

The audit of bank – removal of Practice Note 16

On 14 July 2017, the FRC announced that it would be replacing Practice Note 16 (PN16) with additional application material in ISA (UK) 330 – The Auditor’s Responses to Assessed Risks; and ISA (UK) 505 – External Confirmations. The proposed changes apply to the audit of financial periods beginning on or after 15 December 2017.

In the opinion of the FRC, the requirement for a bank confirmation report continues to be a matter of professional judgment for the auditor and, therefore, the revisions do not change the existing requirements on auditors, but rather are intended to reduce the amount of guidance in issue, and to better integrate that guidance with auditing standards.

However, some key questions have been raised by firms on monitoring visits as to the impact of the wording of the Practice Note. Under PN16:

“Given the importance of cash to an entity’s business and its susceptibility to fraudulent misuse the auditor will usually conclude that, in the absence of a bank report regarding account balances, facilities and securities, it will not normally be practical to obtain sufficient appropriate audit evidence from other sources”.

Following the explicit requirements of the PN wording, a bank confirmation letter has historically been obtained by audit firms as matter of course, regardless of the assessment of risk; and this is also the approach reflected by ICAS Audit Monitoring, when conducting the of audit engagement files.

This wording has now been removed, and the revised guidance within ISAs (UK) 330 and 505 does not closely replicate the wording of the withdrawn PN16, or the prescriptive nature of the extract quoted above. In short, the emphasis is very much on auditor judgement, and consequently auditor’s assessment of risk over cash held in a client’s bank accounts.

Naturally this has led to queries as to what seems like an opportunity for auditors to rid themselves of the bank confirmation letter for good. This follows feedback from our audit firms for a number of years which has been that obtaining an accurate bank confirmation letter can be very frustrating and time consuming.

Common issues include:

- The inability to obtain an accurate confirmation which can delay the signing of an audit report, or simply the confirmation is received in advance of signing;
- Errors or inaccuracies in bank confirmations which have been received; and
- Concerns over completeness – i.e. how can a bank confirmation test completeness when the bank asks the auditor to supply the account numbers first?

These are all valid concerns. They do not, however, remove the existing requirement under PN16 to obtain the confirmation, and from a regulatory perspective the bank letter is, therefore, still an important source of evidence.

Common issues on monitoring visits are reflected in our annual monitoring reports and summary of file findings (the 2017 report can be found at www.icas.com/regulation/annual-reports-on-monitoring-activities). We regularly breach for lack of evidence obtained over bank and cash, though mostly where the firm not only hasn’t obtained a bank confirmation but has not attempted to do so. While other bank testing issues do arise – for example: no additional testing on bank reconciliations; no window dressing tests; and no review for large and unusual items – the key omission is usually the bank letter and, where this is deliberately not requested, is very rarely supported by a detailed assessment of low risk or a suitable alternative audit approach.

Going forward, this assessment of risk is going to be important. On removal of PN16 the question from audit firms is whether, based on auditor’s judgement, a bank balance could be considered low risk and therefore would not require a bank confirmation letter.

We should be clear that attributing low risk to a bank balance requires a number of additional considerations, and might include:

- whether there has been previous fraud or error;
- the size and nature of the balance in relation to the financial statements;
- whether it is the first year of audit; and
- any expectations of a group auditor.

There are also considerations for other disclosures in the financial statements - the bank confirmation letter, for example, is a valuable source of evidence for confirming nature of any securities and obligations; bank loan balances; and title to property. It is worth noting that this point is further reflected in one of the revisions to ISA (UK) 330 on withdrawal of PN16:

“In the UK, depending on the auditor’s risk assessment, the auditor considers whether confirmation is needed in relation to additional information such as trade finance transactions and balances or information about guarantees and other third-party securities, in addition to the confirmation of balances and other banking arrangements usually provided in such a request”.

If the auditor is able demonstrate low risk, they will then have to demonstrate how appropriate evidence can be obtained over all relevant audit assertions which would otherwise be covered by the confirmation letter. In the opinion of ICAS AM, viewing bank statements or bank details online is alone not enough; additional work will extend beyond routine bank testing (e.g. cut-off, window dressing etc); and firms will have to consider whether coverage completeness, existence and accuracy could involve elements of controls testing or data analytics.

