

AUDIT NEWS

ISSUE No 52 December 2012

INTRODUCTION

This winter edition of Audit News reports on some significant change in the audit profession. There has been a change in the audit exemption threshold that the Department of Business Innovation and Skills has stated will impact a significant number of companies in the UK. In addition, the Financial Reporting Council (FRC) has gone through reform and restructuring and the

Audit Registration Committee held a very productive meeting with senior representatives from the FRC to understand the reasons behind these changes.

We have also included articles providing guidance to firms who have Responsible Individuals (RIs) who do not currently conduct any audit work or sign audit reports, advertising for

any RIs that may be eager to join the Audit Registration Committee, and there are details of changes that we will be making to our mandatory Audit Compliance Partner course in 2013.

We hope you find this edition of Audit News useful, and we would like to take this opportunity to wish you a very happy break over the holiday period.

CHANGES TO THE AUDIT EXEMPTION THRESHOLD

The UK Government has announced changes to the audit requirements of companies in response to its consultation on Audit Exemptions and Change of Accounting Framework.

On 6 September 2012 the Department of Business Innovation and Skills (BIS) announced that mandatory audit thresholds were to be aligned with accounting thresholds for small companies from 1 October 2012.

BIS confirmed that small businesses will not need to subject their accounts to an audit if they meet two out of the three qualifying criteria for small company accounts:

- Fewer than 50 employees;
- Balance sheet gross assets total of not more than £3.26m; and
- Turnover of not more than £6.5m.

What are the changes for small and medium sized entities (SMEs) and subsidiary companies?

The announcement by the UK Government to align mandatory audit thresholds with accounting thresholds will allow SMEs to obtain an exemption from a statutory audit if they meet two out of the three criteria above. This is a shift from the current situation under which the criteria is that SMEs must be less than a certain size in terms of balance sheet **and** turnover.

We would consider that the biggest impact of this threshold change may be for investment property companies who

previously would have fallen within the requirement of an audit by virtue of their asset value. Auditors of these types of companies are, therefore, advised to consider this for their client portfolio, and to discuss the impact with clients.

The small company definition follows the Companies Act 2006 (s382) definition precisely, which means that the effect of the size of the company in previous years must also be considered, which is often referred to as the 'two-year' rule. The Companies Act confirms the circumstances that must exist in current and prior years for the definition to apply, however the following simple examples may prove useful:

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| Year 4 (current) | Year 3 (prior) | Year 2 | Year 1 | Exempt from audit in the current year? |
|------------------|----------------|-----------|-----------|--|
| Small | Small | - | - | YES |
| Not small | Small | Small | - | YES |
| Small | Not small | Not small | - | NO |
| Not small | Not small | Small | - | NO |
| Small | Not small | Small | Small | YES |
| Small | Not small | Small | Not small | NO |
| Not small | Small | Not small | Not small | NO |

In addition to this, there is also an exemption for most subsidiary companies, provided that their parent company guarantees their liabilities. We would urge caution, however, to firms and clients considering this option, as these subsidiary companies can only claim the exemption if the following conditions apply:

- The parent is established under the law of an EEA state;
- The company's stakeholders unanimously agree to dispense with an audit in the year;
- The parent gives a statutory guarantee of all the subsidiary's year end liabilities;
- The company must be included in the parent's consolidated accounts;
- The use of the exemption is disclosed in the parent's consolidated accounts;
- Various notices must be filed at Companies House; and
- The company must not be ineligible (for example, quoted companies, insurance firms, trade unions, etc.).

Following consultation by the Financial Reporting Council (FRC) on changes to UK Generally Accepted Accounting Principles (UK GAAP), the Government has also decided to allow companies that prepare their accounts under International Financial Reporting Standards (IFRS) to move to UK GAAP and take advantage of reduced disclosures. This move can be made provided the company has not moved to UK GAAP in the previous five years, and parent companies will be able to take advantage of this change provided they are not required under EU law to prepare their consolidated accounts using IFRS.

When can the changes to the exemption be taken?

The regulations that introduced these changes came into force for accounting years ending on or after 1 October 2012.

What has the Government said about the reasons behind, and the impact of, the changes?

BIS commented that, as a result of

these changes, SMEs will be able to make a commercial decision on whether to have a statutory audit. They estimate that the changes will allow 36,000 companies to decide whether or not to have an audit, a further 83,000 subsidiaries can consider the exemption, and 67,000 dormant subsidiaries will no longer need to prepare and file annual accounts, provided their parent company also guarantees their liabilities.

BIS further states that the decision to make these changes has come largely from an endeavour to ensure UK SMEs are not at a disadvantage compared to their European counterparts and that they hope these changes will allow SMEs "to expand their businesses and will generally make the UK a more attractive place to start, finance and grow a business". This statement was then supported by the BIS estimate that the new measures will save businesses at least £100m and possibly as much as £390m per year.

"Reporting requirements have become increasingly demanding and costly over the years. We listened to business, who made a strong case for reform, and I am delighted that we are now taking this opportunity to make audit more flexible and targeted."

