

AUDITNEWS

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INTRODUCTION

Welcome to the summer edition of Audit News, where we have prepared a number of articles which we hope you find informative and of relevance. The articles have largely been driven by questions from audit firms that the Audit Monitoring team have visited in recent months, and from participants at courses that our team have presented.

The first article is a communication of changes to the Audit Regulations, following their approval by the Irish regulator, and we aim to keep firms up to date with any such changes through this forum.

There are further articles on Irish Auditing and Accounting Supervisory

Authority (IAASA) registration when auditing a non-EU entity that is quoted on the Irish stock exchange, practical Ethical Standard considerations and the problems of self-review. Finally, there are articles on the recent guidance issued by the APB for charity audits, and dealing with the Bribery Act in engagement letters.

UPDATED AUDIT REGULATIONS

The Audit Regulations have been updated with effect from 1 June 2012 following their review and approval by the Irish regulator, the Irish Auditing and Accounting Supervisory Authority (IAASA).

In 2010 the Irish Government enacted SI220 - European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010 of Ireland, which enacted various parts of the EC Statutory Audit Directive which, in the UK, had largely been achieved through the Companies Act 2006. The Audit Regulations were substantially reorganised in 2008 to take account

of the changes brought about by the 2006 Companies Act, including the obligations under the Statutory Audit Directive.

SI220 also enacts the Statutory Audit Directive and the changes to the regulations needed for SI220 are primarily cross-referencing. However a small number of firms with only Irish

audits have been operating under the 1995 regulations and these are now replaced by new regulations, which are significantly different in structure and content. This is reflected in the deletion of regulation 1.07 and the addition of 1.04A. For all firms, there are a smaller number of nuances that are necessary, which are summarised below:

- a. 'Republic of Ireland' is now defined as Ireland.
- b. The UK Act requires the accountancy bodies to make regulations to implement a number of legislative provisions; in Ireland, where the requirement is included in the text of the Irish SI itself, there is no equivalent requirement for a regulation. Consequently, the relevant regulations are not applicable in Ireland. Guidance has been included in the regulations to explain this. In summary the relevant regulations are:
 - i. Regulation 3.09- successor's access to working papers;
 - ii. Regulation 3.14- transfer of audit working papers to another competent authority in an EEA member state.
- c. Certain regulations do not apply to Ireland at all:
 - i. Regulation 3.15- notification to a registration Committee where the registered auditor is appointed as auditor of a 'major audit' client.

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A number of other changes have been made which affect UK and Irish audits, namely;

- a. Definition of audit working papers - SI220 of 2010 includes a definition of audit working papers. As audit working papers are referred to in the SI the definition has now been included in the Regulations.
- b. Definition of appropriate qualification:
 - i. the definition has been expanded to ensure all reference to the section of the 2006 Act have been included; and
 - ii. a new definition for Irish entities as required by the SI220 of 2010 has been included.
- c. As an aide to interpreting the definitions, further guidance is set out in a new schedule within the regulations.
- d. An obligation for registered auditors to provide returns and other information required by the registration committee under new regulation 2.10A.
- e. Email is now accepted as form of notice under the regulation 1.08 (formerly 1.09).
- f. There are some additional guidance notes around firm eligibility under regulation 2.03, in particular the continued prohibition in Ireland of audit firm body corporates acting as an auditor for certain small entities outside the scope of SI220.
- g. Additional independence rules in Ireland set out in schedule 1 of Chapter 3.

Whilst the practical impact of this for the majority of firms is not significant we advise all firms to be aware of the changes. In addition, as is outlined further in the EU Services Directive article at the end of this Audit News, registration as an audit firm enables a firm to express opinions as a statutory auditor in both the UK and Ireland, and stationery, collateral and websites need to be amended to that effect. If, however, audits are unlikely to be undertaken in Ireland, the sole UK reference is acceptable on stationery but the Irish registration needs to be disclosed somewhere, usually on the firm's website.

COMPLIANCE WITH THE ETHICAL STANDARDS – IN PRACTICE

In our last edition of Audit News we discussed some of the most common issues that the Audit Monitoring team identified in 2011, and this included some areas around compliance with the Ethical Standards. In our experience firms do generally act in accordance with the spirit of the Ethical Standards, however it is often the case that a firm may be unaware of the requirements and this is regularly an area where there is discussion and debate during a visit. This has also been subject to a number of questions from participants at courses delivered by the Audit Monitoring team and, with that in mind; we feel it would be useful to provide some further background and guidance in some of the most common areas of discussion.

