



AUDIT NEWS

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Introduction

This is the second issue of *Audit News* that we have delivered electronically. It is of course greener and enables you, as the audit compliance principal, to forward *Audit News* quickly to all the responsible individuals in your firm.

In this issue there are some changes to the Audit Regulations and Guidance. Some are changes to the guidance and one results from a change in ISQC1. While this last change may not affect all firms if it does you will need to act on it.

As the deadline for using 'clarified' ISAs approach, there are a number of articles about how to prepare. There is also information about a new practice support service, 'clarified ISA coaching' to help make the transition to clarified ISAs easier for you.

Company law in Ireland has changed with the implementation of the EU's statutory audit directive into Irish law. Corporate auditors can now accept company audit appointments but restrictions still exist in other areas. Our article touches on some of the changes that affect auditors.

As well as a warning from the Audit Registration Committee about the accurate completion of annual returns and changes of responsible individuals, there is an article about which form to use when, which as well as acting as a signpost reduces some form filling. More assistance is provided with a CPD aide memoire to help members in planning their programme of CPD.

And a wealth of other articles as the following contents list shows.

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Make sure *Audit News* comes directly to you

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To change your email address on our database, go to icaew.com and login using your member number and password (you can get a new password if you have forgotten it). Click 'My ICAEW', 'My details' and then 'Update registered details'. You can update your email address, address and phone number here.

Sending *Audit News* via email means it's easier for you to circulate it to colleagues in the audit team.

Changes to the audit regulations

This article sets out three changes to the Audit Regulations and Guidance:

- arrangements for compliance reviews following a change to ISQC1.
- change to guidance re non UK/RoI audit qualifications.
- change to the affiliate regulations.

ISQC1 - arrangements for compliance reviews

Audit regulation 3.10 requires firms to comply with ISQC1. ISQC1 has been 'clarified' and the revised version applies to audits of accounting periods ending on or after 15 December 2010. One of the changes is to clarify who can undertake cold file reviews that would be part of an annual compliance review, as required by audit regulation 3.20. The engagement partner or engagement quality control reviewer are no longer allowed to undertake a cold file review on an audit that they were involved with.

This means that a firm with a single responsible individual (or with two responsible individuals where, on a particular audit, one is the engagement partner and the other is the engagement quality control reviewer) would need to use an external reviewer to undertake cold file reviews needed as part of the annual compliance review.

Cold file reviews are required as part of each annual compliance review but ISQC1 does not explicitly refer to a review cycle. It does make reference to a cycle of three years, which is the same as the guidance under audit regulation 3.20.

So, to minimise the consequences of this change for smaller firms, who also have to comply with ISQC1, the guidance in the audit regulations is amended to say:

- the engagement partner or engagement quality control reviewer cannot do the cold file review;
- there may be someone else in the firm who is not a responsible individual who could do the review;
- where this is not possible, cold file reviews should be conducted by someone external to the firm at least once every three years; and

Further guidance, which is applicable to all firms, notes that whoever the firm uses to do the cold file review should be technically up to date and have experience of assignments similar to those being reviewed.

The revised ISQC1 is effective for audits of accounting periods ending on or after 15 December 2010. The revised guidance applies from the same date so it is likely that firms will have to comply with the revised ISQC1 in mid 2011 when they do compliance reviews of audits of accounting periods ending on or after 15 December 2010.

Although the revised guidance suggests an external review every three years, for this first cycle it should not be left until year three. Given the changes that implementation of the clarified ISAs may cause, it is important for all firms to review completed clarified ISA audits as soon as possible. Therefore, for firms to whom the revised guidance applies, the suggestion is to arrange an external review as soon as the first audits are completed under the revised ISAs. An external review may be of benefit to larger firms to whom this guidance does not necessarily apply.

The revisions to the guidance follow:

New guidance paragraph added to the guidance under regulation 3.20:

In addition, such firms should note that ISQC1 (effective for reviews of audits for periods ending on or after 15 December 2010) does not permit the responsible individual or the engagement quality control reviewer for a particular audit to undertake a cold file review on that audit. It may be that there is another individual in the firm who, although not a responsible individual, is very experienced in current auditing requirements. Assuming that this individual did not take part in the audit, the firm may decide this individual would be a suitable person to undertake the review. If this is not possible, then the firm should use an external reviewer at least once every three years. In choosing a reviewer, it is important that the firm is satisfied that the reviewer has sufficient experience to undertake the review.

In guidance chapter 2 of the audit regulations, a new paragraph 16 is inserted, the subsequent paragraphs are renumbered and there are minor changes (shown underlined below) to renumbered paragraphs 18, 19 and 20.

