

AUDITNEWS

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INTRODUCTION

Welcome to the first 2015 edition of Audit News, where we wish to announce the release of our Audit Monitoring Annual Report, which summarises our activities and key findings from 2014. The report can be accessed at: icas.org.uk/

[home/regulation-and-ethics/audit-monitoring/annual-reports-on-monitoring-activities/](#)

This edition contains articles on going concern considerations in the audit of companies; the increase

in charity audit thresholds in England & Wales; further proposed amendments to UK GAAP, including the withdrawal of the FRSSE; and changes to the framework for local audit in England and Wales.

We would also like to take the opportunity to provide a reminder on our mandatory courses for Audit Compliance Partners (ACPs): 'Keeping Your Audit Firm on the Right Track' and 'Keeping Your Audit Files on the Right Track'.

2015 is the final year of the first five year cycle of the mandatory course of ACPs. If you have not yet attended the course, and have been an ACP since the course inception in 2010, you will be required to attend before the end of 2015.

The courses are open to all those with an interest or involvement in audit work; but is heavily discounted for those requiring mandatory attendance.

Feedback on the courses has been excellent, and they are very useful to assist in developing a strong compliance culture; and a great way to keep up to date with common issues encountered by audit firms. The courses are developed and delivered by the ICAS Audit Monitoring team and there will be three dates in 2015:

- Aberdeen, 8 June 2015;
- Edinburgh, 24 June 2015; and
- Glasgow, 30 September 2015

Should you have any questions in this regard please do not hesitate to get in touch with ICAS AM at: auditandpracticemonitoring@icas.org.uk

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GOING CONCERN CONSIDERATIONS IN AUDIT OF COMPANIES

Going concern is a fundamental accounting concept that underlies the preparation of financial statements of all UK companies. The high-profile problems facing banks, retailers and other organisations show that going concern continues to be a significant issue. Companies may be less able to obtain a steady stream of liquidity, with financial institutions often imposing stringent requirements when companies are negotiating finance.

Key highlights:

- Management, and not the auditor are responsible for conducting an assessment of going concern;
- The assessment should cover a period of at least twelve months from the date of approval of the financial statements;
- The auditor must discuss going concern with management at the planning stage, and consider the going concern risk throughout the audit process;
- The auditor should evaluate management's assessment of going concern;
- The auditor should perform procedures to obtain appropriate evidence in this regard, and the extent of these procedures will depend on the client's circumstances and risk;
- Following consideration of management's going concern assessment, and the disclosures in the financial statements, the auditor will consider whether the audit report requires modification and qualification; and
- The auditor's procedures and going concern conclusion should be appropriately documented on the audit file.

Responsibilities of management

Management must make an assessment of the company's ability to continue as a going concern and are required to consider all available information about the future at the date they approve the financial statements. Their review should cover a period of at least twelve months from the date of approval of the financial statements and will include procedures such as:

- preparation of forecasts and budgets including sensitivity analysis of key assumptions;
- consideration of borrowing requirements and financial covenants; and
- consideration of market conditions and viability of products and services.

In making their assessment, management may become aware of material uncertainties which may cast doubt on the ability

of the entity to trade as a going concern. In this situation the directors must make specific disclosure in the financial statements explaining the nature of the material uncertainty and why the going concern basis has still been adopted.

Responsibilities of the auditor

ISA 570 requires the auditor to consider and conclude on the appropriateness of management's use of the going concern assumption.

It is not the responsibility of the auditor to conclude on the going concern status of an entity on behalf of management, or to rectify any lack of supporting analysis or prepare budgets and cash flows which support the going concern opinion.

What are some examples of procedures that an auditor should perform?

Planning stage

The auditor should make a preliminary assessment of going concern which should drive the risk assessment process and planned audit procedures. It is also vital that going concern features in client planning meeting discussions.

Potential issues which the auditor should consider in making this preliminary assessment include:

- A net liability or net asset position;
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment;
- Excessive reliance on short-term borrowings;
- Excessive reliance on support from a group entity;
- Loss of a major customer or market sector;
- Indications of withdrawal of financial support by creditors;
- Inability to pay creditors on due dates; and
- Inability to comply with the terms of loan agreements.