What should you be considering in relation to the provision of non-audit services?

As you may expect, most firms provide some element of non-audit services to their audit clients, and in these circumstances firms must be able to demonstrate that there are adequate safeguards in place to eliminate any potential independence threats, or to reduce these to an acceptable level.

The provision of accounting services to an audit client principally creates potential self-review and management threats:

- Self-review threat – where, by virtue of providing the non-audit service, the audit firm is associated with aspects of the preparation of the financial statements; and
- Management threat – arising from the risk of taking decisions on behalf of management.

The following areas are a very brief overview of those more common services provided to audit clients by our audit registered firms. Please note that in these circumstances we are assuming that the PASE (Provisions Available for Smaller Entities) has not been applied, however we would advise firms to also refer to this when making assessments on any potential threats to independence.

Financial statements and corporation tax compliance work

Most firms prepare the financial statements for their clients, either from a trial balance, or from a draft set of accounts which the client has prepared, and provide routine taxation services. This type of work is acceptable under the Ethical Standards, provided that the firm is not making decisions on behalf of the client. This is particularly important when it comes to journals, as many firms will make reallocations, post depreciation journals etc., however these should not be done without the prior approval of management.

Preparation of management accounts

When preparing the management accounts, again it is important that the audit firm does not initiate or code transactions or make any management decisions. Therefore, approval of management should also be evident. Further, the firm should implement safeguards to reduce the self-review threat to an acceptable level, such as use of a separate team who are not involved in the audit; or an independent level of review.

Bookkeeping services

The above safeguards also apply when an audit firm carries out bookkeeping services for an audit client, however given that the nature of these services requires the audit firm to post journals on behalf of the client, sufficient safeguards can sometimes be more difficult to demonstrate. Therefore, in order for the audit firm to satisfy the requirements of the Ethical Standards in relation to these services, we advise that you ensure that all decisions are taken by management, and that the work has a sufficient level of client supervision, in order to address the potential management threat.

Payroll

Again, a large number of firms will carry out some payroll services for their audit clients. In the first instance, we would advise firms to ensure that they receive salary and hours information directly from the client as, if no information is provided, and the firm then conclude on what should be paid, this leads to an unacceptably high self-review or management threat as the firm have prepared the payroll and are also auditing it. As an additional consideration, if the firm makes BACS, or other payments, on behalf of the audit client, we advise firms to ensure that there is evidence that management has approved any payment before it is made, so as to provide a safeguard against the management threat.

Ethical standard 5 covers these, and a large number of other areas, including share valuation, taxation services, internal audit, and information technology services. As such, we strongly recommend that you remind yourself on the requirements of Ethical Standard 5 and consider how this impacts on your current client portfolio.

Ethical standard 5 can be viewed at: frc.org.uk/apb/publications/ethical.cfm

What should you do if you have signed an audit for a client for more than 10 years?

Although very few serious issues are identified on our visits in relation to long association, the primary recurring discussion matter relates to what actions should be taken where Responsible Individuals (RIs) have acted for a non-listed audit client for a period in excess of 10 years.

In a larger firm environment, with a number of RIs, any potential issues can be resolved through partner rotation, however, in a smaller firm, where clients may not be so keen to change audit partner, and indeed feel that the continuity is of benefit to them, the appropriate safeguard is likely to be different.

The following should be considered with regards Ethical Standard 3:

If the audit partner is not rotated after 10 years, the standard provides the following safeguards:

- Involving an additional partner, who is not and has not recently been a member of the engagement team, to review the work done by the partners and advise as necessary; or
- Apply independent internal quality reviews to the engagement in question.

The second point should be interpreted as a hot file review to ensure that any independence issues are addressed. Note that cold file reviews do not fully meet the requirements as when the audit report has already been signed it is too late to identify any issues.

The above scenarios depend on the firm having more than one RI, therefore a further option is allowed under ES3 if none of the above safeguards are employed:

- The reasoning why the individual continues to participate in the audit engagement without any safeguards is documented; and
- The facts are communicated to those charged with governance of the audited entity.

It is also important to note that the last of the above options is not restricted to firms with more than one RI, however, where this option is applied, it is essential that the reasons for continuing to act are carefully documented and communicated to those charged with governance of the entity on an annual basis, preferably in writing.

