

# AUDIT NEWS

ISSUE No 53A February 2014

## AUDIT MONITORING ANNUAL REPORT 2013

Welcome to the first edition of Audit News of 2014! This brief issue acts as an introduction to our Annual Report which summarises our activities and key findings from 2013. The key findings from the report indicate:

- We saw some excellent examples of structured and well recorded audit files;
- Unfortunately some of the findings

from 2012 have recurred, albeit the number of instances has fallen;

- There are often issues on charity audit files; and
- There are instances where corners are being cut and not all of the audit programmes are used leading to non-compliance.

A fully copy of our Annual Report can be found here [icas.org.uk/home/regulation-](http://icas.org.uk/home/regulation-)

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

Also included in this edition are reminders about the upcoming changes to UK GAAP and the FRSSSE; along with the results of the recent thematic review by the Financial Reporting Council on fraud risks and laws and regulations; and finally a reminder about the mandatory course for Audit Compliance Principals.

## CHANGES TO UK GAAP

### FRS 102

#### Overview of the new framework

In November 2012 the FRC published FRS 100 and FRS 101:

- FRS 100 sets out the application of financial reporting requirements in the UK and Republic of Ireland; and
- FRS 101 outlines the reduced disclosure framework available for use by entities reporting under IFRS.

In March 2013 the FRC published FRS 102, a single Financial Reporting Standard that applies to the financial statements of UK entities that are not applying IFRS, FRS 101 or the FRSSSE.

FRS 102 is a complete overhaul of UK GAAP and applies to all unlisted entities, resulting in all current SSAPs, FRSSs, and UITFs being withdrawn.

The objective of FRS 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' is to provide succinct financial reporting requirements and, at 350 pages, it is substantively shorter than existing UK GAAP.

FRS 102 is applicable for accounting periods beginning on or after 1 January 2015, however, early application is permitted for accounting periods ending on or after 31 December 2012.

The FRS is based on the IFRS for SMEs, and brings about a simplified reporting regime, as well as introducing more up-to-date and relevant accounting requirements than those in existing UK GAAP. This is an acknowledgement that current UK GAAP is too complex and practitioners have often complained about the onerous requirements imposed. In response to consultation, FRS102 has some elements similar to IFRS, some similar to IFRS for SMEs, and some similar to current UK and Irish GAAP. We would therefore recommend that firms ensure this is considered when developing CPD plans for 2014.

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## What are the implications of the new framework?

As outlined above, all entities currently reporting under UK GAAP will be required to report under either IFRS, FRS102, or the FRSSE. For the avoidance of doubt, IFRS will continue to only be mandatory for group accounts of entities with securities admitted to trading on an EU regulated market, and even these groups will have the option to apply FRS102 or FRS101 in their individual entity accounts. Entities currently applying the FRSSE will continue to be able to do so (see below).

There are clearly significant implications for audit clients, where the financial statements will have to be presented in a different format, using terminology which is based on IFRS. Many clients will rely on their auditors to assist in the process, and firms

should be careful that they do not make any decisions which are properly those of management. The 'management threat' is explicitly referred to in the Ethical Standards to ensure that the auditors are not taking the role of management. In order to comply with the Ethical Standards, firms must ensure that management take ownership over the financial statements.

Given the implementation date noted above, the earliest comparative figures could be 31 December 2014 – so it's important to start thinking about this now. The standard requires a number of additional reconciliations and explanations in the first year of transition, therefore it is imperative that firms undertake sufficient training in this regard during 2014 if not already done so.

## FINANCIAL REPORTING STANDARD FOR SMALLER ENTITIES – THE FRSSE 2015

The FRSSE has existed for many years, providing small companies with a simplified one-stop-shop for their accounting requirements.

The Financial Reporting Council (FRC) has published an updated FRSSE effective from January 2015. This updates the FRSSE 2008 for the changes as a result of the introduction of FRS 100; FRS 101; and FRS 102, as outlined in our previous edition of Audit News. The revised FRSSE is effective for accounting periods beginning on or after 1 January 2015, with early adoption permissible.

The eligibility criteria for applying the FRSSE has not changed in the 2015 version and therefore companies that qualify as small under Companies Act 2006 will be able to adopt it for their financial statements. For clarification, a company qualifies as small if, during a financial year, it satisfies any two of:

- Turnover less than £6,500,000;
- Total assets less than £3,260,000; and
- Number of employees less than 50.

A company is ineligible from being a small company if it is a plc, a financial services or insurance company, or part of a group containing any of these or containing a European Economic Area listed company.

## What are the main differences to the current FRSSE?

The changes in the revised FRSSE are not dramatic, with key areas of change being in the areas of goodwill, tangible and intangible assets; and related party transactions:

- If an entity is unable to make a reliable estimate of the useful life of goodwill, the life shall not exceed five years. Under the current FRSSE, the life cannot exceed 20 years;
- Each year an assessment is required as to whether there is any indication that a fixed asset should be written down; and
- A widening of the definition of Related Parties, using similar wording to FRS 8 (although it remains only those material to the reporting entity which must be disclosed).

We would advise all firms to ensure their partners and staff undertake appropriate training in advance of application of this standard.

ICAS is offering a number of training courses on FRS 102 throughout the year, and in various locations.

We would advise firms to consider the following half day courses noted below. Booking details can be found by clicking on the associated links (please sign in as a member).