It is important to note that the FRC has ruled out further guidance in this area and, while this does not rule out further guidance which might be issued by ICAS or another professional body, going forward the requirement for bank confirmation letters under the ISAs (UK) will be a matter of professional judgement.

While the removal of PN16 provides the opportunity for consideration and discussion of the bank confirmation process and it’s use as a source of evidence, ICAS AM recommends caution. This should not be viewed an opportunity to action a complete removal of bank confirmation requests. Ensuring bank balances are appropriately tested is a specific consideration for each and every audit client. Like any other area of the financial statements, if the risk assessment is subsequently considered to be incorrect during a Regulatory Monitoring visit, this can lead to deficiencies in audit approach and consequently audit evidence.

GDPR and audit firms

GDPR came into force on 25 May 2018, and with it a new regime for how personal data must be handled and backed up with much tougher sanctions for breaches. Audit firms should already be taking data protection compliance seriously and must ensure that all processing of personal data complies with the following data management principles, which require that data is:

- Processed lawfully, fairly and in a transparent manner
- Collected for clear and legitimate purposes and not further processed for incompatible purposes;
- Adequate, relevant and limited to what is necessary;
- Accurate and, where necessary, kept up to date;
- Kept only for as long as necessary for the purposes for which the personal data are processed; and
- Processed securely;

The auditor as a data controller

In provision of audit services, audit firms will generally be a data controller as the firm has professional obligations under the Audit Regulations; Auditing Standards; and the Code of Ethics (the fundamental principle of professional behaviour) which oblige them to take responsibility for personal data they process.

Audit firms should apply sufficient professional judgement and decision making over the purposes for which data is processed in the normal course of their audit work. As data controllers, audit firms will need to ensure that they:

- have a lawful basis for their processing activities in terms of GDPR;
- have provided the individuals whose data they process with the information which meets GDPR's transparency requirements by explaining how and why they are processing an individual's personal data (i.e. through an appropriate privacy statement, published on the firm's website, included or referenced within a letter of engagement, and otherwise referenced on forms or other channels for data capture); and
- only process personal data in accordance with the terms of these privacy statements.

The GDPR stipulates that before you can process data you must establish that you have a lawful basis for doing so – in relation to audit services, a lawful basis would be to meet a legal or regulatory obligation (i.e. the statutory audit). This should be documented in line with the requirements and specified in the audit engagement letter.

The audit file

If a company engages a firm to provide audit services, the books and records being audited contain personal data such as customer or payroll details. These are often copied and placed on the audit file and utilised for the purposes of audit evidence and documentation.

ISA (UK) 230 - Audit documentation

Under ISA(UK) 230 audit work should be documented in such a way that an independent individual with suitable audit experience can reperform the audit work and come to the same conclusion as the auditor. This clarifies the requirement under the legislation but raises the question under the GDPR, how much information is required on the file to reperform the test, and consequently how much is too much?

In practice a number of audit tests are regularly performed utilising documents provided by the client – common examples are sales and purchase ledger prints; and payroll records, which are often requested on audits and received in an indigestible 'dump of information' from the audit client.

In not tailoring this documentation, the client is providing a lot of information to the firm on its employees, customers and suppliers. Auditors must therefore consider whether a copy is required to evidence the work performed. For example:

- the documents may contain personal data on items not being tested; or
- the documents may include information (names, addresses contact details) not required for the purposes of audit evidence

For example, on monitoring visits we quite often see payroll deduction testing performed on a print out from the payroll system. While this saves time in re-writing the sample selected for testing, these schedules often include the details of employees not selected for testing and may even include information not even required for the purposes of the test (e.g. employee contact details; address; date of birth).

Information not held on the audit file

Firms should also consider information outside the audit file which has been obtained during the course of the audit process. Note that this is not limited to electronically stored information including email, but also includes hard copy documents and working papers.

Often on monitoring visits, schedules and related information not included on the audit file is produced in support of judgements or evidence on the audit file. Firms should continue to ensure that all relevant information is retained on the audit file, and audit principals and staff should be encouraged not to retain additional or duplicate copies documents (working papers; source accounting records; etc) which do not form part of the audit file.