16. Sole practitioners, firms with only one responsible individual and other small firms should note that ISQC1 does not permit the responsible individual or the engagement quality control reviewer for a particular audit to undertake a cold file review of that audit. It may be that there is another individual in the firm who, although not a responsible individual, is very experienced in current auditing requirements. Assuming that this individual did not take part in the audit, the firm may decide this individual would be a suitable person to undertake the review. If this is not possible, then the firm should use an external reviewer at least once every three years.
17. Each Institute can offer direct assistance with audit compliance and cold file reviews.
18. The whole firm aspects of the review could be dealt with completing the annual return. However, an individual practitioner might find it difficult to remain objective in cold reviewing his or her own completed assignments. The tendency will be to fill gaps in the audit process from memory and not to see that the audit evidence or process is deficient. Therefore, it is better to use someone independent of the assignment for the cold file review. As mentioned above, this may be necessary for small firms on a periodic basis.
19. Qualified employees within the firm can do the detailed cold file reviews. Some firms feel that, as a principal approved the issue of the audit opinion, only principals should do cold file reviews. There is an obvious anxiety for an employee in criticising the work of the person who decides future salaries. The most common approach is to have a combined team of principals and staff. However, it may be more helpful to the person being reviewed

if the feedback is given by someone of equal standing and authority. A person who has had experience of being a responsible individual can add those touches of practicality which come from dealing with clients and add further benefits to the process. Also, the individual should not have had any previous involvement in the particular audit.

20. If an ACR is to add value, those doing the review must be technically up to date and have experience of assignments similar to those being reviewed. It can also save time if that person knows how the firm carries out its audits. For a sole practitioner, a suitable person may be the alternate or consultant for technical matters, provided they had not been consulted on the particular audit.

Change to guidance on non-UK and non-Republic of Ireland audit qualifications

Article 14 of the EU's Statutory Audit Directive deals with how an auditor registered in one EEA state can be registered in another state. The article only allows for the migrant auditor to be tested by an aptitude test on local law that is relevant to statutory auditing.

For some time the audit regulations have included, as guidance, a note that an Audit Registration Committee would, when considering an application for responsible individual status, expect an overseas applicant to demonstrate UK/Rol audit experience. This is an addition to the requirements of the EU directive and is against the principle in the directive that, to a large extent, there should be a relatively free flow of auditors around the EU.

When an Audit Registration Committee considers any application for responsible individual status, it always considers the quality and recency of the applicant's audit experience. Depending on that review, the application may be refused, or granted subject to conditions. These conditions could include that the individual's work is reviewed by a more experienced responsible individual before the audit report is signed. With these safeguards in place there is no need to be unduly restrictive on who can apply to be a responsible individual and appropriate safeguards can be included if necessary.

This change is effective from 15 December 2010 and the amendment to the guidance under regulation 4.05 follows.

Each Institute has its own application form which firms should request and complete. A Registration Committee will need to be satisfied that the individual has had recent and sufficient experience of audit work before approving the application. ~~In the case of holders of an approved overseas or EEA qualification they will also have to show experience of UK/Rol audit work.~~

There is a consequent change to the flowchart at the end of chapter 4. The phrase 'including satisfaction of similar experience of audit work as a member of the registering Institute' is deleted.

Change to the affiliate regulations

When the 2008 regulations were produced, the separate chapters for audit affiliates were amalgamated. This resulted in text that previously only applied to ICAS affiliates being applied to affiliates of the ICAEW/ICAI.

One interpretation of regulation 5.04b is that, for example, the CPD requirements and CPD monitoring that applies to members should apply to affiliates. This was not meant to be the case. Affiliates do agree to comply with the Code of Ethics so, by virtue of section 130.1 of the code, they do have to maintain professional knowledge and skill at the level required to ensure that clients or employers receive a competent professional service. Affiliates who are responsible individuals would have to do audit-related CPD by virtue of audit regulation 3.17.

This change is effective from 15 December 2010 and the revised text of regulation 5.04 follows.

5.04 The *Registration Committee* may grant *audit affiliate* status if the committee is satisfied that the applicant:

- a is a fit and proper person to be granted *audit affiliate* status;
- b has agreed to comply with these *regulations* ~~and with the obligations and liabilities of a member of the *Institute* and to be bound by the *Royal Charters, the Rules, Bye-laws and other regulations of the Institute*;~~
- c has agreed to observe and uphold the Code of Ethics of the *Institute*; and
- d has agreed to provide the *Institute* with all the information it requires.

Cost effective ISA application

This article is a summary of a recently published article entitled *Tips for Cost-effective ISA Application*. The full article is at icaew.com/index.cfm/route/171184.

Practitioners will be applying ISAs for 2010 audits in the not-too-distant future. This article is designed to help practitioners get the best out of the new clarified ISAs. It is a summary of a recently published article entitled *Tips for Cost-effective ISA Application* written by the author of IFAC's Small and Medium-Sized Practitioner Committee publication, *Guide to Using ISAs in the Audits of SMEs*. The full article is reproduced at ISAudit2010.com. There is a great deal of scope for both efficiency gains and inefficiency when standards change in this manner and in the current climate, practitioners will be looking to extract the maximum value from the new standards. Here's how to do it.