Ethical standard 3 can be viewed at: frc.org.uk/apb/publications/ethical.cfm

Our experience has shown that there are unique circumstances that are encountered in relation to long association, which can range from questions regarding whether the 10 year period restarts if the RI moves to another firm, or if the audit registration number of the current firm changes, to whether a significant change in the structure of the client could negate the need for additional safeguards. In the vast majority of these types of scenarios, and questions asked of the Audit Monitoring team, the final conclusion has been that the 'spirit' of Ethical Standard 3 would require an appropriate safeguard to be implemented in all such circumstances.

What should you do if you receive a large element of your income from one audit client?

Ethical Standard 4 is very prescriptive on when an independence threat exists when there is a fee dependency concern.

For the avoidance of doubt, Ethical Standard 4 states that:

If total fees (audit and non-audit) from one non-listed audit client are regularly expected to exceed 15% of a firm's total income, then the audit firm should resign from this audit, and there are no safeguards considered appropriate to reduce this threat to an acceptably low level. This is not intended to require the audit firm to resign as auditor or to prevent them from standing for reappointment as a result of an individual event or engagement, the nature or size of which was unpredictable and where a reasonable and informed third party would regard ceasing to act as detrimental to the shareholders (or equivalent) of the audited entity. In such circumstances, the auditor is not required to resign but rather to disclose full details of the position to the Ethics Partner and to those charged with governance of the audited entity and discusses with both what, if any, safeguards may be appropriate in the circumstances. Such events should obviously be one-offs and not expected to occur on a regular basis.

If the fees from one audit client are regularly between 10% and 15% of the total fee income for the firm, then an external hot file review should be performed before the audit report is signed.

Provisions are available for new firms whose fee base is growing. Such an audit firm shall:

- (a) not undertake any audits of listed companies, where fees from such an audited entity would represent 10% or more of the annual fee income of the firm; and
- (b) for a period not exceeding two years, require external independent quality control reviews of those audits of unlisted entities that represent more than 15% of the annual fee income before the audit opinion is issued.

The firm might also develop its practice by accepting work from entities not audited by the firm so as to bring the fees payable by each audited entity below 15%.

Ethical standard 4 can be viewed at: frc.org.uk/apb/publications/ethical.cfm

Should you wish to contact ICAS for advice on any independence or ethical matters, please do so using the following email address: accountingandauditing@icas.org.uk

PERFORMING AN EFFECTIVE RI 'SELF-REVIEW' OF AUDIT WORK

In a sole practice where there is only the one RI who is heavily involved in the audit work, it can be difficult for the RI to either perform, or evidence, an effective self-review before signing the audit report. In light of this, and recent discussions held during firm visits, we want to highlight the considerations that firms may wish to build into their audit process, with particular consideration of the ISAs and ISQC1.

What do the ISAs and ISQC1 say about the level of review required in an audit engagement?

A good place to start in any discussion on review of audit work is to provide an insight into the approach that the Audit Monitoring team take in our reviews.

There are three main areas of reference:

- International Standard on Quality Control (UK and Ireland) 1 (ISQC 1) - In the UK and Ireland, ISQC (UK and Ireland) 1 This applies to firms that perform audits of financial statements, report in connection with investment circulars and provide other assurance services where they relate to activities that are reported in the public domain and are therefore in the public interest;
- International Standard on Auditing (UK and Ireland) 220 – 'Quality Control for an Audit of Financial Statements'; and
- International Standard on Auditing (UK and Ireland) 230 – 'Audit Documentation'.

The underlying tone of our reviews stem from the statement in ISA 230, para 8, that states documentation be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing and extent of audit procedures performed; the results of the audit procedures performed and evidence obtained; and significant matters arising, conclusions, and significant judgments. In addition, ISA 220, para 17, states that 'on or before the date of the auditor's report, the engagement partner shall, through a review of the audit documentation ... be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued'.

It is human nature in some circumstances to perform audit work, or to hold client meetings, and for this information to not be fully recorded on an audit file, and whilst this is the case in all types and sizes of audit engagement, we have seen this to be fairly frequent on audit files where the majority of the audit work is conducted by the RI.

The challenge for individuals in this situation is to take a 'step back' from the audit work to then conduct an effective self-review of work performed and documented. ISA 220 provides useful guidance, at para A17, that suggests a review in any audit should consist of consideration whether:

- The work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the auditor's report; and
- The objectives of the engagement procedures have been achieved.