– Vince Cable, Business Secretary.



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RESTRUCTURING OF THE FRC

Background

In the summer of this year the House of Commons and House of Lords gave the FRC the go-ahead to change its structure. The FRC stated that the changed structure would enable it to operate as a more unified regulatory body, with enhanced independence from those it regulates, and a more proportionate range of sanctions.

The FRC had several operating bodies, including the Accountancy Actuarial Disciplinary Board (AADB), the Audit Inspection Unit (AIU), the Financial Reporting Review Panel (FRRP), the Professional Oversight Board (POB), the Auditing Practices Board (APB), the Accounting Standards Board (ASB) and the Board for Actuarial Standards (BAS).

Following reform and restructuring the FRC now has two divisions:

- Codes and Standards Division: succeeds the ASB, APB and BAS; and
- Conduct Division: covering supervisory and disciplinary matters previously performed by the FRRP, POB, AIU and the AADB.

Further information on this can be found on the FRC website at www.frc.org.uk.

The Conduct Division

The FRC has statutory powers delegated to it by Government for the recognition, supervision and de-recognition of those accountancy bodies responsible for supervising the work of auditors or offering an audit qualification. Audit firms must be registered with, and subject to supervision by, an RSB and persons responsible for company audit work at a firm must hold a recognised audit qualification.

The FRC's Conduct Division undertakes

a number of key activities that are relevant to auditors:

- the FRC's Audit Quality Review team monitors the quality of the audits of listed and other major public interest entities and the policies and procedures supporting audit quality at the major audit firms in the UK (this activity was previously undertaken by the AIU);
- the Corporate Reporting Review team monitors the quality of corporate reporting by public and large private companies (this activity was previously undertaken by the FRRP);
- it is the independent disciplinary body for accountants and accountancy firms (including auditors and audit firms) in the UK (this activity was previously undertaken by the AADB);
- it has a number of oversight responsibilities that include independent oversight of the regulation of statutory auditors by the recognised supervisory and qualifying bodies in the UK (including ICAS) (this activity was previously undertaken by the POB); and
- it may also conduct a supervisory inquiry in certain circumstances.

Meeting between the Audit Registration Committee and the FRC in October 2012

On 9 October 2012 the Audit Registration Committee (ARC) held a meeting with Paul George (Executive Director of Conduct), and Andrew Jones (Director of Audit Quality).

The purpose of the meeting was to provide an opportunity for discussions on the FRC reform and restructuring, and the impact on regulatory procedures.

Paul George provided a detailed summary of the objectives of the FRC reform, which were to:

- Clarify the roles of the FRC and, hence, clarify decision making;
- Enable a more 'joined up' working within the FRC, where reforms would enable more cohesive access to, and consistent interpretation of, information;
- Greater independence in light of discussions at a European level, where there is challenge on all member states to demonstrate independence from the profession; and
- Greater proportionality in relation to sanctions, where the changes will in future allow the FRC to impose a wider range of sanctions on Recognised Supervisory Bodies (RSBs), and indeed on auditors of clients within their scope, should the circumstances warrant.

Following FRC reform there was no immediate change in the current delegation of audit monitoring to RSBs, however during the meeting there was a general discussion on the future scope and nature of FRC inspections, and that a balance needs to be struck between focussing on larger companies with higher risk, and smaller companies that may have a reduced inherent risk, but where there is often a higher incidence of issues. The impact of any change to the FRC scope on the existing delegation regime will be determined at a future date and effective for 2013/14.

In conclusion, this was found to be a very useful meeting, and clarified the reasons behind FRC reform. The meeting was extremely well received by all involved and we would like to thank everyone who attended, particularly Paul and Andrew for their open and honest discussion.

GUIDANCE TO FIRMS THAT HAVE INACTIVE RIS

RIs are individuals who are registered with ICAS as eligible to sign audit reports on behalf of an audit registered firm. RIs who have been approved but who do not currently sign audit reports are known as 'inactive RIs'.

What are the risks to firms of having an inactive RI?

The Audit Monitoring team regularly receives questions from firms regarding the potential risks of an approved RI that is not currently conducting audit work and signing audit reports.

The principal risk is that inactive RIs can easily become out of date and lose their audit competence. It is therefore important for firms to manage this risk by ensuring that the RI maintains audit competence so that they are suitably knowledgeable to conduct an RI role on any future audit engagements.

What is a suitable CPD standard for inactive RIs?

