property plant and equipment; investments in subsidiaries and joint ventures; and inventories.

- The **fair values** of, property, investments, associates and joint ventures might be affected by market volatility, and auditors will require to focus on the approach taken and assumptions used in determining fair value at the period end compared to the carrying values in the financial statements.
- Auditors should similarly consider evidence supporting reviews for **impairment** of assets, including property, plant and equipment. This will include an assessment of assumptions used by management, and appropriateness of value-in-use calculations.
- Consideration of fair value calculations should also include assumptions used in **defined benefit pension valuations** and **share option valuations**.



- **Inventories** should be considered for risk of declining selling prices. It might be necessary to write-down inventories to net realisable value (NRV). Auditors should consider any additional costs such as import tariffs and duties that may increase the cost of certain inventories above NRV.
- Auditors may also wish to consider whether loans payable or receivable in relation to connected or group entities, and consequently investments in associates and joint ventures, are impaired.
- Auditors should consider whether there are any implications on **distributable reserves**, and any consequent impact on the legality of current and future dividends.
- As with any audit, the auditor should consider whether assets held on the balance sheet are **recoverable** but should consider in light of any newly identified risks. This should include review of the recoverability of any recognised **deferred tax asset**.

Corporate reporting

Auditors should consider whether Brexit has had an impact on an audited entity's performance and, if so, the extent to which this has been disclosed by the directors.

In October 2018, the FRC issued its expectations as regards corporate reporting in relation to Brexit, including:

- Disclosures which distinguish between the specific and direct challenges to the entity's business model from broader economic uncertainties;
- Clearly identifying particular threats, e.g. the possible effect of changes in import/export taxes or delays to the entity's supply chain, including description of any actions being taken;
- Disclosure of sufficient information to help users understand the degree of sensitivity of assets and liabilities to changes in management's assumptions.
- A comprehensive post balance sheet events review, in order to identify both adjusting and non-adjusting events and to make the necessary disclosures.

Auditors of FRS 102 financial statements should consider the impact on the Strategic and Director's report and to ensure that the accounts give a true and fair view. In relation to FRS 102 1A, section 1A requires additional disclosures as necessary to give a true and fair view – if Brexit related issues have an impact on true and fair, disclosure will have to be considered.

Post balance sheet events

Firms are reminded that, under ISA (UK) 560, the objectives of the auditor are:

"To obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements in accordance with the applicable financial reporting framework; and



To respond appropriately to facts that become known to the auditor after the date of the auditor’s report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor’s report”.

Auditors should consider Brexit and the impact of events that occur between the year end and the date of signing. Where events arise, the auditor will need to identify whether they are adjusting or non-adjusting events and ensure the necessary disclosures are made.

Going concern

Auditors must consider any related risk factors from Brexit and their impact on the going concern basis of accounting. This includes whether disclosures in the financial statements by the directors as regards going concern are appropriate. From discussion with our firms at monitoring visits, such disclosures are already a contentious issue and can lead to difficult discussions between auditor and client.

The added layer of Brexit uncertainty will make these discussions even more difficult, however auditors must be prepared to challenge director’s disclosures, in particular if these minimal or generic in light of potential uncertainties.

In addition to the potential impacts on trade such as increased costs and decreasing revenue and margins, auditors should carefully consider:

- the ability of an entity to re-finance, in particular where already close to borrowing limits or covenant breaches;
- cash flow forecasts – to ensure that these are based on recent and appropriate budgets and forecasts, and that these have been updated in line with actual results as far as possible, with all assumptions taking account of any Brexit uncertainties.

Accounts impact – Companies Act

Whilst the corporate reporting regime will remain largely unchanged after the UK exits the European Union, there are some changes that impact a small number of companies. You should consider these, together with the transitional arrangements being made by the Government, to ensure that you continue to be fully compliant with the relevant accounting and reporting requirements. Specific areas include:

<p>UK incorporated parent companies with subsidiaries based in the EEA</p>	<p>Confirm relevant reporting requirements in the EEA State where the subsidiary is based. Corporate reporting requirements of the UK’s Companies Act will not be deemed automatically equivalent to the EU’s Accounting Directive so that UK reporting requirements (e.g. UK GAAP) may no longer be considered equivalent to the reporting requirements of the EEA country where the subsidiary is registered.</p>
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UK companies with an EEA presence, e.g. a branch	Confirm relevant reporting requirements in the EEA State where the branch etc has a presence, as the corporate reporting requirements of the UK's Companies Act may not be sufficient and not be automatically deemed equivalent to the EU's Accounting Directive.
EEA companies and groups with cross-border presence in the UK	EEA companies with a UK incorporated subsidiary will no longer be eligible for certain exemptions from preparing and filing of accounts. E.g. an intermediate UK parent company with an immediate EEA parent will no longer be automatically deemed exempt from producing group accounts.
UK registered dormant companies with EEA parents.	Will be required to prepare individual annual accounts for accounting periods beginning after exit date and file these with Companies House.

Existing EU-adopted IAS

At the point of the UK's exit from the EU, the European Union (Withdrawal) Act 2018 brings into UK law International Accounting Standards (IAS) already endorsed in the EU to provide continuity.

