Audit News
Issue 67
Spring 2018

Triennial review of FRS 102

The Financial Reporting Council (FRC) completed its first triennial review of FRS 102 in 2017. The principal areas of change resulting from this are:

a) **Directors' loans** –small entities will no longer need to estimate a market rate of interest when measuring loans from a director who is also a shareholder.
b) **Intangible assets acquired in a business combination** – fewer intangible assets will be required to be separately identified from goodwill and valued.
c) **Investment property rented to another group entity** – entities will now be able to choose to measure these investment properties at cost less depreciation and impairment instead of fair value. At present, such property must be measured at fair value unless the entity can conclude that determining fair value would require 'undue cost or effort'. The undue cost or effort exemption will now be removed for all investment property.
d) **Classification of financial instruments** – additional financial instruments will be considered 'basic' (and thereby measured on a cost rather than fair value basis) beyond those meeting the prescriptive conditions, if they are consistent with a new principle-based description.
e) **Definition of a financial institution** – financial institutions are required to provide additional disclosures about financial instruments.

Amendments are also made to provide relief from recognising tax payable when a wholly owned trading subsidiary expects to make a distribution of a gift aid payment to its charitable parent. This is a potentially complicated change and is discussed in more detail below.

Date of adoption of changes

The principal effective date for all amendments is accounting periods beginning on or after 1 January 2019, with early application permitted provided all amendments are applied at the same time. The only exceptions to this are:

- The amendments relating to directors' loans and the tax effects of gift aid payments, for which early application is permitted separately. As noted above, the option to take the directors loan exemption was brought into FRS 102 1A early, in May 2017, to assist small owner managed businesses; and
- The amendments to Section 1A for small entities in the Republic of Ireland are effective for accounting periods beginning on or after 1 January 2017 (see below).

The decision to early adopt must be disclosed in the accounting policy note for FRS 102 accounts and is a recommended disclosure for FRS 102 1A accounts.

Adoption of changes to the standard

Any change in accounting policy should be made retrospectively (i.e. by prior year adjustment). When an entity first applies the Triennial review 2017 amendments, in relation to specific changes, as an exception to retrospective application:

a) may elect to measure an investment property rented to another group entity at its fair value, and use that fair value as its deemed cost at the date of transition for the Triennial review 2017 amendments; and
b) should not make retrospective amendments to goodwill calculations i.e. should not subsume intangible assets that previously have been separately recognised within goodwill.

Audit firms should ensure that any adjustments are appropriately reflected in the financial statements, including the requirement for prior year adjustment.

Change to treatment of gift aid payments by wholly owned subsidiaries of charities

Historically, gift aid payments have been accounted for by both the parent charity and the subsidiary in the year to which it relates. The changes to FRS 102 mean that, in common with the treatment of dividends payable, the subsidiary will no longer accrue the gift paid payment in the year to which its relates; instead it will be included in the accounts in the year in which it is paid.

The origins of this change are in ICAEW Tech Release 16/14BL which concluded that a donation made from a subsidiary to its parent charity is legally a 'distribution' and therefore can only legally be made when they had sufficient available accounting profits for the purpose.

Under the standard, the same logic applied to dividends will apply to distributions made by a charity's wholly owned subsidiary, so the gift aid payment, as a distribution to owners shall only be accrued when paid and shall be recognised in equity. This means that the payment in the subsidiary should be reflected, in whichever year it is accounted for, as a movement in the Statement of Changes in Equity (SOCIE) not in its Profit & Loss account. Note that the tax effects of a gift aid payment, that it is probable will be made in the nine months following the reporting date, should still be taken into account at the reporting date.

This change will come into effect for accounting periods beginning on or after 1 January 2019, and companies affected may be required to make a prior year adjustment on adoption, depending on previous treatment, to bring comparative figures in line with this new policy. While early adoption is allowed in isolation of all other changes in the triennial review, firms who audit charitable groups should be aware of a potential mis-match with the accounting requirements in the charity parent under the SORP. The Charities SORP Committee is in the process of making amendments to the Charities SORP through an Update Bulletin, however this had not been finalised at the date of this Audit News.

Auditors should ensure that these transactions are appropriately reflected, and should ensure that any historic gift aid payment, as a distribution was legal, with reference to the distributable reserves of the subsidiary.

Subsequent changes to FRS 105 as a result of the triennial review.

A micro-entity in the UK should also apply the amendments to this FRS as set out in the Triennial review 2017 amendments for accounting periods beginning on or after 1 January 2019, except for the amendments to Section 6 Notes to the Financial Statements (including its appendices) which shall apply for accounting periods beginning on or after 1 January 2017. Early application is permitted provided that all the amendments to the FRS are applied at the same time.

Section 6 reflects legal requirements that are applicable in the UK for accounting periods beginning on or after 1 January 2016. The key additional disclosures are:

a) Information about off-balance sheet arrangements as required by section 410A of the Act (see paragraph 6A.1); and
b) information about employee numbers as required by section 411 of the Act (see paragraph 6A.2).

As regard to changes for periods commencing 1 January 2019, the financial statements of a micro-entity in the UK must state:

a. the part of the United Kingdom in which the micro-entity is registered;
b. the micro-entity's registered number;
c. whether the micro-entity is a public or private company and whether it is limited by shares or by guarantee;
d. the address of the micro-entity's registered office; and
e. where appropriate, the fact that the micro-entity is being wound up.

Section 9 further states that the following should be disclosed:

- Financial assets given as security in respect of its commitments, guarantees and contingencies.
- Items of property, plant and equipment or investment property given as security in respect of its commitments, guarantees and contingencies.
- Intangible assets given as security in respect of its commitments, guarantees and contingencies.

Updates to the small company regime in Ireland as a result of the triennial review.

