

# AUDITNEWS

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## INTRODUCTION

Welcome to the autumn edition of Audit News, which we hope you find useful. In this edition we have included articles on FRS 102 and UK GAAP; changes to the Charities SORP and removal of the FRSSSE; the FRC's

discussion paper on the quality of reporting on smaller quoted companies; an update on implementation of EU audit legislation; and providing assurance on client assets to the FCA.

## Course changes

We would also like to take the opportunity to inform you of significant changes to the courses 'Keeping Your Audit Firm on the Right Track' and 'Keeping Your Audit Files on the Right Track'. As you are all aware, in the first cycle of these courses, which have run from 2010 to 2015, every Audit Compliance Principal (ACP) has been required to attend at least once every five years.

We are revamping our approach from 2016 and will be consolidating all of the information into one single course, lasting three hours, which will again be presented across varied locations each year.

The most significant changes are that the Audit Registration Committee, in response to the Financial Reporting Council focus on audit quality, will now be requiring the following:

- Each ACP will be required to attend at least once every three years (previously every five years); and
- Each Responsible Individual (RI) will be required to attend at least once every five years (no previous requirement).

We acknowledge that some firms, particularly those with a large number of RIs, may consider there to be a more efficient method of providing the course messages to all RIs, and should any firm wish to discuss this, or have any other questions in this regard, please do not hesitate to get in touch with ICAS AM at: [auditandpracticemonitoring@icas.com](mailto:auditandpracticemonitoring@icas.com)

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## AN UPDATE ON FRS 102 AND UK GAAP

- The FRC has withdrawn the FRSSE for periods beginning on or after 1 January 2016.
- The FRC has issued an amendment to FRS 102, in the form of a new Section 1A – Small Entities of FRS 102.
- A new standard has been introduced, being FRS 105 – The Financial Reporting Standard applicable to the Micro-entities Regime.

In July 2015, the Financial Reporting Council (FRC) issued a suite of changes that update and, in many cases simplify, accounting standards. Key changes include new requirements for micro-entities and small entities, and the withdrawal of the Financial Reporting Standard for Smaller Entities (FRSSE). The changes are largely in response to the implementation of the new EU Accounting Directive, and include:

- A new standard, FRS 105 The Financial Reporting Standard applicable to the Micro-entities Regime; and
- A new Section 1A Small Entities of FRS 102.

### FRS 105 – The Financial Reporting Standard applicable to the Micro-entities Regime

#### Audit Opinion

It would normally be the case that any company which qualifies as a micro-entity would not be subject to a

statutory audit. However, there may be the odd case where such entities do decide to have an audit. From an auditing perspective it needs to be remembered that the audit opinion in relation to ‘true and fair’ is more akin to a compliance opinion as such accounts, given the required accounting treatment of certain items and the minimal level of disclosures required, would in many cases fail to ensure that a micro-entity’s financial statements convey a ‘true and fair’ view in the traditional sense.

#### Qualifying Criteria

A company qualifies as a micro-entity if it does not exceed two or more of the following criteria:

- Turnover £632,000;
- Balance sheet total £316,000; and
- No. of employees 10.

#### The usual two year rule and certain other criteria apply.

FRS 105 has simplified the requirements of FRS 102, where, as governed by legislation, the micro-entities regime requires limited disclosures and constrains the accounting policies that can be applied, significantly:

- The only primary statements required are a balance sheet and profit and loss account, and the information is condensed;
- No assets can be measured at fair value or a revalued amount;
- Deferred tax and equity-settled share-based payments are not recognised; and
- All accounting policy choices have been removed, including the options to capitalise development costs and borrowing costs.
- Disclosure is limited to advances to directors and advances, credit and guarantees granted to directors and financial commitments, guarantees and contingencies as required by regulation 5A of, and paragraph 57 of Part 3 of Schedule 1 to, the Small Companies Regulations

Micro-entities may voluntarily choose to disclose more information, and every entity that is eligible to apply it should consider whether the standard meets its individual needs. It is important to remember that using the micro-entities regime is optional even if an entity meets the eligibility criteria.