Tip 1: Know your ISAs

It is probably unrealistic, to expect every practitioner to read every word of every new standard; it probably wouldn't be helpful either. Nevertheless, if no-one in the firm apart from one newly qualified person has looked at the core standards (such as the risk ISAs), the result is very likely to be wasted time deliberating over what has to be done and performing unnecessary work, just in case it may be needed. Lack of knowledge about requirements creates uncertainty about what is really required and may lead to:

- the risk assessment phase of the audit becoming an add-on to the other substantive audit work performed, instead of being used to focus audit effort on areas where there is a greater risk of misstatement; and
- turning what should be a simple audit into a complex and time consuming project, particularly if staff spend too many hours completing badly designed and unnecessary standard checklists that they do not understand, rather than using professional judgment to scale the work according to the size and complexity of the entity being audited and the risks involved.

Another important element is attitude. If the engagement partner has a negative attitude then ISA implementation may simply mean extra work just to comply rather than an opportunity to improve the quality and cost effectiveness of the audit. Knowledge of the standards equips partners and key staff to lead the way, to use their professional judgment wisely, and to make informed, confident decisions on matters such as the extent of partner involvement in the planning, identifying the areas where staff training is required, how to address the risk of fraud, and efficient allocation of staff and other resources.

An understanding of the ISA requirements is also important for building the underpinning required to implement future change and refining the firm's audit approaches to deal with issues arising from implementing the standards on particular engagements. Audits of many small entities may be straightforward, but some can also pose challenges (such as less sophisticated accounting expertise and less formalised internal control) that do not exist in larger entities.

Tip 2. Identify sources of risk, not just effects

When auditors are asked to identify risks, the natural tendency is to start by reading the financial statements. While this may identify the effect of risks that could apply to virtually any entity, it may fail to identify fully the bigger and more pervasive risks that are specific to the entity. These sources of risk could include adverse industry trends or an accountant prone to error, which could affect virtually any account balance.

Start by identifying the sources of risk and then, as the second step, link those sources to possible effects in the financial statements. For example, a source of risk could be a declining demand for the entity's products. One obvious misstatement (effect) in the financial statements would be valuation of inventory. But it would be a mistake to stop there. Declining sales could result in a sales manager just missing a bonus threshold, banking covenants could be breached, or a going concern issue may exist. And what may seem on the surface to be a straightforward business risk may also provide someone with the opportunity or incentive to commit fraud.

Tip 3. Spend time to plan well

For every hour spent in planning, several hours can be saved in execution. Effective audit planning is often the difference between a quality audit within budget and a poor quality audit over budget.

Effective planning requires two key ingredients:

- quality engagement partner and key staff time (but not necessarily dedicated team meetings held in the office)
- the willingness to make key decisions based on professional judgment.

Planning involves:

- informing the team on what the entity is all about, what has changed in the past year, and the likely implications of those changes
- addressing audit inefficiencies identified in prior year engagements.
- ensuring staff fully understand what they are required to do and why, and encouraging staff to identify areas where audit procedures seem excessive in relation to the risk of misstatement being addressed.
- taking time to ensure each staff member understands the necessity and purpose of the documentation they are required to complete.

Other planning tips include:

- ensuring that fraud risk is properly addressed; because fraud is deliberate, detecting it may require some element of unpredictability, such as performing certain audit procedures on a surprise basis; encourage staff to be sceptical and inquisitive and empower them to raise issues, observations, or unexplained matters; fraud may be discovered through piecing together a number of small matters that, by themselves, would seem insignificant; and
- consider assigning similar or related file sections to the same staff member; this will ensure work performed in one area is not repeated again in another.

Tip 4. Understand the control environment

When obtaining an understanding of internal control relevant to the audit, focus on the control environment. Pervasive controls, which are quite different from transactional controls, address

matters such as integrity and ethics, corporate governance, employee competence, management's attitudes towards control, fraud prevention, risk management, and controls monitoring.

If the tone at the top is good, the owner-manager of a small entity may exercise effective control over transactions which would be achieved through extensive segregation of duties in a larger entity.

Tip 5. Aim for continual improvement

There is a tendency to replicate what was done in the previous year. A better approach would be to document once (in the first year) and then update the existing documentation (to the extent necessary) for changes in subsequent years. The documentation in year one should enable auditors in subsequent years to leverage their understanding of the entity and focus attention on new industry trends, key operational changes, new inherent risks, and revised internal controls. If changes are minimal, then so too will be the additional documentation.

Considering existing practices at all planning meetings might involve revising the file index, considering how file information can best be reviewed, and considering documentation; are links between risks, controls, responses and findings clear, for example?