Amendments are also made to incorporate the new small entities (Section 1A) regime in the Republic of Ireland, and this will be reflected as Appendix D to Section 1 of the standard.

In June 2017 the Republic of Ireland implemented the EU Accounting Directive. The requirements are effective for accounting periods beginning on or after 1 January 2017, but early adoption is permitted for accounting periods beginning on or after 1 January 2015 provided that the financial statements have not yet been approved. 111 As a result, the new small entities regime, as reflected in Section 1A of FRS 102, became available in the Republic of Ireland, however there are some differences in the disclosure requirements applicable in the UK and the Republic of Ireland. For example, contrary to UK law and FRS 102, Irish companies cannot fair value stock.

As such, Irish companies will have to give due consideration to both the Irish company law disclosure requirements and the disclosure requirements in the relevant accounting standard, remembering that there remains an overarching obligation on directors of companies adopting the small company regime to prepare financial statements that give a true and fair view.

The amendments to disclosure requirements under Section 1A for small entities in the Republic of Ireland are effective for accounting periods beginning on or after 1 January 2017. However, early application is permitted for companies in the Republic of Ireland provided that the *Companies (Accounting) Act 2017* is applied from the same date.

Revision of Practice Note 11: The audit of charities in the UK

The Financial reporting Council (FRC) has issued a revision of Practice Note 11: The audit of charities in the United Kingdom. The revisions to Practice Note 11 reflect:

- **Revisions to International Standards on Auditing (UK) (ISAs (UK));**
- **Changes to UK accounting standards (FRS 102) and the revision of the Charities SORP;**
- **Continuing developments in regulation and guidance issued by the UK Charity Regulators; and**
- **Changes in relevant legislation.**

As with the recent revision of other practice notes, the guidance has been updated to address the drivers for revision identified above, but also to omit material that is a repeat of what is in the relevant ISA (UK) itself, and to remove material that an auditor would be able to find elsewhere, (including guidance issued by the Charity Regulators).

Specific updates and changes from the previous Practice Note include:

- Legislative and Regulatory Framework: this section has been updated to reflect changes across the different jurisdictions in the United Kingdom.
- Reporting matters of material significance to Charity Regulators: a separate section has been included covering content previously in ISA (UK) 250 Section B and to reflect guidance on the duty of the auditor to report matters of material significance to CCEW and OSCR issued by the charity regulators in 2017.
- Material has been incorporated, into ISAs (UK) 250, 315, 330 and 600 reflecting the special features of charities.
- ISAs (UK) 315 and 330 have been updated to reflect changes in the charity accounting framework and best practice where appropriate.
- A new appendix has been inserted (Appendix 1 – Conditions and events that may indicate risks of material misstatement) which sets out conditions and events which may give rise to a risk of material misstatement specific to charities.
- Going concern: the section on ISA (UK) 570 has been expanded and updated to provide more guidance to auditors.
- Other information: the section on ISA (UK) 720 has been updated to provide guidance on how the revised standard applies to the trustees' report. The Trustees' Report is considered 'statutory other information' which means that auditors will be required to report on the consistency of information provided as well as considering whether it has been properly prepared.

The practice note has a revision date of November 2017, with the revised guidance taking immediate effect.

Revision of ISA (UK) 250A – removal of Practice Note 12

The Financial Reporting Council (FRC) has issued a revision of ISA (UK) 250 Section A –'Consideration of Laws and Regulations in an Audit of Financial Statements', which includes a new Appendix providing revised guidance on the auditor's responsibilities in respect of money laundering, terrorist financing and proceeds of crime legislation in the UK.

The Appendix was revised following consultation with HM Treasury, HM Revenue and Customs and the National Crime Agency. The new ISA (UK) is effective for audits of financial statements for periods commencing on or after 15 December 2017.

This Appendix supersedes the guidance included in Practice Note 12 'Money Laundering—Guidance for Auditors on UK Legislation' and consequently this Practice Note is withdrawn.

A copy of the Revised ISA can be found on the FRC website.

Reminder: Mandatory course for ACPs and RIs – "Keeping Audit on the Right Track"

- **As of 1 January 2016, there was an increase in the mandatory requirement for Audit Compliance Partners (ACPs) who are required to attend once in the period from 1 January 2016 to 31 December 2018, meaning that ACPs who haven't attended will require to do so by the end of this year.**
- **We will be contacting each ACP who hasn't attended to discuss attendance in 2018.**

As part of the ICAS developmental approach to regulation, 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. The course is prepared, presented and regularly updated by the Audit Monitoring team, and covers a number of key areas of audit compliance including:

- The role of the Audit Compliance Principal;
- How to ensure the Audit Compliance Review process is effective;
- Consistency of audit quality and use of audit procedures;
- Common pitfalls and audit file issues identified on monitoring visits;
- The FRC Ethical Standard; and
- Current developments.

As of 1 January 2016, there was an increase in the mandatory requirement of this course, where the Authorisation Committee has considered that the course will be beneficial to a wider audience.

The resulting requirements are that:

- Each ACP will be required to attend at least once in the three-year period from 1 January 2016 to 31 December 2018;
- 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.

Consequently, ACPs who haven't attended in the current cycle only have one year left to do so. ICAS will be contacting all ACPs who have still to attend the course to discuss options for attendance in 2018.

With this in mind, please note that, in 2018, the course will be held in the following locations:

- Ayr: Thursday 19 April
- Inverness: Wednesday 9 May
- Edinburgh: Wednesday 16 May
- Midlands: Wednesday 6 June
- Aberdeen: Thursday 14 June
- Glasgow: Wednesday 26 September

For further details, including dates and locations for all 2018 courses, please search for '*keeping audit on the right track'* on icas.com