

In this edition we focus on a number of changes to the UK audit and accounting frameworks, following implementation of EU Directives, including the adoption of SI 2015/980 and the removal of the Financial Reporting Standard for Smaller Entities (FRSSE).

We also look at Financial Reporting Standard (FRS) 102 Section 1A for smaller entities, including potential audit issues that firms should consider as their clients embark on this.

This edition also includes further information on revisions to UK Ethical and Auditing Standards, and the provision of non-audit services to Public Interest Entity (PIE) audit clients.

Finally, we will also provide some more guidance on the revision to International Education Standard 8 (IES 8).

AUDIT ISSUES - IMPLEMENTATION OF THE EU ACCOUNTING DIRECTIVE

- Changes affecting small companies will become effective for accounting periods commencing on or after 1 January 2015.
- Small company accounting changes can be early adopted for accounting periods beginning on or after 1 January 2015 but not the increased audit thresholds.
- There are a number of potential issues for auditors.

[The Companies, Partnerships and Groups \(Accounts and Reports\) Regulations 2015 \(SI 2015/980\)](#), transposes the new EU Accounting Directive into UK company law. As a result, there will be changes to the Companies Act 2006 (CA06) to reflect this. Note that the recent decision to leave the EU will have no impact on this legislation.

This follows on from a significant period of change in the UK Accounting Framework. In this article we look at changes taking place, and some audit issues that may arise from upcoming changes to the company size and audit exemption thresholds; small company reporting; and accounts filing requirements.

Upcoming Changes to the UK Accounting Framework

A brief summary of the recent and upcoming changes to the UK Accounting Framework is summarised below:

Accounting periods beginning before 1 January 2015:

There were four levels to the UK GAAP framework for accounting periods beginning before 1 January 2015:

- Micro entities were able to produce very short form accounts. The accounting requirements for micro-entities were included within the FRSSE 2008.
- Small companies were eligible to apply FRSSE 2008.
- Listed companies had to apply IFRS in their consolidated accounts.
- All other UK companies (essentially medium-sized and large companies) used Statements of Standard Accounting Practice (SSAPs), Financial Reporting Standards (FRSs) and Urgent Issues Task Force (UITF) Abstracts.

Accounting periods beginning on or after 1 January 2015:

For accounting periods beginning on or after 1 January 2015, the UK GAAP framework changed as follows:

- Micro entities – no change, with the accounting requirements included within FRSSE 2015.
- Small companies are eligible to apply FRSSE 2015 or FRSSE 2008.
- Listed companies – no change
- All other UK companies use the new UK GAAP. Although this involves a number of new standards, the key new standard is FRS 102.

Accounting periods beginning on or after 1 January 2016 (adopting the 2015 Regulations):

The accounting framework for accounting periods beginning on or after 1 January 2016 is as follows:

- Micro entities will apply the Financial Reporting Standard for Micro-Entities (FRS 105).
- Small companies will apply FRS 102 but with limited disclosures (this is in Section 1A of FRS 102).
- Listed companies – no change.
- All other UK companies – no change.

Statutory Instrument 2015/980

A key feature of the new legislation is the EU's harmonised small company regime, which means that the UK is only permitted to obligate small companies to include certain information in their financial statements. These disclosures are included in Appendix C of FRS 102 Section 1A, a copy of which can be found on the FRC website.

Other key points to note in respect of the new legislation are:

- SI 2015/980 (and Section 1A of FRS 102) can be early adopted from accounting periods beginning on or after 1 January 2015 (SI 2015/980 may only be early adopted if FRS 102 Section 1A is also early adopted, and vice versa);
- SI 2015/980 (and Section 1A of FRS 102) may mean that the content of accounts for small companies will be reduced compared to full FRS 102;
- SI 2015/980 abolishes abbreviated accounts.
- Audit thresholds will increase in line with the new small company thresholds for accounting periods beginning on or after 1 January 2016. Please note that early adoption is not permitted to take advantage of audit exemption.