ISA (UK) 600 – Use of the work of another auditor

From time to time, firm's may utilise the work of another audit firm (or be involved as a component auditor themselves), commonly in group or remote audits, or in a specific area such as attendance at an annual stock count.

Firms should be wary of the transfer of information to third parties, in particular if outside the EEA, and take steps to ensure appropriate data security measures are in place. Firms should also review information received from component auditors to ensure that there is no un-necessary data collection

Use of electronic procedures

Auditors using electronic procedures should also confirm how the audit system will be compliant with GDPR. A comprehensive map of dataflows should be utilised to identify any issues with how the software interacts with personal data and other systems. As well as considering encryption and the extent of back-up and recovery procedures, this may also include:

- Access rights;
- The technical specifications of the software; how this is updated and whether the most recent version is being used;
- Use of data both within the system itself and the extent of integration with other software (statutory database; firm's practice management system; accounts and tax preparation software – particularly if moved to the cloud);
- The use of anonymisation or pseudonymisation;
- Security, including considerations for portable electronic devices including laptops; mobile phones.

Staff training

Audit firms should ensure that their employees understand the importance of personal data and their obligations to treat it responsibly and securely. Audit staff should understand how the requirements of GDPR are relevant to the day to day work that they do, to make sure they can recognise data breaches, and respond accordingly. They also need to be able to identify requests by individual data subjects to exercise their rights under GDPR so that they can ensure that these requests are drawn to the attention of the correct person internally to be handled promptly and properly.

Data destruction

If the data is processed under any other processing condition, such as legitimate interest, then there is no automatic right to be forgotten. This would apply to client data held for audit, tax, anti - money laundering or other regulatory purposes.

Where the personal data is held under a lawful basis other than consent and is no longer necessary in relation to the purpose for which it was originally collected (so where personal data held as part of an audit assignment but the period it has been held exceeds the statutory requirements) then the right to be forgotten can be applied.

Further information and guidance on GDPR, including an engagement letter style clause, can be found on the ICAS website at www.icas.com/regulation/preparing-for-gdpr

High quality audit enhanced by stronger culture

A new report by the Financial Reporting Council (FRC), '*Audit Culture Thematic Review*' emphasises the importance that firms create a culture where achieving high quality audit is valued and rewarded. This is the first time that the FRC has published a report on audit culture and, looking forward, the FRC plans to review the culture at the largest firms as part of its recently announced expanded monitoring and supervision of those firms.

The thematic review provides a 'snap shot' of the actions being taken, by the eight firms adopting the Audit Firm Governance Code, to establish, promote and embed a culture that is committed to delivering consistently high-quality audits. The report further recognises the time firms are investing in 'firm wide' culture and provides some examples of good practice.

The report highlights key areas that firms should address to enhance audit quality and embed an appropriate culture where achieving a high-quality audit is valued and rewarded. These include:

- Additional emphasis on audit specific values, including integrity, objectivity, independence and professional scepticism;
- Ensuring that audit partners and staff appreciate the societal impact of good audit and how this promotes transparency and integrity in business;
- Ensuring the firms' processes are appropriately balanced to both sanction poor quality work and better recognise positive contributions to high audit quality;
- Developing of existing root cause analysis techniques; and
- Improving the firms' monitoring of how successful they are at embedding their desired culture.

A copy of the report can be found on the FRC website at www.frc.org.uk/news/may-2018/high-quality-audit-enhanced-by-stronger-culture

IAASA – Brexit and its potential impact on audit and accountancy

The *Irish Auditing and Accounting Supervisory Authority (IAASA)* has issued its review paper '**Brexit and its potential impact on Audit and Accountancy**'. The document provides an overview of various challenges, potential issues and opportunities that *Brexit* may bring to IAASA and those entities within its remit, while IAASA engages with all relevant parties as part of its preparations for regulation of the accountancy and audit profession post-Brexit.

A key discussion point from the paper is the status and audit qualification of all Recognised Accountancy Bodies (RABs) in the UK – ICAS, ICAEW and ACCA. Currently, the UK audit qualification is recognised in the UK and Ireland, and all UK audit firms registered with a UK RSB are able to carry out audits in both the UK and Ireland. IAASA are considering whether this will require to change post Brexit.