Tip 6. Two-way communication

Good ongoing communication between the auditor, management and those charged with governance is important to avoid misunderstandings and to develop constructive working relationships. Consider, for example, explaining to management (and those charged with governance) what an audit is all about, the responsibility of the auditor under the ISAs, and what management can do to help the audit go smoothly.

Summary

- Take time to study the ISAs.
- Identify the sources of risk specific to the entity, and then identify the effects on the financial statements.
- Time spent in planning will save hours in execution. Use professional judgment to focus audit effort where it is needed most.
- Understand the control environment.
- Aim for continual improvement in the audit. This includes documenting audit evidence in year one so that it can be easily updated in subsequent years, as well as considering each year how audit efficiency can be improved.
- Ensure management is fully informed as to what an audit is all about and establish clear and constructive channels of communication that will help the audit run smoothly.

Auditor independence – another APB consultation

The Auditing Practices Board has issued another consultation on the provision of non-audit services by auditors to the entities they audit. This consultation (which can be accessed via [icaew.com/ethics](https://www.icaew.com/ethics)) includes proposals for additional fee and governance disclosures for listed company audits, some additional prohibitions on the provision of non-audit services and the possibility of extending some of these proposals beyond listed company audits. We are encouraging key stakeholders to respond directly to the APB. If you would like to contribute to ICAEW's response to this consultation, please send your comments to tony.bromell@icaew.com, by 24 September.

Auditor cessation statements

In the UK

Just another reminder about these.

We are still receiving far more notifications from firms than from companies. We suggest in the audit regulations that the departing auditor could helpfully remind the company of its responsibilities. It would also seem useful if the new auditor checked that the appropriate notifications had been made and if not assisted the company with its legal obligations. There is guidance about cessation statements at icaew.com/index.cfm/route/155861.

The Department for Business, Innovation and Skills (BIS) undertook a consultation on simplifying these requirements before the general election. ICAEW responded to this and made a number of suggestions for easing the burdens in this area. BIS has published a summary of responses (which you can see at bis.gov.uk/Consultations/simplification-for-companies-and-auditors?cat=closedawaitingresponse) but there is no published timescale for making changes.

In Ireland

Auditor cessation statements are now required in Ireland. Unlike in the UK, these statements only need to be sent to the Irish Auditing & Accounting Supervisory Authority (IAASA), within one month of the date of cessation. There is no need to send these to ICAEW. IAASA intend to publish a template for the format of notifications but until they do you should just notify IAASA at:

Willow House
Millennium Park
Naas
Co Kildare
Ireland

The change in Irish law applies to cessations after 20 August 2010 that meet the criteria set out in the law. Basically, statements are required if an auditor ceases to hold office in the period between two consecutive AGMs or indicates that he does not want to be reappointed. As in the UK, the company also has to make a notification. The new law is set out in sections 161A/B/C of the Companies Act 1963 as amended.

Countdown to implementing clarified ISAs: ten questions we all need to answer

As 2010 progresses, there is a pressing need to start getting into shape for the clarified ISAs. The overriding issue for all practitioners is how we make the best use of the change. Clarified ISAs provide us with a rare opportunity to improve the quality of our audits and audit efficiency. We have to make the transition to clarified ISAs and we might as well achieve other improvements at the same time.

Clarified ISAs apply to audits for periods ending on or after 15 December 2010. Some of the benefits of the clarity project are self-evident: they should result in a genuine improvement in audit quality and in audit outputs, they are very much easier to read and the arrival of these standards is timely as they respond to the credit crisis. With proper partner engagement, there is also scope for efficiency gains. The keys to efficiency, effectiveness and enhanced audit quality include good forward planning for the introduction of the new standards, buy-in at the highest level within the firm, enhanced engagement partner involvement in the planning of audits and a robust but proportionate approach to the implementation of standards for SME audits as exemplified in the APB's PN 26 *Guidance on smaller entity audit documentation*. All APB's standards, including the clarified ISAs, can be found at frc.org.uk/apb/publications/index.cfm.

In this article we concentrate on the planning. If 'failing to planning' is 'planning to fail', there are a number of key questions we need to ask ourselves now, if we have not already done so.

Audit software, training and methodologies

Almost all practitioners rely on good quality audit software for their methodologies, supplemented by a similar standard of training to back it up.

1. When will our new ISA-compliant software be available and when will we be able to issue our updated audit manual?
2. Will our software, training and methodology providers deliver on time, and will their material be the right quality?
3. When will our training for trainers be ready and will they know enough to explain why the changes are being made and to promote the benefits of clarified ISAs?

If we do not have answers to these questions, or we are not sure, it is going to be difficult to do any planning at all, and we need to get answers by asking our providers! If we are developing this material internally, we need to make sure that our technical people have enough clear time in their diaries to devote to the issue.