Company size thresholds and the audit exemption

One key feature of SI 2015/980 is that it increases the small and medium-sized company and group accounting thresholds as follows:

| | Small | | Medium | |
|--------------|-----------------------|----------------------|----------------------|------------------------|
| | Company | Group | Company | Group |
| Turnover | £10.2m (was £6.5m) | £12.2 (was £7.8m) | £36m (was £25.9m) | £43.2m (was £31.1m) |
| Gross Assets | £5.1m (was £3.26m) | £6.1m (was £3.9m) | £18m (was £12.9m) | £21.6m (was £15.5m) |
| Employees | 50 (no change) | | 250 (no change) | |

The audit exemption test remains that a stand-alone company (i.e. one which is not a member of a group) must meet the definition of a small company. In summary, this means that it must meet these conditions taking account of the two-year rule, and must not be ineligible.

Some companies are ineligible from applying the small company regime irrespective of size:

- Public companies;
- Authorised insurance companies;
- Banking companies;
- MiFID investment firms; and
- Undertakings for Collective Investments in Transferable Securities (UCITS).

These rules are largely unchanged under SI 2015/980, though there has been a relaxation of the 'ineligible groups' rules in section 384 (2) of CA06. Under the current section 384 (2) of CA06, companies within groups are 'ineligible' from applying the small company regime and taking advantage of audit exemption whenever the group contains a public limited company. Under SI 2015/980, this will only be the case when the public limited company is a traded / quoted company.

Statutory Instrument 2015/980 is available for early adoption from accounting periods beginning on or after 1 January 2015. When applying the 'years rules' under SI 2015/980 to see if a company can take advantage of the small company exemptions, the new thresholds can be applied retrospectively to prior years.

REMEMBER!

- **SI 2015/980 cannot be used to take early advantage of the increase in the audit exemption thresholds.**
- **Early adoption of SI 2015/980 comes with an all or nothing approach – i.e. the full accounting framework otherwise applicable for accounting periods beginning on or after 1 January 2016 must be adopted, with the relevant threshold changes.**

The [LLP regulations](#) were also updated in summer 2016 to apply SI 2015/980 to LLPs. A copy of the new regulations can be found on www.legislation.gov.uk

FRS 102 section 1A

A copy of the most up to date version of FRS 102 (issued September 2015) can be found on the FRC website.

[Section 1A of FRS 102](#) sets out the presentation and disclosure requirements for small entities. This, together with recognition and measurement requirements of FRS 102, replaces the FRSSSE for periods commencing 1 January 2016.

While providing reduced disclosure requirements, there are a number of key differences between previous UK GAAP and FRS 102 Section 1A, including areas where the principles of recognition and measurement under FRS 102 Section 1A are substantially different.

The areas which have the biggest impact will depend entirely on the individual circumstances of each entity and ICAS Audit Monitoring strongly recommends that principals and staff undertake sufficient training in the requirements, and do not rely solely on accounts preparation software. You may also wish to refer to [Audit News 59](#), which includes an article on potential audit issues on adoption of full FRS 102. Previous editions of Audit News can be found in icas.com by searching for 'audit news'. Risks to consider include:

- *Audit risks* – There are specific audit risks in relation to transition arrangements, including auditor judgement and appropriate professional scepticism.
- *Potential ethics issues* – There are ethical matters for auditors to consider if involved in the accounts preparation process, and where clients implementing FRS 102 Section 1A may request help and advice with transition; and
- *Potential accounts / transition issues* – There are potential challenges for some audited entities and the firms auditing these FRS 102 Section 1A transition adjustments.

Key areas of change

Small companies reporting under FRS 102 will find the presentation and disclosure requirements contained in Section 1A. Note that this section solely outlines the presentation and disclosure requirements, but where the recognition and measurement issues are concerned, full FRS 102 principles will apply. For example, if your client has an investment property then the accounts must apply the full recognition and measurement principles in Section 16 - Investment Property.