### Implementing FRS 102

[icas.org.uk/businesscourses/ImplementingFRS102/](http://icas.org.uk/businesscourses/ImplementingFRS102/)

### Preparing for FRS 102 - Steps to take now

[icas.org.uk/businesscourses/PreparingForFRS102/](http://icas.org.uk/businesscourses/PreparingForFRS102/)

### A new UK GAAP for unlisted companies

[icas.org.uk/businesscourses/aneukgaapforunlistedcompanies/](http://icas.org.uk/businesscourses/aneukgaapforunlistedcompanies/)



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## FINANCIAL REPORTING COUNCIL'S THEMATIC REVIEW RESULTS

On 23 January 2014, the Financial Reporting Council (FRC), published the results of its thematic review covering fraud risks and laws and regulations which was undertaken by its Audit Quality Review team (AQR, previously the AIU).

The scope of the review specifically covered the 'auditors' identification of and response to fraud risks, and their consideration of compliance with laws and regulations by audited entities', as the FRC believe these to be areas of public interest.

The AQR reviewed 26 files for this review and found that there was evidence of some good practice being followed in respect of fraud risks on the files reviewed, including using appropriate techniques for testing journal entries to mitigate the risk of management override of controls; completion of a final conclusions document to summarise the audit procedures; and bringing together all accounting estimates in one place to review for any indicators of management bias.

In respect of laws and regulations, most audit files used a proforma document to identify key laws and regulations and how they would impact the financial statements; and audit teams had had training on how to respond to the Bribery Act in conducting audits.

### Fraud risks

The key findings however were:

- Auditors should ensure that fraud risk discussions amongst the audit team are led by the engagement partner and are more focused on identifying fraud risk factors as well as the risks of material misstatement in the financial statements due to fraud;
- Auditors should improve their assessment of fraud risk factors and fraud risks by having more meaningful discussions with management, including internal audit and those outside the finance function;
- Fraud risk factors should be reassessed at the end of the audit and a conclusion reached as to whether fraud risks have been reduced to an acceptable level;
- Assessment of fraud risks and the audit procedures which are intended to address them should be more tailored to the entity;
- As fraud risks should always be considered to be significant risks, auditors should evaluate the design and implementation of the entity's internal controls to detect and prevent fraud, where such risks are identified; and
- Auditors should ensure that final analytical review procedures are not limited to comparing line items in the current year income statement and balance sheet to the prior year figures.

### Laws and Regulations

The key findings were:

- Auditors should improve their identification and assessment of the laws and regulations affecting the audited entity;
- Auditors' discussions with management should include management responsible for compliance matters;
- Auditors should evaluate the design and implementation of the entity's internal controls to monitor compliance with laws and regulations;
- Auditors should exercise greater professional scepticism throughout the audit in relation to possible breaches of laws and regulations that may have a material impact on the financial statements.

The report also provides some key messages for Audit Committees, and therefore firm's should expect to be challenged by audit clients on how they are tackling these areas.

The FRC's overall conclusion is that there should be an increased focus on identifying fraud risk factors when assessing the risks of the financial statements being materially misstated due to fraud, and in particular this should be tailored to the audited entity. Compliance with the fraud ISA is also a common finding of ICAS Audit Monitoring, as can be seen in our annual report for 2013. While the number of instances has fallen since 2012, over half of the firms visited in 2013 had not complied with some aspect of the fraud ISA.

Likewise, auditors should also improve their identification and assessment of the laws and regulations affecting the specific audited entity, as well as exercising greater professional scepticism in relation to possible breaches that could affect the financial statements. This is consistent with the findings of ICAS Audit Monitoring in 2013, where this was one of our most common findings in the completion stage of the audits reviewed. 30% of the visits conducted in 2013 did not comply with the ISA requirements in this area.

The FRC's report can be found here [frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-Fraud-Risks-and-Laws.pdf](http://frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-Fraud-Risks-and-Laws.pdf)

The ICAS Audit Monitoring report for 2013 can be found here [icas.org.uk/home/regulation-and-ethics/audit-monitoring/annual-reports-on-monitoring-activities/](http://icas.org.uk/home/regulation-and-ethics/audit-monitoring/annual-reports-on-monitoring-activities/)

## MANDATORY AUDIT COURSE FOR AUDIT COMPLIANCE PARTNERS

The monitoring team have designed and developed this course, and we also present it. There are two separate modules: Keeping your Audit Firm on the Right Track and Keeping your Audit Files on the Right Track. All Audit Compliance Partners are required to attend both modules at least once every five years, however the cost of this course is subsidised by ICAS.

Again, the aim here is prevention – we are trying to nip potential compliance issues in the bud by reinforcing the requirements of the Audit Regulations and Auditing Standards. The course provides many examples and real life scenarios of issues which arise on audit visits and we hope that our firms can learn from these.

Both modules are covered in a morning session, which

makes the attendance requirement less onerous. This course is featured heavily in each edition of Audit News to reinforce the requirement to attend. We do monitor attendance of ACPs, and therefore as we are into our fourth year of running this course, we will be contacting firms who have yet to attend, to ensure they meet the five year requirement.

In 2014, we will be running two face to face courses:

- Perth: Thursday 27 March 2014
- Glasgow: Thursday 6 November 2014

The course is available to book on the ICAS website at the following link [icas.org.uk/businesscourses/](http://icas.org.uk/businesscourses/)

We look forward to seeing you there!

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