Managing our people

4. What behaviours within the firm are we seeking to change and what learning techniques can we apply to achieve them?

Will our people view new ISAs with enthusiasm, and if not, what are we are going to do about it? What did we do when ISAs were originally introduced in the UK? There is a great deal of material out there to help practitioners understand the new standards, more than there was when the clarified ISAs were first introduced in the UK back in 2005. ICAEW's clarified ISAs website, for example, has a wealth of UK-specific material including details of its *Climbing the clarity learning curve* roadshows at ISAAudit2010.com. The IAASB's clarity centre has a series of no less than seven videos and slide decks covering the clarity project and six of the more important revised standards, including ISA 600 on groups, ISA 260 on communicating with those charged with governance, ISA 540 on accounting estimates and ISA 550 on related parties. There are also a number of publications available including Staff Q&A entitled *Applying ISAs proportionately with the size and complexity of the entity*. All this material can be found at web.ifac.org/clarity-center/index. The April 2009 edition of *Audit News* (icaew.com/index.cfm/route/155221) deals with ICAEW's intended regulatory approach to the new standards and a number of practical publications covering matters such as groups and related parties are available to ICAEW Audit and Assurance Faculty members. Last, but not least, APB's *Summary of changes in the new ISAs (UK and Ireland)* can be found at frc.org.uk/apb/publications/pub2129.html.

5. How are we going to get our leadership to lead on this?

We need to get the right tone at the top for clarified ISAs and encourage the right behaviour.

6. If we are part of a network, will our other network member firms deliver?

There may be a need to communicate with our member firms on this issue.

7. How are we going to keep things simple and avoid over-complexity?

We need to develop principles and messaging we are going to apply to make sure that the change goes as smoothly as possible.

Managing our clients and our practice

8. What will be the impact of the new ISAs on our practice economics and what are our strategies in this area?

Have we considered the likely first year impact and the ongoing impact? APB's October 2008 paper on whether clarified ISAs should be adopted in the UK contains some impact assessments frc.org.uk/apb/publications/pub1743.html.

9. Are our new-style engagement letters ready and what messaging are we giving to clients?

We need to make sure that staff will be able to explain the benefits of the clarified standards to clients.

10. Have we prepared an implementation plan for when we meet external reviewers and are we making good use of the PN 26 material to assist an effective and efficient approach to the audit of smaller entities?

How will we demonstrate to reviewers that we have complied with the clarified standards? If we are not making much use of PN 26, should we be doing so and have we looked at the recent revisions to it?

In short, we need to ask ourselves whether our ISA implementation management is under control, whether it is likely to deliver what is needed on time, and what more we need to do to ensure that our audits will be better going forward.

This article was written by Martyn Jones (National Technical Partner at Deloitte) who is the chair of ICAEW's ISA Implementation sub-group and Katharine Bagshaw, secretary to the sub-group. 'Small' practitioners are also represented on the sub-group.

Importance of providing accurate information on annual returns

The annual return is a key part of the monitoring process for audit registered firms, and it's vital that the information firms disclose on the return is accurate.

The Audit Registration Committee (ARC) has seen an increase in the number of errors on annual returns that come to light during Quality Assurance Department (QAD) visits. In particular, several firms have made incorrect confirmations about their annual audit compliance review (ACR), including stating that:

- an ACR had been conducted in the year when this was not the case;
- the ACR included cold file reviews when no such reviews had been done; and
- the results of the ACR (and cold file reviews) had been retained when the documentation could not be found at the time of QAD's subsequent visit to the firm.

Any misstatements made on an annual return can lead to regulatory and even disciplinary action against the firm, depending on the severity of the errors.

When it decides the level of regulatory penalty to offer a firm, the ARC uses ICAEW's *Guidance on Sentencing* (icaew.com/index.cfm/route/163833). The starting point for inadvertent errors and inaccurate statements in a firm's annual return is £2,500. The sum increases if there are aggravating factors, such as errors over several years or multiple errors.

The committee also refers for disciplinary action more serious cases of deliberate or false statements made on the annual return.

Also, please note that the annual return is not the place to tell us about changes to your firm, such as the appointment of new partners, new responsible individuals etc. You should email details to regulatory.support@icaew.com in accordance with audit regulation 2.11, within 10 business days of the change.

Audit in the Crown Dependencies of Jersey, Guernsey and the Isle of Man

From 5 April 2010, new requirements apply for firms that audit companies incorporated in one of the Crown Dependencies which have 'transferable securities' admitted to trading on a 'regulated market' in the EU. These are called 'market traded companies' in the various pieces of legislation. The new requirements apply even if the firm or company is not operating in a Crown Dependency.

There is a note about these new arrangements at www.icaew.com/index.cfm/route/171339. This describes the audit arrangements that already exist for companies incorporated in the Crown Dependencies and the new arrangements for those who audit market traded companies.