Any initial assessment of the going concern basis can be complicated by volatility or uncertainty in the industry in which a company operates, leading to slow growth or decreasing demand for goods and services, pricing pressure or constraints on financing. The auditor should discuss this with management fully at the planning stage considering key effects such as:

- the stability of the cost base;
- potential labour difficulties including the risk of losing key staff;
- risks of losing key suppliers and significant customers;
- potential losses on long-term contracts; and
- adequacy of the company's insurance policies.

The following are current issues that should also be taken into consideration:

- **Eurozone:** Companies that have subsidiaries, business activities and/or have business with governments in troubled economies may face slow growth or decreasing demand for goods and services, pricing pressure and constraints on financing. Recent reports highlight that entities that continue to do business in countries such as Greece, Italy, Spain and Portugal have experienced long delays in payments and mandatory restructuring of older unpaid debtors.
- **Oil prices:** Volatility in the world's most important commodity is becoming the new normal and while prices, currently at a five-year low, may put a smile on the face of motorists and the transport and manufacturing industries, companies who are either in or connected to the oil trade are facing a period of uncertainty. Review of the financial press highlights that some oil companies are already looking at options including the sale of a portion of assets, recapitalisation, debt restructuring or a combination of these, to repay debt and fund operations.

Fieldwork and completion

The auditor is required to consider going concern throughout the audit process, and should any concerns be identified through the audit process, these should be addressed in a timely manner, including appropriate communication with those charged with governance. Procedures which the auditor should consider include:

- 1) Ensuring that, to support its going concern assumption, management has prepared monthly cash flow forecasts and/or monthly budgets covering, as a minimum, a period of twelve months from the expected date of approval of the financial statements;
- 2) Performing a detailed review of the assumptions that support the forecasts including:
 - gross profit margins – ensuring that these are realistic and consistent with past performance;
 - expected debtors days – including consistency with current debtor collections;
 - levels of stock holding and work-in-progress;
 - working capital requirements;
 - payment terms with creditors – considering contractual terms;
 - cost increases – taking account of inflation, and contractual terms with suppliers; and
 - overhead levels – including consistency with current overheads, and contracted staffing costs such as pay increases or bonuses.

- 3) Consideration of whether forecasts have been subject to sensitivity analysis on the critical assumptions,

particularly in relation to differing levels of sales and debtors days.

- 4) Comparison of past forecasts and ensuring that subsequent actual results been appropriately reflected – including the correct brought forward figures for bank, debtors, creditors, stock and work in progress.

The auditor should also consider the cash flow of the entity, particularly where there are already short or long term borrowings. Procedures which the auditor should perform include:

- 1) Consideration of whether all known liabilities, commitments and repayment dates in the future are reflected in the Directors assessment of going concern;
- 2) Identification of projected cash-flow deficits and enquiry if management has considered how funds will be raised and whether appropriate arrangements can be put in place to meet payments as they fall due;
- 3) Confirmation that the covenants on current borrowings are satisfied as at the balance sheet date; and
- 4) Comparison of budgets and forecasts to current banking facilities to establish whether or not there are any projected deficits and, if so, whether there are plans in place to cover them, e.g. to renegotiate facilities with the company's bankers.

When should there also be consideration of the impact on the audit report?

If the auditor believes that significant uncertainty exists in relation to the company's ability to continue as a going concern, and the uncertainty has been adequately disclosed by the directors, the auditor should issue an unqualified report, modified by including an 'emphasis of matter' paragraph highlighting those disclosures.

If the auditor believes the going concern basis is not appropriate, or that the relevant disclosure given in the accounts is not adequate, then a qualified audit report should be issued.

