

AUDIT NEWS

INTRODUCTION

Welcome to the September edition of Audit News, where we have prepared some short articles which we hope you will find useful.

The first article announces the changes to the client assets regime for investment

firms, issued by the Financial Conduct Authority (FCA), and considers which audit firms this applies to.

There are further articles on some minor revisions to FRS 101 and 102, issued by the Financial Reporting Council

(FRC); proposed amendments to FRS 102 relating to pension obligations; the UK Government's proposed increase in small company thresholds; and new ICAS helpsheets to assist in the audits of friendly societies and industrial and provident societies.

CHANGES TO THE CLIENT ASSETS REGIME FOR INVESTMENT FIRMS

On 10 June 2014 the FCA published its Policy Statement (PS14/9) setting out the changes to the client assets sourcebook (CASS).

The FCA undertook a comprehensive review of CASS and consulted on changes to the custody, client money and client money distribution rules for investment firms. In the consultation paper (CP13/5) the FCA proposed changes to clarify the requirements and address specific risks; whilst enhancing the client assets regime in order to achieve better results for consumers and increase confidence in financial markets.

This Policy Statement summarises the feedback the FCA received to the consultation paper, and sets out the final rules.

How does this impact on audit firms with investment firm clients?

The Policy Statement affects all firms that are subject to CASS, because they conduct investment business and hold client money; custody assets; collateral; and/or mandates in relation to that investment business.

The FCA have specifically commented that the Policy Statement will be of interest to auditors in relation to providing annual auditors' client assets reports, and other reports related to the alternative approach to client money segregation and non-standard methods of internal client money reconciliation.

The changes are being implemented in stages from 1 July 2014 to 1 June 2015 and, as such, auditors should be considering whether their investment firm clients are in compliance with the changes introduced at each stage.

Firms who are impacted by this Policy Statement are advised to refer to the requirements set out in the full document, which can be accessed on the FCA website at: fca.org.uk/news/firms/ps14-09-review-of-the-client-assets-regime-for-investment-business

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FRC CONSULTS ON REGULATIONS AND GUIDANCE FOR LOCAL PUBLIC AUDIT

In July 2014 the Financial Reporting Council (FRC) issued a consultation on statutory regulations and guidance for local public audits in England and Wales.

Under the Local Audit and Accountability Act 2014, the auditors of these bodies will move from being appointed by the Audit Commission to being appointed by local bodies. Local public bodies will appoint private sector audit firms, which must be registered with a Recognised Supervisory Body (RSB), and subject to regulation by that body. The Government laid an Order before Parliament that delegates to the FRC most of its responsibilities for oversight of the regulation of auditors of local public bodies by RSBs.

The consultation on draft regulations and guidance seeks views on the way in which the FRC should give effect to three specific responsibilities delegated to it by the UK government:

- Transparency reporting by local public auditors;
- The establishment of a register of local public auditors; and
- Guidance on the approval of an individual as an audit engagement partner for local public audits.

The FRC expects to implement the regulations and guidance by the end of 2014 and they will be applicable to the audits of local public bodies in respect of accounting periods ending 31 March 2018.

The consultation document can be accessed on the FRC website, at: frc.org.uk/Our-Work/Publications/Professional-Oversight/Consultation-Document-Regulation-of-Auditors-of-Lo.pdf, and the consultation period will end on 17 October 2014.

ICAS will be providing a response on this consultation, and this will be published on the ICAS website for members to view.

FURTHER REVISIONS TO FRS 101 AND 102

We would like to draw your attention to the FRC's announcement, on 22 August 2014, that it had issued revised editions of FRS 101 'Reduced Disclosure Framework'; and FRS 102 'The Financial Reporting Standard'.

The August 2014 revised edition of FRS 101 incorporates amendments set out in:

- Paragraph 1.14 of FRS 103 'Insurance Contracts' issued in March 2014; and
- Amendments to FRS 101 'Reduced Disclosure Framework' issued in July 2014.

The August 2014 revised edition of FRS 102 incorporates amendments set out in:

- An editorial amendment to Section 11 'Basic Financial Instruments' and Section 12 'Other Financial Instruments Issues' in relation to the presentation requirements for financial instruments;
- An editorial amendment to Section 35 'Transition to this FRS' in relation to the transitional exemptions for service concession arrangements issued in March 2014;
- Amendments to FRS 102 – Basic financial instruments and Hedge accounting issued in July 2014; and
- The correction of some minor typographical errors.

The documents can be accessed on the FRC website at: frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/Accounting-Standards-and-Statements-issued-by-the/Standards-in-Issue.aspx

FRC PROPOSES AMENDMENTS TO FRS 102 RELATING TO PENSION OBLIGATIONS

On 20 August 2014 the FRC issued the exposure draft 'FRED 55: Draft Amendments to FRS 102 – pension obligations', to clarify issues relating to accounting for defined benefit pension plans in advance of new GAAP becoming mandatory from 1 January 2015.