Firms are advised to familiarise themselves with the new standard and the disclosure changes for accounts which may previously have been prepared under the FRSSE. The key differences between FRS 105 and the FRSSE are summarised in the table below:

<b>Preparation of only two primary statements required</b>	Micro-entities are only required to prepare a balance sheet and profit and loss account and not a statement of recognised gains and losses (STRGL) or a cash flow statement.
<b>Significantly condensed formats of statements</b>	The statutory formats for the balance sheet and profit and loss accounts are significantly condensed, for example “current assets” is not disaggregated into stocks, debtors, investments and cash.
<b>Significantly reduced number of disclosures</b>	Micro-entities can voluntarily provide more disclosures. This is in contrast to the FRSSE which mandates significantly more disclosures.
<b>Simplified accounting treatment</b>	FRS 105 has simplified the accounting treatment for some transactions. For example, micro-entities do not account for deferred tax.
<b>Fair value and revaluation accounting not permitted</b>	Micro-entities are not permitted to fair value or revalue any assets or liabilities, therefore all assets and liabilities (such as land and buildings and investment properties) must be held at cost. This is in contrast to the FRSSE which permitted or required certain assets to be revalued.
<b>No accounting policy Choices</b>	All accounting policy options have been removed. In general, the mandatory treatments result in earlier recognition of income / expenses in the profit and loss account rather than deferring on the balance sheet.

## Section 1A Small Entities of FRS 102

The FRC has issued an amendment to FRS 102, in the form of a new Section 1A Small Entities, which sets out the information to be presented and disclosed in the financial statements of a small entity. A company qualifies if it does not exceed two or more of the following criteria:

- Turnover £10.2m;
- Balance sheet total £5.1m; and
- No. of employees 50.

The usual two year rule and certain other criteria apply.

Similar to the new micro-entities regime, Section 1A Small Entities of FRS 102 has been developed from the

requirements of FRS 102, however, the requirements are more comprehensive and the recognition and measurement requirements are the same as those set out in the rest of FRS 102, with key differences from the current FRSSE including:

- The use of fair value and revaluation accounting; and
- The additional accounting requirements in respect of financial instruments (including derivatives), deferred tax and equity-settled share-based payments.

For entities previously applying the FRSSE, the table below sets out the key differences between that standard and Section 1A of FRS 102. More guidance is contained in FRS 102 which will help firms apply and interpret the treatment required.

<b>Preparation of only two primary statements required</b>	Small entities are only required to prepare a balance sheet and profit and loss account and not a statement of recognised gains and losses (STRGL) or a cash flow statement.
<b>Reduced number of mandatory disclosures</b>	Small entities are only legally required to provide a limited number of specified disclosures. However, directors of small entities are still required to ensure the financial statements provide a true and fair view and therefore must consider what additional information may be needed to achieve this. For the avoidance of doubt it is most unlikely that the inclusion of purely the mandated notes would lead to a true and fair view being presented by the financial statements.
<b>Improved reporting for financial instruments</b>	FRS 102 will require recognition of some financial instruments that the FRSSE did not. In particular, small entities will need to recognise derivatives such as options, swaps and forward contracts at fair value.
<b>Removal of contract rate accounting for foreign currency transactions</b>	FRS 102 does not permit the use of contract rate accounting in relation to foreign currency transactions and a small entity must apply the hedge accounting requirements of FRS 102 instead if they wish to achieve similar accounting results.
<b>Deferred tax arising on revaluations</b>	FRS 102 requires small entities to recognise deferred tax arising on revaluations of fixed assets including buildings and investment properties.
<b>Addition of the performance method of accounting for government grants</b>	FRS 102 permits an accounting policy choice between the accruals method (the method mandated in the FRSSE) and the performance method in relation to government grants. The performance method is simpler to apply and may lead to earlier recognition of income in the profit and loss account in some circumstances.
<b>Gains / losses on investment properties recognised in profit or loss</b>	FRS 102 requires that gains and losses on investment properties must be recognised in profit or loss, rather than in reserves as previously required by the FRSSE. Please note however that such gains or losses do not form part of the determination of distributable profits.

## What do these changes mean for smaller entities going forward?

The UK and Ireland GAAP reporting framework will now be made up of regimes within FRS 102; FRS 101; and FRS 105.

Smaller entities will have a choice between three core UK GAAP regimes subject to meeting relevant criteria:

- The micro-entities regime (FRS 105);
- The small entities regime (Section 1A Small Entities of FRS 102); and
- FRS 102.

The main changes are effective for accounting periods beginning on or after 1 January 2016, with early application permitted for accounting periods beginning on or after 1 January 2015. Companies will be able to avail themselves of the increase in the financial reporting thresholds for accounting periods commencing on or after 1 January 2015 but no provision for early adoption of the increased thresholds for audit exemption is available. However, unless the UK Government changes the existing legislation the audit exemption thresholds will be increased for accounting periods commencing on or after 1 January 2016.