Examples of modified and qualified audit reports can be found in APB bulletin 2010/2, which is available on the FRC website at frc.org.uk/Our-Work/Publications/APB/Bulletin-2010-2.aspx

The following table provides some guidance on the effect of different going concern conclusions in the accounts:

Going concern conclusion	Director's disclosures in the financial statements	Consequence for Auditor's Report
No material uncertainties related to events or conditions that may cast significant doubt about the ability of the company to continue as a going concern	Going concern is presumed in preparing financial statements.	Unmodified report provided the auditor agrees with the directors' assessment and supporting disclosures.
Material uncertainties have been identified by the directors, but the going concern basis remains appropriate.	Disclosures explaining the specific nature of the material uncertainties and why the going concern basis has still been adopted.	Modified report including an emphasis of matter paragraph highlighting the existence of material uncertainties, provided the auditor agrees with the directors' assessment and supporting disclosures.
The going concern basis is not appropriate as the company has no realistic alternative but to cease trading or go into liquidation, or the directors intend to cease trading or place the company into liquidation.	Disclosures explaining the basis of the conclusion and the accounting policies applied in preparing the financial statements on other than a going concern basis (eg break-up basis) and any uncertainties about the carrying amounts of assets and liabilities.	Unqualified opinion provided that the financial statements contain the necessary disclosures and the auditor considers the basis to be appropriate to the specific facts and circumstances. The auditor may also wish to include an emphasis of matter paragraph in this regard.

Where the auditor does not agree with the director's assessment of going concern, or the extent of disclosure in the financial statements, this could result in qualification. Examples of qualified reports can be found in the APB bulletin, however, in the experience of ICAS AM, a number of firms have found that further discussion with the directors has resulted in provision of adequate supporting documentation, including extension of budgets and

forecasts to an acceptable point beyond the signing date.

ICAS AM would advise audit firms to consider whether there is a need for internal or external consultation on consideration of going concern issues and implications for the audit report. Further technical advice can be obtained from ICAS Accounting & Audit by emailing accountingandauditing@icas.org.uk

INCREASE IN THE CHARITY AUDIT THRESHOLD IN ENGLAND AND WALES

The Cabinet Office has announced that the income thresholds above which charities registered in England and Wales must have their accounts audited will be doubled from 31 March 2015 to::

- increase the income threshold from £500,000 to £1 million;
- increase the aggregate group income threshold at which parent charities should have group accounts audited from £500,000 to £1 million;
- increase the preparation threshold for group accounts from £500,000 to £1 million; and
- add the Institute of Financial Accountants and the Chartered Public Accountants Association (subject to the submission of appropriate evidence) to the list of recognised professional accountancy membership bodies whose appropriately qualified members can carry out independent examinations of the accounts of charities with incomes that are more than £250,000.

The changes will come into effect for accounting years ending on or after 31 March 2015, and it is estimated that this will

remove the requirement to have accounts audited from around 4,000 charities in England and Wales.

From information provided to the consultation process by the Office of the Scottish Charity Regulator (OSCR) there are 100 charities registered in both Scotland and England & Wales (cross-border charities) and with an income of between £500,000 and £1 million. These charities still require an audit in order to comply with Scottish charity law requirements.

It is not clear at the current time if the Scottish Government will follow the UK Government's lead and increase the audit threshold for Scottish based charities. Figures produced in 2014 by the Scottish Council for Voluntary Organisations (SCVO), show that there are approximately 420 Scottish charities with income between £500k and £1m.

A full copy of the consultation response and proposals can be found at gov.uk/government/consultations/charities-audit-and-independent-examination

FRC CONSULTS ON NEW STANDARDS FOR SMALL AND MICRO ENTITIES

The Financial Reporting Council (FRC) has issued for consultation new proposed accounting standards for small and micro entities as the UK government prepares to implement the EU Accounting Directive. The consultation introduces a significant change in financial reporting for smaller entities as it signals the end of the Financial Reporting Standard for Smaller Entities, from accounting periods beginning on or after 1 January 2016.