FRED 55 proposes limited amendments to FRS 102, to clarify that:

- UK and Irish GAAP does not include all the complexities of IFRS; no additional liabilities need be recognised in respect of a 'schedule of contributions' that has been agreed in

order to address a deficit in the plan; and

- as is consistent with current practice, the effect of restricting the recognition of a surplus in a defined benefit plan, where the surplus is not recoverable, is recognised in other comprehensive income, rather than profit or loss.

The FRC have invited comments on these proposed amendments by 21 November 2014, and FRED 55 can be accessed on the FRC website at: frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRED-55-Draft-Amendments-to-FRS-102-Pension-obliga.aspx

UK GOVERNMENT PROPOSES INCREASE IN SMALL COMPANY THRESHOLDS, WITH NO INCREASE IN AUDIT EXEMPTION THRESHOLDS

In June 2013, the EU adopted a new Accounting Directive 'EU Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings'. Chapters 1 – 9 of the Accounting Directive provide the legal foundations upon which the UK's financial reporting framework is built. The Directive can be accessed at: eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:182:0019:0076:EN:PDF

The Accounting Directive consolidates, modernises, and updates the previous 4th and 7th company law Directives governing this area and introduces a 'building block' approach to the statutory financial statements that companies prepare, with increasing levels of disclosure dependant on the size of the undertaking.

It seeks to increase the comparability of financial reports across Member States by reducing the number of options available to the preparers of financial statements in respect of recognition, measurement and presentation. Further, the Accounting Directive creates a largely harmonised small company regime and limits, for the first time, the amount of information that Member States are permitted to require small undertakings to place in their annual statutory accounts. However, the effects of this on the UK are limited as we had already implemented many of the options previously available and which form the basis for this regime.

On 29 August 2014, the UK Government published the BIS Consultation paper 'UK Implementation of the EU Accounting Directive, Chapters 1-9'. The UK is required to transpose the Accounting Directive into UK law no later than 20 July 2015, however is proposing to take up the option permitting that the changes may first apply to financial years beginning on or after 1 January 2016. BIS are inviting views on whether adoption of the new reporting framework ahead of this date may be desirable or practicable, and the UK Government proposes to introduce legislation implementing the Accounting Directive early in 2015. This consultation closes on 24 October 2014, and can be accessed at: gov.uk/government/uploads/system/uploads/attachment_data/file/348997/bis-14-1025-implementation-of-eu-accounting-directive-chapters-1-to-9-consultation__2_.pdf

What are the UK Government Proposals?

Principally, the proposals will raise the thresholds for determining company size (small, medium-sized and large) in line with the mandatory thresholds imposed by the Accounting Directive:

- For small companies the turnover and balance sheet total (fixed plus current assets) thresholds would be raised to £10.2 million and £5.1 million respectively. They are currently £6.5 million and £3.26 million respectively. This would allow around 11,000 additional companies to access the small company accounting regime.
- For medium companies the turnover and balance sheet total thresholds would be raised to £36 million and £18 million respectively (currently £25.9 million and £12.9 million).
- In relation to this, the proposals also consider the following matters:
 - Consider if the method for determining thresholds for company size should be amended where "net turnover" is not a relevant factor for a company or where it might be more appropriate to consider the thresholds on a consolidated or aggregated basis.
 - Implement changes to comply with the new largely harmonised small company regime - including changes to the mandatory notes to the accounts.
 - Consider whether small companies should be permitted to prepare an abbreviated balance sheet and abbreviated profit and loss account.
 - Review the exclusion of public companies (except for those whose securities are traded on a regulated market) from the small company regime and the medium-sized company regime.
 - Explore the opportunities offered by the option to provide greater flexibility in the layout of the profit and loss account and balance sheet.
 - Amend the approach in relation to the writing off of goodwill and development costs as required by the Accounting Directive.
 - Require that information on subsidiaries included with the consolidated financial statements is only provided as a note to those statements.
 - Remove the requirement for micro-entity companies to prepare a Directors Report.
 - Seek views on the interaction of the Accounting Directive with the UK's statutory audit framework.
 - Seek views on the implications of the revised accounting framework for charitable companies.

What impact will the Accounting Directive have on audits?

The Accounting Directive determines which companies are within scope of mandatory audit for financial statements. The Directive introduces changes related to audit in three areas:

- 1) The companies within scope of audit, impacting upon the application of the audit exemption;
- 2) The audit report; and
- 3) Group reporting of fees paid for non-audit services.

1) Audit Exemption

The Accounting Directive adopts a new approach to what was previously the exemption from the audit requirement for the accounts of small undertakings. Previously the 4th Company Law Directive contained a Member State derogation allowing the introduction of an audit exemption for some or all small undertakings. Instead the Accounting Directive simply excludes all small undertakings, other than those that are Public Interest Entities, from the audit requirement. It is then a matter for Member States to require an audit as a matter of national law in those cases where they consider it appropriate.