## CHANGES TO THE CHARITIES SORP AND REMOVAL OF THE FRSSE

- Charities will no longer be able to apply the FRSSE from 1 January 2016.
- The withdrawal of the FRSSE, and its replacement with Section 1A of FRS 102, means it is almost certain that all charities will have to apply FRS 102 from 1 January 2016.
- The Charities SORP-making body is consulting on how the withdrawal of the FRSSE will impact on charity accounts.

The removal of the FRSSE, and the changes to UK GAAP, has implications for the majority of charities preparing true and fair accounts, principally where charities eligible to use the Charities SORP (FRSSE), which will only have been in place for one year, will require to adopt the Charities SORP (FRS 102) in 2016, thus making significant changes to their accounts in two successive years. The Charities SORP making body is currently minded that charities should not be able to avail themselves of the smaller entities regime contained in Section 1A of FRS 102.

The withdrawal of the FRSSE after one year of implementation may result in some charities moving directly to the Charities SORP (FRS 102) from 1 January 2015, though any decision will depend on:

- the individual circumstances of each charity; and
- the extent to which all the information necessary to move directly to the Charities SORP (FRS 102) can be obtained.

A potential matter which could influence a decision to adopt FRS 102 early relates to the treatment of defined benefit pension liabilities, in particular those which participate in multi-employer schemes.

ICAS has published detailed guidance on accounting for pension liabilities under the new Charities SORP, which can be found at: [icas.com/technical-resources/accounting-for-pension-liabilities-under-the-new-charities-sorps](http://icas.com/technical-resources/accounting-for-pension-liabilities-under-the-new-charities-sorps)

The SORP-making body has launched a consultation on the withdrawal of the Charities SORP (FRSSE) and whether or not it should be replaced, with the body's preferred option for all charities to apply the Charities SORP (FRS 102) in full, with an exemption only from the preparation of a statement of cash flows for charities with a gross income of under £500,000. The consultation further makes proposals about the extent to which the newly introduced Section 1A of FRS 102 will be available to the sector, and which may affect entities which are not companies but which meet the new small company threshold (turnover of £10.2m; balance sheet total £5.1m; employee total of 50).

A copy of the consultation can be found on the Charities SORP website at: [charitiessorp.org/the-sorp-consultation-process/sorp-consultation---your-views-sought](http://charitiessorp.org/the-sorp-consultation-process/sorp-consultation---your-views-sought)

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## FRC'S DISCUSSION PAPER ON THE QUALITY OF REPORTING ON SMALLER QUOTED COMPANIES

- The discussion paper highlights a number of factors that contribute to a "higher incidence of poorer quality annual reports by smaller quoted companies than by their larger counterparts".
- The FRC highlights that auditors can make a real and substantial difference to the quality of annual reports by engaging more effectively in the reporting process.

In June 2015 the Financial Reporting Council (FRC) launched a discussion paper proposing a programme of measures to improve the quality of reporting by smaller quoted companies. The paper is the result of the first phase of an FRC project launched in 2014 which aims to achieve a change in the quality over a three year period.

The discussion paper includes analysis of the key causes of what the FRC describes as a "higher incidence of poorer quality annual reports by smaller quoted companies than by their larger counterparts".

Amongst issues such as corporate governance, the financial information which is of interest to investors, and resourcing within the finance function of smaller listed entities, the paper also considers the role of auditors, specifically:

- The nature, complexity and application of reporting, professional and ethical standards; and
- The role of auditors in raising the overall quality of smaller listed company reporting.

The FRC has highlighted concerns from its own reviews of listed companies outside the FTSE 350, specifically regarding a number of annual reports, where the auditors had failed to identify basic reporting errors. The FRC has reaffirmed that auditors should consider deferring their opinion if they have insufficient time to conduct the audit to an appropriate standard.

In addition, the FRC identified that many smaller audit firms do not require technical reviews to be carried out by specialist staff and do not always require partners to be IFRS accredited. The FRC concludes that tightening audit practice and procedures in a number of areas would increase the effectiveness of the audits, and these areas for improvement include:

- Early communication of any concerns that the audit team have over the quality of the finance function;
- Increased involvement at an earlier stage of the audit by partners and staff who carry out the technical review of the financial statements;

- Improvements in the support provided to audit teams to ensure that common issues are addressed; and
- Training and guidance to audit partners and staff who are involved in the audits of smaller quoted companies.