With the increase in thresholds, many more companies will become eligible for the new small company regime. That being said, those which previously adopted the FRSE and do not qualify as micro entities may find some of the recognition requirements challenging (e.g. financial instruments and share-based payments) however will benefit from the reduced accounting disclosures.

Potential audit issues

Whilst FRS 102 Section 1A contains a number of mandatory disclosures, there are a number of disclosures which are only 'encouraged'. The FRC has stated that including both the mandatory and encouraged disclosure may not be sufficient to show a true and fair view and that preparers of financial statements should have regard to all of the disclosures required by 'full' FRS 102.

A draft revision to ISA 210, Terms of Engagement, reinforces this and states that 'the auditor ... considers carefully whether additional disclosures will be necessary in the financial statements when compliance with an accounting standard is insufficient to give a true and fair view'. From an audit perspective, we would anticipate that audit teams will fully document the considerations and conclusions in this regard on the audit engagement file.

With this in mind, FRS 102 section 1A cross references throughout to full FRS 102. Reference is also specifically made in Appendix D to five disclosures that are not strictly required by SI 2015/980 but which the FRC believes will always be needed, where relevant:

- A statement of compliance with FRS 102, adapted to refer to Section 1A;
- Statement that an entity is a public benefit entity, where relevant;
- Disclosures relating to going concern;
- Dividends declared and paid or payable; and
- On first-time adoption an explanation of how transition has affected both position and performance.

FRS 105 – Micro entities and 'true and fair'

The micro-entities regime was introduced in UK company law in 2013, with significantly reduced financial statements presentation and disclosure requirements. In July 2015, the Financial Reporting Council (FRC) published a new standard, FRS 105 The Financial Reporting Standard applicable to the micro-entities regime for use by those micro-entities choosing to adopt this simpler regime.

Entities that prepare their financial statements in accordance with the micro-entities regime are not required to have an audit and, in practice, it is unlikely that many will choose to. Financial statements prepared in accordance with the legal requirements of the micro-entities regime are presumed to give a true and fair view, therefore directors are not required to consider what additional information is required for the financial statements of the entity to give a true and fair view.

Where an audit **is** requested, the auditor will need to address the "deemed" true and fair view in the auditor's report.

Abridged and filing accounts

The regulations introduce the principle of 'file what you prepare' so that small companies may:

- prepare and file full accounts;
- prepare and file abridged accounts; or
- use the option (under section 444(1)) not to file the profit and loss account and directors report (i.e. file only the balance sheet and notes).

Abridged

SI 2015/980 give small entities the right to prepare abridged accounts for the members, subject to an appropriate legal process being followed. All the members must consent annually and a balance sheet statement is required to explain that the abridged accounts regime has been used.

Auditors will need to consider whether any abridgement will allow a true and fair view to prevail and will also need to ensure that the necessary legal process has been followed.

Accounts for filing Small companies can remove the Directors' Report, the Profit & Loss Account and any related notes for filing at Companies House. When advantage is taken of this, no audit report is included with the filed accounts. Instead, disclosure is included in the notes to the financial statements of:

- Whether or not the audit report has been qualified;
- The basis of any qualification;
- Details of any emphasis of matter; and
- Details of the senior statutory auditor.

Changes to the audit report

SI 2015/980 impose new obligations on auditors in respect of the audit report, specifically, a requirement for auditors to give a more detailed opinion on the directors' report and, where applicable, the strategic report.

The audit report must state whether, in the opinion of the auditor:

- Information given in the strategic report (if any) and the directors' report for the financial year...is consistent with those accounts;
- Any such strategic report and the directors' report have been prepared in accordance with applicable legal requirements;
- The auditor has identified material misstatements in the strategic report (if any) and the directors' report; and
- If applicable, the audit report must give an indication of the nature of any misstatements.

Note that the FRC has not yet updated its example audit report wording following the release of the revised ISAs (effective for audits of financial statements for periods commencing on or after 17 June 2016). For further information, please refer to the FRC website.

This is only a limited review of some of the issues auditors may face as clients begin to implement SI 2015/980.