The balance sheet and turnover thresholds for small undertakings have been raised. Given the UK Government's proposals on the implementation of this change for some undertakings that currently are medium-sized, it would be possible to provide an audit exemption to some or all of the current medium-sized companies qualifying as small under the increased accounting thresholds. However, the UK Government is not proposing to increase the audit exemption thresholds for the small undertakings as part of the initial implementation of the Accounting Directive. This will mean that the balance sheet and turnover thresholds for the small undertakings will differ for the purposes of the small companies regime for accounting purposes and the small companies audit exemption.

The small companies audit exemption in the Companies Act will, therefore, need to be amended so that it no longer refers back to the thresholds that apply for small company regime for accounting purposes. Instead the audit exemption framework in the Companies Act will have to explicitly set out the current thresholds so that those thresholds continue to apply for the purpose of audit exemption, while the thresholds that apply for the purpose of the small companies accounting regime are increased.

The UK Government intends to consider in due course the possible increase in the audit exemption thresholds for small undertakings. However this will not form part of the initial implementation of the Accounting Directive or of the Audit Directive and Regulation.

2) Audit Report

The Accounting Directive extends the requirements of the audit report to the company's management report. Previously,

the 4th Company Law Directive only required an opinion on whether the management report was consistent with the financial statements of the same year. The Accounting Directive now goes further and requires auditors to:

- Express an opinion on the compliance of the management report with the applicable legal requirements; and
- State whether any material misstatement has been identified by the auditor in light of knowledge and understanding of the audited entity which they have gained during the course of the audit.

The Audit Directive further amends the framework governing the auditor's opinion and statement so that both of these now need to be based only on the work undertaken in the course of the audit. This reduces the regulatory burden that would otherwise arise from the new requirement in the Accounting Directive. To avoid creating an intervening period (following the implementation of the Accounting Directive) in which this amendment does not apply, and in which the resulting regulatory burden is briefly increased, BIS is proposing for the relevant provision in the new Audit Directive to be implemented at the same time as the implementation of the requirement in the Accounting Directive.

3) Disclosure of Non-audit Service Fees

The Accounting Directive requires some companies to include in the notes to their accounts a statement of the amounts they have paid to their auditor for audit and non-audit services. The Accounting Directive suggests three changes to the scope of this requirement:

- Disclosure of non-audit service fees will no longer be required for medium sized companies. BIS does however intend to continue to require disclosure of audit fees by all audited undertakings.
- UK law provides that all public companies and companies in the same group as a public company are required to disclose the fees paid for their audit and non-audit services. BIS are considering whether this blanket requirement should be maintained in respect of the disclosure of non-audit services by most medium sized and small public companies. They are proposing that these companies (excepting those that are banks, insurers or whose securities are traded on a regulated market) should not be required to disclose in the notes to their accounts a statement of the amounts paid to their auditor for non-audit services.
- BIS are also proposing that small and medium sized companies in the same group as a public company should not be required to disclose their non-audit fees on this basis.

• ICAS will be hosting a webinar consultation event on 10 October 2014 on this topic, hosted by James E Barbour, Director, Technical Policy. Further details will be available from the ICAS website icas.org.uk.

ICAS HELPSHEETS – THE AUDITS OF FRIENDLY SOCIETIES AND INDUSTRIAL AND PROVIDENT SOCIETIES

When we issued our Audit Monitoring Annual Report 2013 at the start of this year we noted that many of the audit files in 2013 that were identified as being of poorer quality were of a specialist or regulated nature. As a result, we strongly advise firms to ensure that Responsible Individuals who have responsibility over such clients are undertaking regular training in the relevant area; that audit procedures reflect the specialist aspects of the assignment; and that sufficient time is devoted to these audits, which can often be perceived to be of a 'smaller' nature.

In previous editions of Audit News we have drawn your attention to helpsheets for the audits of various specialist and regulated entities.

Helpsheets for the audits of friendly societies and industrial and provident societies

We are now pleased to announce that we have issued two new helpsheets, on the audits of friendly societies and industrial and provident societies.

All of our helpsheets are available to ICAS members on the ICAS website, at icas.org.uk/regulation/news/helpsheets/

REMINDER – MANDATORY COURSE FOR AUDIT COMPLIANCE PARTNERS

Keeping Your Audit Firm and Files on the Right Track

As we confirm in each of our Audit News editions, these courses are mandatory for Audit Compliance Partners, however to ensure mandatory attendance is not too onerous, you are required to attend only once every five years, and the courses are still heavily discounted for those requiring mandatory attendance.

Courses are developed and delivered by the ICAS Audit Monitoring team and there is one further course date this year, being on the 6 November 2014 in Glasgow, and you can book a place on this course at: icas.org.uk/Businesscourses/

The first course was run in 2010, and therefore we are nearing the end of the first five year cycle for attendance,

therefore if you have not yet attended we would strongly recommend attending the Glasgow date.

If you would like to see any particular articles in future editions of Audit News or any particular auditing areas covered in future monitoring helpsheets please send your ideas to: auditandpracticemonitoring@icas.org.uk