CPD aide memoire

ICAEW requires members to continue to develop their expertise and professional skills throughout their career. There is no requirement to complete a specific amount of 'structured' CPD (ie, attendance on courses). Instead, members are expected to plan their own programme of development activities to enable them to ensure that they have the knowledge and expertise to fulfil their role and responsibilities.

To assist members in planning their programme of development activities, we have produced a CPD aide memoire (visit icaew.com/auditnews) which includes the key technical changes and developments that have been issued, or have become effective, between 1 July 2009 and 30 June 2010. This will be relevant to auditors and those who prepare financial statements.

We will update the CPD aide memoire every six months to reflect changes issued over the previous 12-month period.

Clarified ISAs: take one easy step towards compliance

The deadline for implementing Clarified ISAs is looming. If you are concerned about the new standards, don't leave it too late to get help. Clarified ISA coaching could make a big difference to your firm. Coaching is available from ICAEW's new practice support service and our goal is to make the transition to clarified ISAs easier for you.

What's involved?

An experienced reviewer will examine one of your completed audit files and highlight the changes necessary under the clarified ISAs. Then, they will explain the changes in person so you understand exactly what needs to be done. Finally, you will receive a report summarising the findings.

How you will benefit

The file review, together with one-to-one coaching, will provide you with the building blocks you need to apply clarified ISAs to your client base. You will save time and money by doing it correctly from the start, and importantly, you will know how to be compliant without doing more work than you have to.

Sole practitioners save time and money

Sole practitioners can combine a Clarified ISA Coaching session with the annual compliance review, or split the cost by sharing with another member.

Book now

Find out more at [icaew.com/clarify](https://www.icaew.com/clarify) or call us on +44 (0)1908 248 250.

Responsible individual status

If an individual signs an audit report when they are not a responsible individual (RI), the firm will be in breach of audit regulation 4.04 and may be liable to regulatory or disciplinary action.

Many individuals assume that they are automatically an RI when they are appointed as a principal in the firm, or when they get their practising certificate. This is not the case. In order for an individual (employee or principal) to be responsible for audits and sign audit reports on behalf of their firm, the firms must apply for RI status on the individual's behalf and wait until the application has been approved.

The Audit Registration Committee also sees instances where an individual - who was an RI in firm A - leaves and joins firm B, presuming the RI status is transferable between the two firms. This is not the case. Firm B must apply for RI status on behalf of the individual before the individual signs any audit reports.

The Companies Act 2006 now requires the name of the responsible individual in charge of the audit (the 'senior statutory auditor') to be disclosed on the audit report, and for the report to be signed in this person's name. This applies to audit reports on accounting periods commencing on or after 6 April 2008 (see [Audit News issue 44](#) for further details). The names of all such individuals are now disclosed on the [UK public audit register](#) and members of the public, or other firms, are able to check that the signatory is appropriately authorised to sign the report.

It is therefore important for firms to make sure all individuals who are responsible for signing audit reports are properly designated as an RI within their firm. It is also important to remind those individuals who are not RIs in a firm that they cannot sign audit reports.

If you would like more information about becoming an RI and an [application form](#), please visit the website. If you have any questions about RI status, please contact Regulatory Support on +44(0)1908 546 302 or email regulatory.support@icaew.com.

Which form do I need and when?

We do have a number of forms that firms need to use when dealing with audit regulation matters and have produced a note ([icaew.com/index.cfm/route/172591](https://www.icaew.com/index.cfm/route/172591)) to help firms work out which one to use and when.

In some cases we have indicated that firms do not need to use the responsible individual (RI) application form. For example, when a firm changes its legal status (from a partnership to an LLP) there is no need to complete RI forms for those individuals who just move between the two firms. However, if (during the process of changing legal status) a completely new RI is added, then a form is required. In this example the firm will nevertheless have to complete a new application form for registered auditor status as there has been a change of legal entity.

If you are still unclear, please call regulatory support on +44 (0)1908 546 302, or email regulatory.support@icaew.com.

Change in AIU scope

Under audit regulation 3.15, you have a period of 21 business days to notify us if appointed to a 'major audit' client or if you become aware that an existing audit client is now a major audit client. The AIU has revised its list of what constitutes a major audit client. You can view the AIU's scope list at frc.org.uk/pob/audit/; select the publications page.

The main change is that the separate category of subsidiaries of foreign parent companies has been combined with UK companies. This means that the turnover limit that was applicable to foreign-owned subsidiaries drops from £1,000m to £500m. Also, UK incorporated banks that are not already included in any other category are now included.

QAD to work more closely with firms

With the clarified ISAs on the way (they apply to audits for periods ending on or after 15 December 2010) it is more important than ever that firms keep abreast of developments and maintain audit quality in the face of change. For our part, we want to offer firms as much timely support as is practical. With this in mind, we are developing some new initiatives to enhance the contact we have with our audit registered firms.

Given the pace of change within the auditing profession, many firms say that six years (our standard visit cycle) is too long a gap between visits. We are therefore planning to introduce some additional touch points with firms, but of a less formal nature than traditional on-site monitoring visits.