The FRC will continue to monitor changes that audit firms are making to their processes and procedures in response to FRC audit quality review findings and carrying out further thematic studies on areas of the audit processes that have particular relevance to the audit of smaller listed companies

A copy of the full discussion paper can be found on the FRC website at: [frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Improving-the-Quality-of-Reporting-b-File.pdf](http://frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Improving-the-Quality-of-Reporting-b-File.pdf)

The ICAS response to the discussion paper can be viewed at: [icas.com/technical-resources/improving-smaller-quoted-company-reports](http://icas.com/technical-resources/improving-smaller-quoted-company-reports)

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## UPDATE ON IMPLEMENTATION OF EU AUDIT LEGISLATION

Further to the Government statement in July 2015, public interest entities (PIEs), including listed companies, banks, building societies and relevant insurers, will be required to put their audit out to tender at least every 10 years and change their auditor at least every 20 years. BIS will issue a consultation paper in October which will provide greater detail on this matter. The FRC has also been named as the intended UK Competent Authority for the regulation of auditors. Overall, this will mean the FRC would only have to conduct audit inspections, investigations and disciplinary cases in relation to PIEs, and would oversee the work of the RSBs for other audits.

A copy of the full statement can be found at: [parliament.uk/business/publications/written-questions-answers-statements/written-statement/Lords/2015-07-20/HLWS137/](http://parliament.uk/business/publications/written-questions-answers-statements/written-statement/Lords/2015-07-20/HLWS137/)

A further Government statement was made on 26 August. This can be viewed at: [icas.com/news/eu-audit-legislation-government-announces-next-steps](http://icas.com/news/eu-audit-legislation-government-announces-next-steps).

The Department for Business, Innovation and Skills (BIS) is continuing to work with the FRC, Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA) and the Professional Bodies to implement the requirements of the Audit Directive and Regulation. The reforms take effect on 17 June 2016.

The FRC will issue an exposure draft of its proposed revised ethical standards for auditors and also proposed changes required to International Standards on Auditing (ISAs) (UK and Ireland) in the autumn. These revisions are primarily to take account of changes required by the EU audit legislation.

## IAASA FOCUS ON THE COMPETENCE OF FIRMS AUDITING IRISH COMPANIES

IAASA is taking a significantly greater interest in the competence of firms conducting the audits of companies based in the Republic of Ireland (ROI).

As such, it is crucial that any audit firm, and related Responsible Individuals (RIs), that conducts such audit work, is keeping up to date with all relevant audit and accountancy matters impacting such engagements.

Of particular current relevance is The Companies Act 2014 ('The Act'), where the majority of provisions of the Act came into effect on 1 June 2015.

The Irish Auditing and Accounting Supervisory Authority (IAASA) is the independent body in Ireland responsible for the:

- Examination and enforcement of certain listed entities' periodic financial reporting; and
- Supervision of the regulatory functions of the Prescribed Accountancy Bodies ('PABs'), of which ICAS is one.

As a consequence of the increased focus from IAASA, the ICAS Audit Monitoring team will be directing attention to any ROI audit engagements, and will continue to include these engagement files for potential selection during monitoring visits. In addition, ICAS Audit Monitoring will assess the training, experience, and competence of RIs, relevant to the performance of audit work for ROI companies.

### The Companies Act 2014

As noted above, each RI that conducts audit work for an ROI company should maintain CPD in relation to this work, including an understanding of The Act.

The Act contains a large number of requirements; changes from the previous Companies Acts; and required financial statement disclosures. ICAS advises any RI conducting such work to undertake appropriate CPD in sufficient time prior to commencing such an audit engagement.

As further background, The Act has an impact on audit exemption and audit reporting:

- An extension of the audit exemption to certain types of companies, including small companies which are parent or subsidiary companies, companies limited by guarantee, and dormant companies. The qualifying conditions for a small company are satisfied by a company in relation to a financial year in which it fulfils two or more of the following requirements:
  - The amount of turnover of the company does not exceed €8.8 million;
  - The balance sheet total of the company does not exceed €4.4 million;
  - The average number of employees of the company does not exceed 50 (section 350(5)).

This represents a change from previous Companies Acts whereby a company has to satisfy all three qualifying conditions to be able to avail of audit exemption.