The **draft** International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019 will give power to the Secretary of State to endorse new or amended standards, and to delegate this responsibility to a body. The intention is to delegate these functions to a newly-formed independent UK endorsement body.

In October the Government published a Technical Notice covering the Accounting and Audit sector. Firms are advised to read this Technical Notice as well as related important information contained [here](#)

Changes to corporate reporting – s172 Companies Act 2006

For periods beginning on or after 1 January 2019, the directors of all large companies will have to prepare narrative disclosures that explain how they have taken wider stakeholders' needs into account while performing their duties in the year.

Under S172 of the Companies Act 2006 (CA 2006), directors of UK companies have a duty to promote the success of their company for the benefit of the members as a whole and, in doing so, have regard to:

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- The likely consequences of any decision in the long term
- The interests of the company's employees
- The need to foster the company's business relationships with suppliers, customers and others
- The impact of the company's operations on the community and the environment
- The desirability of the company maintaining a reputation for high standards of business conduct, and
- The need to act fairly between members of the company.

The purpose of the strategic report has always been to inform members about how directors have performed their S172 duties but strategic reports have traditionally concentrated more on annual company performance.

To address this, the Government has added a new requirement for all large companies (including large subsidiaries included in higher consolidations) to include a separate 'S172 Statement' in their strategic reports. Unquoted companies will also have to include this new statement on a website (either separately or via the website publication of their annual report).

S172 Statement contents

The legislation provides little guidance on the nature of information that should be included in the S172 Statement but the Government has published accompanying Frequently Asked Questions suggesting that it should include some (or all) of the following:

- The issues, factors and stakeholders the directors consider relevant in complying with S172(1)(a)-(f) and why
- The main methods the directors have used to engage with stakeholders and understand the relevant issues, and
- Information on the effect taking these into account had on the company's decisions and strategies during the financial year.

The Financial Reporting Council is also revising its Guidance on the Strategic Report and will include a section on this new reporting requirement.

Further changes

Also taking effect for periods beginning on or after 1 January 2019, new directors' report disclosures will be required as follows:

- All large and medium-sized companies with more than 250 UK employees (including those employed by a subsidiary of the company) must include a statement summarising how the directors have engaged with employees, taken their interests into account and the effect of doing so (including on the principal decisions taken in the financial year).
- All large companies (irrespective of the number of staff they employ) must include a statement as part of their directors' report summarising how the directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect that has had (including on the principal decisions taken in the financial year).

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FRC issues staff factsheets on FRS 102

The FRC has issued a suite of staff factsheets on aspects of FRS 102, including the 2017 triennial review. The factsheets are intended to assist stakeholders by highlighting certain requirements of FRS 102, and are as follows:

[Fact Sheet 1 - FRS 102: Triennial Review 2017 Amendments](#) (PDF)

[Fact Sheet 2 - FRS 102: Triennial Review 2017 Transition](#) (PDF)

[Fact Sheet 3 - FRS 102: Illustrative Statement of Cash Flows](#) (PDF)

[Fact Sheet 4 - FRS 102: Financial Instruments](#) (PDF)

[Fact Sheet 5 - FRS 102: Property: Fair Value Measurement](#) (PDF)

[Fact Sheet 6 - FRS 102: Business Combinations](#) (PDF)

[Fact Sheet 7 - FRS 102: Transition to FRS 102](#) (PDF)

Withdrawal of Practice Notes 25 and 27

The Financial Reporting Council (FRC) has withdrawn the following Practice Notes with immediate effect:

Practice Note 25 Attendance at Stocktaking - This Practice Note was last revised in February 2011 and much of the content is covered by application material in ISA (UK) 501 Audit Evidence – Specific Considerations for Selected Items and other ISAs (UK).

Practice Note 27 The Audit of Credit Unions in the United Kingdom - This Practice Note was last revised in May 2011 and relates to a small sector on non-PIE entities which the FRC no longer considers necessary to provide guidance on.

Spotlight: recent guidance for auditors of charities, pension schemes and RSLs

Charities

Important new guidance has been published by the Charities SORP Committee for non-charitable trading subsidiaries on how to account for corporate gift aid:

<https://www.icas.com/technical-resources/non-charitable-trading-subsiidiaries-accounting-for-corporate-gift-aid>

The Charities Panel has also published an update of its Guidance for ICAS members acting for Scottish charities:

<https://www.icas.com/technical-resources/guidance-for-icas-members-acting-for-scottish-charities>

Pension schemes

The Pensions Research Accounts Group (PRAG) has published new guidance on 'Accounting for Guaranteed Minimum Pension (GMP) equalisation by pension schemes following the Lloyds judgement' (March 2019):

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<https://www.icas.com/technical-resources/guidance-for-pension-schemes-on-accounting-for-guaranteed-minimum-pension-equalisation>

Housing associations

The National Federation of Housing Associations issued guidance on pensions accounting which is relevant for the first time to 31 March 2019 year-ends. The guidance is based on the FRC's proposals in FRED 71 (on accounting for a change from DC to DB accounting) being confirmed as amendments to FRS 102:

<https://www.housing.org.uk/latest-updates/pensions-accounting-guidance-for-housing-associations/>

Mandatory course: Keeping Audit on the Right Track

Full details of dates and times for this course can be found on the ICAS website by searching '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.