Firstly, we will be writing to audit firms in the early autumn about the clarified ISAs to provide helpful information about sources of help and guidance. To gauge how firms are approaching this issue, we plan to ask a sample of firms to tell us about their plans for training and for updating their audit systems to deal with the clarified ISAs. We can then provide further help to these firms as necessary.

Secondly, starting later this year, we are going to contact some firms between regular visits to discuss how they are progressing with audit compliance. We hope firms will see this as a good opportunity to discuss any concerns they may have and we will be happy to point firms in the direction of useful assistance if appropriate. To get the most out of this contact, we may ask some firms to send in documents such as their latest audit compliance review or CPD records.

Other initiatives include roadshows. The Practice Assurance roadshows were very well received and we plan to do something similar on audit from 2011. Roadshows will provide an opportunity for us to share our monitoring experiences and explore the reasons why some firms sometimes struggle to maintain standards. It will also give firms, particularly those who do not have regular contact with external sources such as training providers, a chance to ask questions.

We will include further details about these initiatives in future editions of *Audit News*.

Quality control in the audit environment

There is now a revised edition of the Audit and Assurance Faculty's practical guide for firms on ISQC (UK and Ireland) 1 (ISQC1). The guide takes into account recent developments, including the clarified ISQC1, which is effective for engagements relating to periods ending on or after 15 December 2010. It is important for auditors to consider carefully the requirements of the redrafted ISQC1, as it does eliminate ambiguity that might have existed in the previous version. One possible matter to consider is establishing lines of communication with external reviewers who may now be called on to do reviews where they were not before. This is likely to be a particular action point for sole practitioners and firms with a very small number of responsible individuals.

The publication identifies seven key areas for firms to consider. Illustrative policies and procedures are provided for selected aspects of each key area, including some examples for sole practitioners. The guide also includes an appendix with answers to a number of frequently asked questions on ISQC1.

ICAEW members can download the guide free of charge from icaew.com/qualitycontrol. For printed copies (£20 each), please email tracy.larby@icaew.com for further details.

The Audit Registration Committee needs you

The Audit Registration Committee is seeking a chartered accountant sole practitioner who is audit registered to join the committee.

Meetings are usually held monthly at Chartered Accountants' Hall in London and normally last about half a day. Time is needed to read the agenda papers before each meeting, which can take up to three hours.

If you would like further information about the application process, please email fiona.lancaster@icaew.com.

We always welcome general expressions of interest for any committee. For details of other quasi-judicial committee vacancies, please visit icaew.com/index.cfm/route/142489.

Directory of firms

Audit compliance principals will have recently received information about the *ICAEW Directory of Firms* from Wilmingtons (the publisher). This allows you to amend what is shown in the directory about your firm. However, if you notify Wilmingtons of any changes to your firm's structure – addition or removal of principals, office changes or trading names – you also need to tell us. Such changes, under audit regulation 2.11, should be notified to us within 10 business days of the change happening. You can do this by email to regulatory.support@icaew.com.

Audit in Ireland

The Republic of Ireland has recently implemented the EU's statutory audit directive. This was by way of a statutory instrument (European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010) which amends existing law and creates some stand-alone regulations.

A copy of the statutory instrument can be obtained from the website of the Department of Enterprise, Trade and Innovation (deti.ie/publications/sis/2010/si220.pdf).

This note is to draw firms' attention to a few matters relating to this change in the law.

Corporate auditors

One amendment to existing Irish law removed the prohibition in section 187 of the Companies Act 1990 that prevented corporate firms being auditors. So auditors who are constituted as companies or limited liability partnerships can now accept appointment as company auditor in Ireland.

The law changed with effect from 20 May 2010. So, from that date, corporate audit firms can accept audit appointments regardless of the date of the accounting period.

The change in the law does not, however, apply to all audit appointments. The law was not changed for 'public auditors'; that is auditors of societies registered under the Industrial and

Provident Societies Acts 1893 to 1978, or the Friendly Societies Acts 1896 to 1993. The restriction still applies for these audits and so corporate auditors cannot accept these appointments.

The position in respect of other entities is not straightforward as there has not been a wholesale change of all laws to reflect the changes made for companies. So, for example, section 87 of the Building Societies Act 1989 refers to a person qualified to be an auditor of a company. That would permit a corporate firm to take the appointment. In contrast, section 114 of the Credit Union Act 1997 refers to a public auditor, which would mean that a corporate auditor could **not** accept the appointment.

Before you accept appointment to an Irish entity that is not a company, we suggest you check the legislation that applies to that entity (or the entity's constitution for those that are not governed by a specific law) to ensure that the entity can appoint a corporate auditor.