ICAS AM strongly recommends that principals and audit staff undertake sufficient training in the requirements and do not rely solely on accounts preparation software.

For further information, including technical guidance and upcoming course, search 'FRS 102' on icas.com

REVISED AUDITING AND ETHICAL STANDARDS

- On 17 June 2016 changes in EU legislation in respect of statutory audit become effective.
- The FRC has issued revised Auditing and Ethical Standards to support the work of audit practitioners in delivering high quality audit, and thereby underpinning investor confidence.
- The revised standards apply for accounting periods commencing on or after 17 June 2016.

[The Statutory Auditors and Third Country Auditors Regulations 2016 \('SATCAR 2016'\)](#) came into effect on 17 June. SATCAR 2016 makes the FRC the UK's Competent Authority for audit, and places obligations on Public Interest Entities (PIEs) in connection with auditor appointments, including retendering and rotation requirements.

The FRC will delegate regulatory tasks to recognised supervisory bodies (RSBs), of which ICAS is one. Accordingly, the FRC has reviewed and carried forward the recognition of each RSB, who have each entered into a delegation agreement with the FRC.

The FRC will monitor directly the quality of PIE audits and certain other retained classes of audit and published on 1 April its inspection scope for 2016/17, which is available on the FRC website.

As covered in the last edition of Audit News, the Audit Regulations have been updated with effect from 17 June 2016 to take account of the changes initiated by the EU Audit Regulation and Directive of 2014 (ARD) and transposed into UK law by SATCAR.

The final version of the updated [Audit Regulations](#) are available on [icas.com](#)

The FRC has effected further changes alongside SATCAR, including finalised standards and related material that are aligned to the final legislation:

- [The Corporate Governance Code and Guidance on Audit Committees](#) (listed entities only) and the [2012 publication](#);
- [The Ethical Standard for Auditors](#); and
- [The Auditing Standards \(ISAs\) and Quality Control Standard \(ISQC1\)](#).

A summary of key changes to the above standards is set out below. ICAS AM strongly recommends that principals and audit staff undertake sufficient training in the new requirements.

The Ethical Standard for Auditors

- The FRC has consolidated its existing five ethical standards for auditors into a single revised Ethical Standard (the 'FRC ES'). This standard will apply to all audit and other public interest assurance engagements for periods commencing 17 June 2016.
- This approach is intended to help avoid a situation where the current ESs 2-5 may be considered in isolation without regard to the overarching principles in ES 1.
- Restrictions on provision of non-audit services to PIEs – covered in detail in the following article.
- Section 6 of the revised standard replaces the PASE for application to the audit of smaller entities.

The revised standard has been drafted on the basis of seeking to make the overarching principles and supporting ethical provisions more prominent and more clearly outcome-based. A detailed article on the requirements can be found at: <https://www.icas.com/technical-resources/ethical-standards-for-auditors-the-frcs-key-proposed-changes>

Auditors now need to consider their independence from the perspective of an objective, reasonable and informed third party (the "3rd party test"). Where applicable, safeguards have to reduce threats to "a level at which it is probable that an objective, reasonable and informed third party would not conclude that independence would be compromised" (rather than just saying reduce them to an "acceptable level").

In the case of a PIE, the standards ban the provision of certain types of non-audit services, and subject others to a fee cap of no more than 70% of the audit fee calculated on a rolling three-year basis.

The Auditing Standards and ISQC1

The FRC has made changes to reflect the EU reforms throughout the Auditing Standards and ISQC1. Key changes include the requirement for enhanced auditor reporting for all PIEs and all listed companies, which is a change from the existing regime, which only applied to those companies required to or choosing to comply with the Code. The change will affect listed UK together with unlisted banks, building societies and insurance undertakings. There are some further changes to the contents of the enhanced audit report which may add to the length of reports, including an expansion of the auditor's description of significant risks; disclosure of the auditor's tenure; and a declaration of independence.