We would, therefore, advise RIs who are performing a self-review to consider these matters in the context of their engagement.

What other safeguards could you consider?

Any involvement by an appropriate independent party is seen as a positive element of an audit process, and in the situation where an RI is conducting the majority, or all, audit work on an engagement this becomes even more powerful. The most obvious role by an independent person may be in the performance of a hot or cold file review:

- ISQC1 paras 35-42 states that an audit firm must have a policy to determine when an Engagement Quality Control Review (hot file review) is required, and that the criteria should include such considerations as public interest; risk; and an entity's laws and regulations. APB Ethical Standard 4 (as explained in our ethics article) also requires an external hot file review when fee dependency is between 10 and 15% for non-listed audits. In the instance of an RI conducting all audit work, you may wish to consider in what other circumstances an independent review would be appropriate to aid an effective review process.
- ISQC paras 48-53 and Audit Regulation 3.20 govern the Audit Compliance Review, which requires a cold file review to be conducted on an annual basis. Whilst a sole practitioner is only required to obtain an external cold file review of an audit file once every three years, you may wish to consider more regular external review, either on a particular engagement, or area of audit concern, so as to drive an effective review process.

In addition to the above, making use of contacts external to the firm, including ICAS, so as to consult on any matters of complexity or that are technical in nature, can also be a positive aspect in obtaining external involvement in the audit process.

ISQC 1, ISA 220 and ISA 230 can be viewed at: frc.org.uk/apb/publications/isa/oct2009.cfm

APB UPDATES GUIDANCE FOR THE CHARITIES ACT 2011 (ENGLAND AND WALES ONLY)

Following the implementation of the Charities Act 2011, on 14 March 2012, which applies in England and Wales only, the Auditing Practices Board (APB) has published:

- An updated Practice Note 11 (Revised): *The Audit of Charities in the UK*; and
- Updated illustrative charity auditor reports within Bulletin 2010/2 (Revised): *Compendium of Illustrative Auditor's Reports on United Kingdom Private Sector Financial Statements ended on or after 15 December 2010*.

Whilst the implementation of the Charities Act 2011 and the revised APB guidance should not require any change to your current audit process or procedures, auditors should be familiar with the updated legislative framework and its impact on charity auditor reports.

It is also important that auditors of English and Welsh charities keep in mind that auditor's reports should reflect the statutory basis for the audit, which of course must also be reflected in the engagement letter. The APB has taken the view that in the certain circumstances a charitable company can receive an audit solely under charity law while electing for exemption under company law. ICAS takes the view that it is good practice where any piece of legislation requires a charity to be audited that the charity is audited under all applicable legislation.

Links to the updated Practice Note and Bulletin are available on the ICAS website at: icas.org.uk/home/technical-and-research/technical-information-and-guidance/charities/guidance-for-the-auditors-of-charities/

Further information on the Charities Act is also available on the ICAS website at: icas.org.uk/home/technical-and-research/technical-information-and-guidance/charities/charity-law-in-england-and-wales/

Guidance for ICAS members acting for Scottish Charities

The ICAS Charities Committee updated its guidance for ICAS members acting for Scottish Charities for periods commencing on or after 1 April 2011. This update was prompted by changes to the Charities Accounts (Scotland) Regulations 2006, and the guidance is available on the ICAS website at: icas.org.uk/charityguide2011/

DEALING WITH THE BRIBERY ACT IN ENGAGEMENT LETTERS

In Audit News 48A, issued last summer, we discussed the Bribery Act 2010 and advised firms that the Act came into force on 1 July 2011 and created offences that involved bribing someone, to be bribed, to bribe a foreign official, and to fail to prevent bribery.

In light of the final offence stated, we have been advising firms to establish and document an anti-bribery policy to cover reporting responsibilities within the firm, a risk assessment covering the firm's potential exposure to bribery and a code of conduct for all employees (including details of what you consider to be reasonable and proportionate limits for corporate hospitality and gifts that are received and given).

As an additional point of consideration we do not, at this time, consider it necessary to include a paragraph on the Bribery Act 2010 either in your engagement letters or standard terms of business.

IRISH 'THIRD COUNTRY' AUDITORS

We would also like to take the opportunity to alert and remind relevant firms of your responsibilities with regard to registration with IAASA as 'third country' auditors.