Companies that meet the definition of a 'micro-entity' will have the option to prepare their accounts under the proposed new Financial Reporting Standard (FRS) 105 - 'The Financial Reporting Standard applicable to the Micro-Entities Regime'. Those other small entities which do not qualify as micro-entities, will now be required to follow FRS 102 for recognition and measurement purposes, with simplified presentation and disclosure requirements applying. They will of course still be able to apply EU-adopted IFRS, if they so desire.

The EU Accounting Directive introduces new requirements intended to simplify company accounting requirements, and to harmonise accounting across Europe. It will be implemented in the UK via amendments to the Companies Act 2006. The changes introduced by the Directive made it necessary for the FRC to amend existing UK GAAP.

Thresholds

The micro-entity regime was introduced in company law in September 2013, arising from EU legislation designed to simplify accounting for the smallest companies. The basic criteria are that a company qualifies if it does not exceed two or more of the following thresholds:

- Turnover - £632,000;
- Balance sheet total - £312,000; and
- No. of employees - 10

LLPs, charities, financial institutions and companies excluded from the small companies regime are not permitted to apply the micro regime.

The new legislation will increase the thresholds for small companies to the following:

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

The new thresholds will be effective for accounting periods beginning on or after 1 January 2016, but the government plans to permit early adoption.

The usual 2 year rule applies i.e. in relation to a year which is not a company's first year, where on its balance sheet date a company meets or ceases to meet the qualifying conditions, that affects its qualification only if it occurs in two consecutive financial years. Where the period is not 12 months, tie apportionment applies to the turnover criterion.

If a subsidiary is included in the consolidated accounts of a group then it cannot qualify as a micro-entity. A parent company can qualify provided that it satisfies the micro-entity criteria and the group which it heads up satisfies the definition of a small group. However, if the parent prepares group accounts (the Companies Act 2006 does not require it to) then it will not qualify for micro-entity status.

Content of proposed FRS 105

Proposed FRS 105 is structured along the same lines as FRS 102, but includes the simplifications required by company law (e.g. no revaluation of assets), along with some additional simplifications appropriate to the size of company (e.g. removal

of accounting policy options). Overall, the requirements of FRS 105 are expected to be the same, or more simple than those of the FRSSE.

Under company law, micro entity accounts are not required to give a true and fair view as other accounts are – rather, financial statements prepared in accordance with the legal requirements of the micro-entities regime are presumed to give a true and fair view, so the directors are not required to consider whether any additional disclosures are required. The statutory formats for the profit and loss account and the balance sheet are significantly condensed (for example, current assets is not broken down into stocks, debtors,

investments and cash), and only two disclosure notes are required, although micro-entities may voluntarily provide additional disclosures.

Small entities

The FRSSE has been in place now for almost 20 years, and is considered to be an effective approach to small company reporting. However, the FRC's decision to replace existing UK GAAP with FRS 102, an IFRS-based reporting framework, means that from 2015 onwards, the FRSSE will no longer be consistent with 'big GAAP'. This fact, coupled with the company law changes introducing the micro-entity classification and simplifications for small companies, has effectively signalled the end of the FRSSE. In its place, the FRC is proposing that small entities will follow FRS 102 for recognition and measurement, but with specific, limited presentation and disclosure requirements. This approach has been chosen in order to maintain consistency in the general accounting principles for different sizes of entity, and to avoid undue complexity by retaining a separate standard for small entities.

Eligibility

The types of entity eligible to apply the small entities accounting regime will be the same as those currently eligible to apply the FRSSE. In addition, company law is changing to permit small companies that are in the same group as a public company (not listed) to access the small companies regime.

Recognition and measurement

Small entities will now follow FRS 102 for recognition and measurement. Some of the key differences in these areas from the FRSSE are:

- Financial instruments – small entities will be required to recognise more financial instruments than previously e.g. options, swaps and forward contracts, and may need to measure some on a different basis e.g. listed investments will be measured at their fair value, whereas these could currently be carried at cost.
- Deferred tax – FRS 102 requires deferred tax to be recognised on the revaluation of fixed assets.
- Investment property – gains and losses on investment properties must be recognised in profit and loss, not in reserves as is the case under the FRSSE. The

resultant profits from any such gains will however not be distributable.