Some changes are also made to auditor's reports for all entities, including:

- an amendment to the auditor's reporting on the going concern basis of accounting;
- a revised description of the scope of an audit; and

an opinion as to whether the directors' report and any strategic report have been prepared in accordance with the legal requirements. This is limited to confirming that the relevant information has been produced and the requirement is also reflected in SI 2015/980.

The Corporate Governance Code and Guidance on Audit Committees

For entities which apply the UK Corporate Governance Code, the changes to the code are minimal. There is a new requirement that the audit committee as a whole is required to have competence relevant to the sector in which the company operates.

The requirement to tender the external audit every 10 years has been removed, as this is superseded by the EU requirements for mandatory tendering and rotation of the audit firm which are now reflected in UK law by SATCAR.

Changes made to the Guidance on Audit Committees are the most substantial, including a number of additional disclosure requirements in Audit Committee reports. A copy of the guidance (April 2016) is available on the FRC website, however the key revisions relate to:

- the role and composition of the audit committee;
- the interaction of the committee with the internal audit function; and
- the clarity of audit committee reporting

EU REFORM – PROVISION OF CERTAIN NON-AUDIT SERVICES

- EU legislation providing a new EU regulatory framework for statutory audit was adopted in April 2014.
 - Summary of adopted legislation regarding the prohibition of certain non-audit services to public interest entities (PIEs).
 - The laws will apply to the first financial year starting on or after 17 June 2016.

There are new measures regarding the introduction of prohibitions on the provision of certain non-audit services by a statutory auditor to their PIE audit clients. The new measures prohibit a statutory auditor of a PIE “directly or indirectly to provide any prohibited non-audit services to the audit entity, to its parent undertaking or to its controlled undertaking within the EU.

What is a PIE?

Where an audit client is a PIE then the prohibitions of the [EU Audit Regulation](#) apply. A PIE is defined by the FRC as follows:

- a) An issuer whose transferable securities are admitted to trading on a regulated market¹³;*
- b) A credit institution within the meaning of Article 4(1)(1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council¹⁴, other than those listed in Article 2 of Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and investment firms;*
- c) An insurance undertaking within the meaning given by Article 2(1) of Council Directive 1991/674/EEC of the European Parliament and of the Council on the annual accounts and consolidated accounts of insurance undertaking.*

The UK Government decided not to take advantage of the option to specifically designated in law in the UK other entities as ‘public interest entities’.

The FRC has stated that the requirements of its standards which are applicable to PIEs are only applicable to those entities as defined in Directive 2006/43/EC (as amended). This was to provide clarity that the FRC was not seeking to extend the PIE definition.

PIE Non-Audit Services Prohibitions

It will be the case that some smaller entities, such as an insurance undertaking or a small bank, will fall within the scope of the PIE definition. If so, then there are no exemptions available from the applicable provisions.

In relation to non-audit services which can be provided by the auditor of a PIE, there are specific prohibitions included in the EU Audit Regulation. These have been included in the [FRC Ethical Standard \(June 2016\)](#), which replaces the former Ethical Standards for Auditors 1-5 for accounting periods commencing on or after 17 June 2016.

The list of prohibited services includes:

- certain tax services;
- services that involve playing any part in the management or decision-making of the audited entity;
- bookkeeping and preparing accounting records and financial statements;
- payroll services;
- valuation services;
- legal services;
- services related to the audited entity's internal audit function; and
- human resources services.

The view of the FRC is that any such services, if provided, must only have an indirect effect on the financial statements and the scale of that service must be inconsequential i.e. any such services which have a direct impact cannot be provided.

On the basis of these changes, it is likely that audit firms will be prohibited from providing some non-audit services that were previously provided to the PIE audit clients.

Cap on Non-Audit Services that can be provided to PIE Audit Clients

A cap on the types of non-audit services that can be provided to PIE audit clients will also apply. The cap on non-audit services is detailed at paragraph 4.34R of the revised FRC Ethical Standard.