International Education Standard 8 (IES8) provides guidance on audit engagement partner competencies and capabilities. The following table is an extract from the guidance that was issued by ICAS when IES8 initially became effective, and this summarises the core competencies and capabilities required by IES8 of audit professionals:

| | |
|--|--|
| IES8 Pre-requisites for all audit professionals: | |
| <ul style="list-style-type: none"> • Capabilities and competence in the following areas: <ul style="list-style-type: none"> – Best practice in auditing; – International Standards on Auditing (ISAs); – Financial accounting and reporting processes and practices; – Other applicable standards and laws (auditing financial reporting, or other laws and regulations); – Information Technology Systems and frameworks for evaluating controls and assessing risks in accounting and reporting systems (ICAS note: obviously the training in this area depends on the complexity of the audit engagements allocated to the audit professional); – Professional skills; and – Professional values, ethics and attitudes. • Not less than three years' practical experience, with at least two years auditing of financial statements | |
| Additional requirements: | |
| Those involved with IFRS accounts | International Financial Reporting Standards |
| Those involved in specialist audits | The audit professional needs to demonstrate how the specialist skills/knowledge has been achieved and also demonstrate the practical experience gained in that area (e.g. for a charity audit: attendance at charity courses, review of OSCR website etc.) |
| Those involved in transnational audits | <p>The knowledge content of the education and development program for audit professionals involved in transnational audits should cover the following subject areas, for the jurisdictions for which the transnational audit is conducted:</p> <ul style="list-style-type: none"> • applicable financial reporting and auditing standards; • controlling of multi-location and group audits; • applicable listing requirements; • applicable corporate governance requirements; • applicable national regulatory frameworks; and • the global and local economies and business environments. |
| Audit Engagement Partners | <p>Additional requirements for Audit Engagement Partners (or Responsible Individuals) are:</p> <ul style="list-style-type: none"> • leadership; • forming conclusions; • client acceptance and continuance; • assignment of engagement teams; • direction, supervision and performance of the audit; consultation, review and discussions; and • development of the audit report. |

As highlighted above, the additional requirements for Audit Engagement Partners, being RIs, are around leadership; forming conclusions; client acceptance and continuance; assignment of engagement teams; direction, supervision and performance of the audit; consultation, review and discussions; and development of the audit report.

CPD sufficient to ensure that IES8 requirements are met is a suitable standard for both active and inactive RIs.

How are inactive RIs monitored by ICAS?

The Audit Monitoring team monitor any situations where there is an inactive RI on a visit by visit basis, assessing CPD and training and ensuring that this is being maintained.

This 'reactive' approach is also supplemented by a 'proactive' approach, where an identified inactive RI may be asked to submit their CPD to ICAS or the Audit Registration Committee, in order to assess whether there has been an effort to keep up to date with audit related matters.

It is for a firm to decide on who they wish to initially put forward for RI status, and, in the vast majority of cases, when that status is removed. However, should the Audit Registration Committee have a significant concern over the competence, experience, or knowledge of an inactive RI, then the appropriateness of the RI status will be considered.

That being said, if a firm decides to remove the RI status of a current RI, any subsequent application to reinstate this status will be subject to the same approval process as that of a new RI.

APPLICATIONS FOR APPOINTMENT TO THE AUDIT REGISTRATION COMMITTEE

Help Build Trust in the Profession

The ICAS strategy of 'Building a Professional Community' seeks to reinforce in Members their lifetime's professional identity as CAs and regard for the public interest. To serve the public interest effectively requires that we retain the confidence of the public in the audit profession and that we deliver the services to the standards that society expects of ICAS members and our regulated firms. Respect for the public interest within ICAS is achieved through a number of ways, including rigorous regulatory procedures.

ICAS has five Regulatory Committees which are responsible for the main regulatory areas (audit, insolvency, public practice, complaints and CPD). Each Regulatory Committee reports to the Regulation Board. Further information about the Board and its Regulatory Committees is available on the ICAS website at www.icas.org.uk.

The Regulation Board would like to receive applications for appointment to the Audit Registration Committee. If you are a Member and Responsible Individual, are keen to become involved with ICAS and have an interest in the maintenance of professional standards then please send your CV to Michelle Mullen, Executive Director, Regulation Division, ICAS, CA House, 21 Haymarket Yards Edinburgh EH12 5BH or email mmullen@icas.org.uk.

REMINDER

Keeping Your Audit Firm and Files on the Right Track

Some exciting changes are coming to our courses for 2013!

We have received positive feedback from those who have attended the courses to date and are always keen to hear your views. Having delivered the course now for two years, we have decided to condense some of the course delivery. So whilst the content of the course will be largely unchanged, we plan to deliver the two courses in a more succinct way over a half day, instead of the full day, which hopefully means less disruption to you and your client work.

We also intend to deliver webinars next year, so you are struggling to get to any of the course locations this may be a good alternative for you. We would, however, still encourage Audit Compliance Principals to attend in person given that it provides you with more of an opportunity to speak to the

monitoring team face to face and ask any questions pertinent to your firm.

As we have previously stated, these courses are mandatory for ACPs, however to ensure mandatory attendance is not too onerous, ACPs are required to attend only once every five years. The course is still heavily discounted for those requiring mandatory attendance.

We would also strongly encourage other Responsible Individuals and senior audit professionals to come along. Particularly "Keeping Your Audit Files on the Right Track" should provide a useful update on recent changes and help you prevent the common pitfalls we find on monitoring visits.

Further details, including 2013 locations and dates, and an outline of each course, will shortly be added to our website at www.icas.org.uk/Businesscourses/