Presentation and disclosure

The EU Accounting Directive specifies 13 disclosure notes relevant to small companies, and does not permit standard-setters to mandate any additional disclosures. However, small companies, unlike micro-entities, are still required to ensure that their financial statements give a true and fair view, and must include additional disclosures as necessary. The Directive also permits small companies to prepare a condensed profit and loss account and balance sheet, provided that all members of the company agree to it.

A new section has been added to FRS 102 - section 1A, small entities, which sets out the specific presentation and disclosure requirements for small entities. This section sets out the disclosure requirements required by law, and adds another five 'encouraged' disclosures, which are likely to be required to give a true and fair view. It also emphasises the importance of considering whether a true and fair view is given, and encourages entities to consider all of the disclosure requirements in FRS 102 and determine which ones are relevant to them.

The company law requirements relating to financial statements for small companies are included in section 1A, but unlike in the FRSSE, all of the reporting requirements from company law are not included.

The above changes have been issued for consultation by the FRC, with a comment deadline of 30 April 2015. It is expected that the final standards and amendments will be published in July 2015, coming into effect for 2016 financial years (with early adoption available), therefore it is important that practitioners and their clients familiarise themselves with the proposals as soon as possible.

The consultation documents are available to download from: frc.org.uk/News-and-Events/FRC-Press/Press/2015/February/FRC-consults-on-amendments-to-UK-and-Irish-GAAP.aspx

ICAS has been a contributor to the development of FRC's proposals and the implementation of the Accounting Directive, and will be responding to the current consultations.

LOCAL PUBLIC AUDIT IN ENGLAND AND WALES, AND THE ROLE OF ICAS

ICAS intends to apply to the Financial Reporting Council (FRC) to become a Recognised Supervisory Body (RSB) for local public audit work in England and Wales. Following the disbandment of the Audit Commission there is an opportunity for a number of our audit registered firms to become involved in these public sector audits in England and Wales.

We would like to ensure that we have an appropriate regulatory framework in place to ensure that our audit firms can be licensed with us and supported by us for both private company audit work and this new area of public sector audit work going forward.

In 2010 the Secretary of State for Communities and Local Government announced plans to disband the Audit Commission in England and Wales. This was enacted in The Audit and Accountability Act 2014, which provides for the abolition of the Audit Commission and establishes a new framework for the regulation of auditors of local public bodies that reflects the current framework for the regulation of company auditors.

Under this new framework, councils and local health bodies will procure and appoint their own auditors, and makes the FRC (Financial Reporting Council) responsible for:

- inspecting the quality of the audits of the largest local public bodies;
- overseeing the regulation of auditors of local public bodies by Recognised Supervisory Bodies (RSBs) the FRC recognises for this purpose; and
- setting specific statutory requirements on auditors.

The responsibilities of the Audit Commission will transfer to other bodies, with the National Audit Office being responsible

for the codes of audit practice and guidance, which set out the way in which auditors are to carry out their functions; and RSBs will be responsible for the registration of audit firms and auditors.

The first audits to be carried out under the new framework will be the accounts of local bodies for the financial year 2017/18, and likely for year-ends 31 March 2018. As such, firms wishing to bid for these audits will require to be registered under the new arrangements by 2016.

What role will ICAS have in this new framework?

ICAS, as an RSB for company audit, registers a large number of England and Wales based audit firms. As such, we have notified the FRC of our intention to apply as an RSB for local audit, to license, register and monitor audit firms conducting such work, on the basis that some ICAS audit registered firms will enter into this market.

ICAS will be required to establish and implement FRC approved audit regulations, which will be separate, but similar to, the existing Audit Regulations & Guidance. The local audit regulations will set out the eligibility requirements for firms and for engagement leads to be appointed as local auditors.

Should you have any questions in this regard please do not hesitate to get in touch with Lesley Byrne, Director, Regulatory Authorisations & Monitoring at regulatoryauthorisations@icas.org.uk or 0131 347 0245.

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