“4.34R When the statutory auditor or the audit firm, or a member of its network, provides to the public interest entity that it audits, its parent undertaking or its controlled undertakings, for a period of three or more consecutive financial years, non-audit services other than those referred to in Article 5(1)43 of this the EU Audit Regulation:

(a) the total fees for such services provided to the audited entity and its controlled undertakings shall be limited to no more than 70% of the average of the fees paid in the last three consecutive financial years for the statutory audit(s) of the audited entity and of its parent undertaking, of its controlled undertakings and of the consolidated financial statements of that group of undertakings; and

(b) the total fees for such services provided by the audit firm shall be limited to no more than 70% of the average of the fees paid to the audit firm in the last three consecutive financial years for the statutory audit(s) of the audited entity and, where applicable, of its parent undertaking, of its controlled undertakings and of the consolidated financial statements of that group of undertakings. [AR 4.2]”

So, if we assume that a PIE audit client has a year end of 31 December, then a 70% cap will first apply in the year 31 December 2020, using the average of the audit fee charged in the three preceding years.

The FRC has produced staff guidance notes on [Non-audit services](#) and [Playing any part in management](#).

Rotation and Retendering – PIE Audits

Consideration will also need to be given by PIE audit clients as to the auditor rotation and retendering requirements which are contained in the regulations published by BIS in June 2016, which can be viewed at: http://www.legislation.gov.uk/ukxi/2016/649/pdfs/ukxi_20160649_en.pdf

INTERNATIONAL EDUCATION STANDARD 8 - REVISED

- Revised and effective from 1 July 2016.
- Relevant to all Audit Engagement Partners.
- Far more prescriptive in relation to the competencies and learning outcomes required compared to the previous version of the standard.
- New guidance can be found on icas.com

The revised [International Education Standard 8 \(IES8\)](#) is effective from 1 July 2016. The Standard is aimed at ensuring that each Audit Engagement Partner develops and maintains the necessary competencies to perform their role effectively, and replaces the previous version of IES 8.

The standard is relevant to you if:

- You are a CA who holds the position of Audit Engagement Partner, wherever based in the world;
- You are a Responsible Individual (RI) in an ICAS audit registered firm, whether an ICAS member or not; or
- You are working towards becoming an Audit Engagement Partner.

This is also relevant to all ICAS audit registered firms, as they are responsible for ensuring that their Audit Engagement Partners comply with the requirements.

What are the main changes?

The revised IES 8 is very different from the previous version of the standard:

- The previous standard applied to all “Audit Professionals”, this version narrows it to Audit Engagement Partner only.
- It is far more prescriptive in relation to the competencies that a RI must develop and maintain.
- It now takes a learning outcomes approach – i.e. what you have learned, rather than what you have done.
- It recognises that the audit environment is dynamic and that the standard should apply “career-long”.

IES 8 (Revised) requires Audit Engagement Partners to develop and maintain professional competencies which can be demonstrated by achieving specified learning outcomes. These competencies and learning outcomes are prescriptive and set out in Table A of IES 8 (Revised). The requirements can be split into two areas:

- Technical requirements – including audit, financial accounting & reporting, governance & risk management, business environment, taxation, business law, IT; and
- Professional requirements – including interpersonal, personal, and organisational skills; and professional values, ethics and attitudes.

Does my annual CPD need to cover every learning outcome?

No. CPD only requires to be targeted at those aspects of the engagement partner role which are either new (i.e. the 'develop' part of CPD) or in need of update (i.e. the 'maintain' part of CPD).

The previous standard was not as far-reaching and could be dealt with by the firm conducting a fairly "tick-box" exercise for the audit professionals in the firm. The revised standard is more detailed and audit partners are expected to consider their compliance with the requirements within their CPD records and there is far more linkage between the performance appraisal process, training plans, CPD and the Audit Compliance Review process.

As part of the Audit Monitoring visit to your firm we will assess compliance with IES8 (Revised). This will be achieved by reviewing a number of areas, including CPD, appraisal processes, the audit compliance review process and the quality of audit engagement files.

New guidance on the [Revised IES 8](#), including example CPD records and how to implement IES 8 in practice can be found on icas.com.

Please note you will have to log on to access this content.