- CAI Technical Release 03/2015, alongside The Act, provides useful commentary on the form of the audit report. In general terms, the requirements are equivalent to those in the Companies Acts 1963 to 2013, however The Act introduces varied wording, and the statutory auditor is no longer required to give an opinion as to whether the company has complied with requirements in relation to accounting records; and no opinion is required on the existence of a 'financial situation' necessitating an EGM. Illustrative examples of wording for reports are set out in Appendix 1 of Technical Release 03/2015.

The Companies Act 2014 can be accessed at: [irishstatutebook.ie/2014/en/act/pub/0038/](http://irishstatutebook.ie/2014/en/act/pub/0038/); and the Technical Release 03/2015 can be accessed at: [charteredaccountants.ie/Documents/Technical%20news/Technical%20Releases/Technical%20Release%2003\\_2015\\_Statutory%20Auditor's%20Report\\_June%202015.pdf](http://charteredaccountants.ie/Documents/Technical%20news/Technical%20Releases/Technical%20Release%2003_2015_Statutory%20Auditor's%20Report_June%202015.pdf)

## FRC ASSURANCE STANDARD ON PROVIDING ASSURANCE ON CLIENT ASSETS TO THE FCA

- The FRC issued an exposure draft earlier this year.
- The finalised standard will be issued before the end of the year.

### Reasonable assurance client assets reports

Where a firm holds client assets the FCA's Supervision Manual (SUP) rules require the Client Assets Sourcebook (CASS) auditor, annually, to provide a Reasonable Assurance Client Assets Report and, in Part 1 of such a report, to provide its opinions as to whether the firm, among other things:

- a) Has maintained systems adequate to enable it to comply with the applicable FCA client money rules, custody rules, collateral rules, debt management client money rules and mandate rules throughout the period; and
- b) Was in compliance with those rules at the period-end date.

Part 2 of a Reasonable Assurance Client Assets Report is a schedule of identified CASS breaches that have occurred during the period. The Breaches Schedule sets out all the breaches the CASS auditor has identified through its work and all breaches disclosed to it by the firm or any other party.

The proposed Client Asset Assurance Standard focuses on the client money and custody rules. The SUP rules also require the FCA's CASS auditor, where applicable:

- a) To express an opinion as to whether a nominee company, in whose name custody assets of the firm are registered during the period, has maintained, throughout the period, systems for the custody, identification and control of custody assets which were adequate and included requisite reconciliations; and
- b) If there has been a secondary pooling event during the period, the firm has complied with the rules in CASS 5.6, CASS 7A and CASS 11.13 (as applicable to the firm) in relation to that pooling event.

Other than for references in the illustrative client assets reports, the Client Asset Standard does not establish basic principles and essential procedures with respect to these elements of the report.

### Limited assurance client assets reports

Some investment businesses may claim not to hold custody assets or client money. In these circumstances, the SUP Rules may require the CASS auditor to provide a Limited Assurance Client Assets Report. Such reports are also required to be made annually and to provide the CASS auditor's opinion as to whether "nothing has come to its attention that causes it to believe that the firm held client money or custody assets during the period".

In the context of the issuance of the FCA's revised CASS rules, the primary objectives of the FRC in developing an Assurance Standard to supersede the extant guidance are to:

- a) Improve the quality of CASS audits;
- b) Adequately support and challenge CASS auditors when undertaking CASS engagements and, in particular, to define the nature and extent of the work effort required for both reasonable assurance and limited assurance CASS engagements without undermining the importance of the CASS auditor's judgment;
- c) Support the objectives of the FCA's Client Asset regime regarding the effective safekeeping of client assets and client monies and, in particular, to guard against systemic failure of the CASS regime;
- d) Manage the expectations of the management of firms that hold client assets; and third party administrators when they engage a practitioner to provide assurance to the FCA on client assets that they handle or account for;
- e) Support the effective training of CASS auditors by both the accounting bodies and other training organisations;
- f) Help to establish realistic expectations regarding the integrity of the UK Client Asset Regime with the beneficial owners of client assets; and
- g) Underpin the effectiveness of the FRC's enforcement and disciplinary activities with respect to CASS assurance engagements

The consultation period closed in July and we expect a final standard to be issued in the Autumn.

The ICAS response to the exposure draft can be viewed at: [icas.com/technical-resources/frc-new-assurance-standard](https://icas.com/technical-resources/frc-new-assurance-standard).