Statutory auditors that express an audit opinion on an entity incorporated outside the EU, but which is quoted on the Irish stock exchange, are required to register separately with IAASA in accordance with Regulation 113(1) of SI 220 2010.

There is a series of application forms and this notification and registration process is set out at: www.iaasa.ie/legislation/3cae/3rdcountry.htm. However, if the statutory auditor is already registered with ICAS as Irish statutory auditors, then a streamlined approach is applied and the auditor will only need to write to IAASA detailing the entity involved, the names of the engagement partner and requesting registration under Regulation 113. Registration needs to be effected before the audit report is signed.

Further detailed guidance, including copies of the relevant application forms, is provided on the IAASA website at the link above.

REMINDERS

The EU Services Directive

You may remember back in Audit News 46 we informed firms that the EU Services Directive became effective on 28 December 2009. As the Audit Monitoring team have identified a number of instances in recent months where firms have not been fully compliant we felt it was timely to provide a short reminder.

The Directive was enacted by the Provision of Services Regulation and was designed to outline what a service provider (which includes an auditor) must tell clients and potential clients about itself and the services it provides.

A help-sheet on this Directive was issued by ICAS, a copy of which can be found at icas.org.uk/home/regulation-and-ethics/quality-review/helpsheets-and-guidance/

In respect of audit firms, disclosure of general contact information is mandatory, however you will likely have this information already displayed on your letterhead, and many of the other requirements will be covered by a typical audit engagement letter or indeed on your website, if you have one. That being said, there is one aspect that continues to crop up on monitoring visits, relating to the audit registration disclosure. The Directive introduced a new requirement for audit firms to disclose:

- Their professional title, and the member state in which the regulated professional title has been given;
- The particulars of the competent authority; and
- The details of the public register and the firm's audit registration reference number (the four digit ICAS firm number).

We have been providing firms with the following example wording to be used in order to meet the above requirement:

Example wording for firms to disclose details of their audit registration:

Registered to carry on audit work in the UK by the Institute of Chartered Accountants of Scotland. Details about our audit registration can be viewed at auditregister.org.uk under reference number XXXX [insert firm no.]

In practical terms, firms do not need to reprint letterheads and can meet the requirements via disclosure elsewhere, however, it makes sense to reflect the new requirements in letterheads when you next need to re-order.

That being said, as discussed in the new Audit Regulations article at the start of this Audit News, audit firms can express an audit opinion in both the UK and Ireland, and disclosure to clients and potential clients should reflect this. In the situation where a firm is expressing an audit opinion in Ireland the example wording above should refer to audit work in the 'UK and Ireland' and details on audit registration should also refer to 'www.cro.ie/auditorsforireland'.

Keeping Your Audit Firm and Files on the Right Track

We have now presented our mandatory courses for Audit Compliance Principals (ACPs) in Edinburgh and Inverness this year, to very positive feedback. The remaining 2012 date for these courses, 'Keeping Your Audit Firm on the Right Track' and 'Keeping Your Audit Files on the Right Track', is 4 October, and this will be held in Glasgow.

As we have commented in previous editions of Audit News, in order to ensure mandatory attendance is not too onerous, ACPs are required to attend only once every five years. In addition, ICAS is subsidising this course for ACPs and the rate is only £80 plus VAT for ACPs for the full day. We have also been keen to open the course up to others involved in audit, and those who have attended who are not ACPs have also found the course to be of great benefit, and the course rates for such attendees is £100 plus VAT for a half day course, and £150 plus VAT for the full day course.

Information on how to book, together with an outline of each course, can be found at icas.org.uk/Businesscourses/

AUDITNEWS

COMING SOON

We hope you have an enjoyable summer period and please be on the lookout during the rest of 2012 for upcoming editions of Audit News, where, in addition to covering relevant updates and releases, we will be discussing a range of areas, such as Engagement Quality Control Reviews; International Education Standard 8; professional scepticism; and the approach to ISA 620 and the use of an auditors expert.

ICAS Practice Review Service

How confident are you in the quality of your audit files?

Is your firm complying with the Audit Regulations and carrying out an audit compliance review annually?

Have you taken all steps necessary to apply the clarified ISAs?

This is where the ICAS Practice Review Service can help!

- We carry out a confidential and independent review of your files.
- We come to you and test your compliance with the regulations.
- You get detailed feedback on where you are, where you need to be and how to bridge any gap.

For more information on our fully flexible range of services and competitive rates, please contact Linda Laurie on 0131 347 0249