Other key impacts include the portability of the audit qualification or the transfer of audit qualified staff between the UK and Ireland. A copy of the paper can be found here: www.iaasa.ie/News/2018/Brexit-and-its-potential-impact-on-Audit-and-Accou

Further information on the accounting, auditing & liquidator requirements in Ireland can be found on the ICAS website at www.icas.com/regulation/ireland

Charitable companies – Which format to use

With significant changes in financial reporting over the last two years, we have seen a number of cases on monitoring visits where charities have submitted accounts in the wrong format. Recently, there have been a small number of cases where firms have prepared and submitted accounts for charitable companies which have been prepared in the wrong format.

We would therefore like to take the opportunity to remind firms of the requirements:

For periods commencing on or before 1 January 2019, charitable companies must prepare accounts which are in line with the requirements of the Charities SORP (FRS 102), and this currently includes Update Bulletin 1. In addition, there are further requirements within the SORP for charities with income of £500,000 or more.

In relation to filing accounts, a copy of the full accounts of a charity should be submitted to both Companies House **and** to OSCR.

Note that charitable companies are **not** eligible to:

- a) Use the micro-entity regime - charities are specifically excluded from it under the legislation which introduced the regime; or
- b) Prepare abridged accounts– this is prohibited by legislation which specifically excludes charitable companies.

OSCR has also raised concerns with the format of recent sets of accounts filed with them, and has issued further guidance at www.oscr.org.uk/news/charitable-companies-what-accounts-format-to-use

Registered societies – changes to the audit exemption level

On 6 April 2018 new legislation came into effect amending the levels at which the financial statements of a society registered under the Co-operative and Community Benefit Societies Act 2014 (“the Act”) require an audit.

From this date, under the Co-operative and Community Benefit Societies Act 2014 (Amendments to Audit Requirements) Order 2018, societies registered under the Act can **disapply the requirement to audit** where:

- the gross assets in the preceding year of account were below the value of £5.1m (previously £2.8m); and
- the turnover in the preceding year was below £10.2m (previously £5.6m).

To disapply the requirement, a resolution must be passed at a general meeting and meet the requirements of the Act in this regard.

The exemption does not apply to a society that:

- a. is a credit union;
- b. is a subsidiary;
- c. has a subsidiary;
- d. holds a deposit (as a regulated activity) or has at any time since the end of the preceding year of account held a deposit (other than a deposit in the form of withdrawable share capital), or
- e. is registered in the register of social landlords maintained under section 20(1) of the Housing (Scotland) Act 2010.

In addition, these changes do not apply to societies which are charities. These societies can **disapply the requirement to audit** where:

- the gross assets in the preceding year of account were below the value of £5.1m (previously £2.8m); and
- the gross income in the preceding year was below £250,000 (unchanged).

Publication of amendments to FRS 101 and feedback statement to FRED 69

On publication, the FRC committed to review FRS 101 on an annual basis and update it to ensure consistency with IFRS. FRED 69 was the fifth of these annual updates and was issued back in October 2017. The FRED proposed no amendments to FRS 101, however, indicated that a detailed consideration of IFRS 17 Insurance Contracts would be deferred until a clearer picture of the progress of its endorsement is known.

On 10th May 2018, the FRC issued the documents ‘Amendments to the Basis for Conclusions FRS 101 Reduced Disclosure Framework’ and the associated ‘Feedback Statement to FRED 69 FRS 101 – 2017/18 cycle’, confirming that no amendments to FRS 101 have been made as a result of the 2017/18 review.

Keeping Audit on the Right Track – Final course of 2018!

ICAS AM would like to remind firms that all ACPs are required to attend the Mandatory Audit Course once in the period between 1 January 2016 and 31 December 2018. The course is presented by the ICAS Audit Monitoring team and has been created to educate and support ACPs and RIs and covers all areas of audit compliance responsibilities, key regulatory issues, common compliance failings, and key findings from ICAS audit monitoring visits.

The final course of 2018 will be held in [Glasgow: Wednesday 26 September](#)

ICAS will make contact with all ACPs who have yet to attend to ensure the mandatory requirement will be met by the end of this year.