Responsible individuals

There is another issue you may need to consider, although it should only affect a very few firms and then, not significantly. Chapter 4 of the audit regulations states that, although the audit qualifications of the three chartered institutes (and the ACCA) are recognised in the UK and Ireland, other qualifications are not.

Individuals who hold an EEA audit qualification need to pass an aptitude test. The test in the UK is different to the one in Ireland, so passing an aptitude test in one country does not give the holder of an EEA qualification the right to be a responsible individual in the other country. Nevertheless, they can still count towards the control requirement of an audit firm in each country.

For audit qualifications from outside the EEA, a similar position arises. As well as different aptitude tests, the underlying qualification may not have been recognised in both countries; at the moment the UK has recognised certain Australian and Canadian qualifications, Ireland has yet to recognise any. So such people can only be responsible individuals (and count towards the control requirement) in the country in which they have taken an aptitude test.

Signing audit reports

The Irish Companies Registration Office (CRO) is considering asking firms to add an identifying number (this will be your firm number that starts C00) to audit reports. The legal status of this possible suggestion is unclear, but in theory it would allow the CRO to identify audit reports signed by firms that are not registered auditors. If the CRO goes ahead with this suggestion, we suggest that firms comply with it. We will update you when the situation becomes clearer.

Audit regulations

We are currently revising the 2008 edition of the audit regulations to deal with these points and with other matters arising from the implementation of the EU directive in Ireland. We will publish further details in *Audit News*. When the revised regulations are issued, the 2005 edition of the regulations will cease to apply to audits of Irish companies and will be withdrawn.

Some matters that are the subject of audit regulations in the UK are not required to be reflected in the audit regulations for Ireland. These are the requirements for a 'predecessor' auditor to allow a 'successor' auditor access to the predecessor's audit working papers on a change of audit appointment and the mechanism for the transfer of audit working papers to a non-EEA audit regulator. The legal requirements are set out in regulations 47 and 109 respectively of the statutory instrument and within the UK audit regulations are dealt with in audit regulations 3.09 and 3.14 respectively.

Clarified ISAs - the right way

At a recent meeting of ICAEW's Advisory Group on Audit Software, Methodologies and Training there was much discussion on approaching the clarified ISAs in the right frame of mind in order to get maximum benefit from the improvements, and the increasing amount of support material available. If you are responsible for implementing ISAs within your firm, you may wish to think about including the following positive messaging as part of your training to make sure that clarified ISA implementation results in the right changes in behaviour, the right mind-set and more efficient and effective audits. You may also like to take a good look at the material that is now available to support clarified ISA implementation.

Efficiency benefits of clarified ISAs

The best efficiency results will be achieved if the new standards are properly understood before they are implemented – intelligent, well-informed audits should cost less than uninformed audits which means that changes to software, manuals and methodologies should be accompanied by training. Partners should understand that a positive attitude to the clarified ISAs and an upbeat tone at the top will determine how effectively the new standards will be applied. Everyone should understand that clarified ISAs are this year's issue, particularly if 2010 audits need to be signed off early!

Technical and compliance Issues

Clarified ISAs present an opportunity to improve risk analysis – the clarified risk ISAs are much easier to read than previous version. The benefits of clarified ISAs include improvements to ISAs on related parties and groups, which will help auditors responding to the economic crisis. And clarified ISAs should result in partners and staff spending more time with the client and understanding the business in greater depth.

Support material for clarified ISAs

An increasing amount of support material is available.

- IFAC is has already producing a number of videos of clarified ISAs which are free to download and there are more on the way within its *Clarity Center* web.ifac.org/clarity-center/index.
- The Audit and Assurance Faculty has already issued guidance on related parties, group audits and quality control, see ISAudit2010.com.
- Ten web-based Audit and Assurance Faculty ISA implementation *Technical Briefing* publications on specific clarified ISAs are in the pipeline and scheduled for delivery in October/November 2010.
- Practice Note 26-style audit documentation examples for charities are planned for publication by the Audit and Assurance Faculty in the third quarter of 2010.
- Clarified ISA coaching is available from ICAEW – see the article in this edition of *Audit News*.
- IFAC Practice Management ISA and Quality Control guides are available and may provide some interesting examples web.ifac.org/publications.
- Audit and Assurance Faculty roadshows in 2010 have covered clarified ISAs in depth. There are still a few 2010 roadshows left - see the events section under icaew.com/aaf. The 2011 roadshows will also feature clarified ISAs as a topic.

FSA and client assets

Audit firms should be aware that the FSA is allocating additional resources to review authorised firms' compliance with the Client Assets Sourcebook (CASS). The objective of the CASS rules is to minimise losses to clients through the segregation of those assets from those of the firm and includes requirements for holding all client money in an account acknowledged by the bank as held by the firm as trustee.

This initiative, dating back to early 2009, was in response to the greater risk of insolvency, with particular emphasis on ensuring that authorised firms have adequate arrangements to protect and segregate client assets as required by CASS.

The FSA wrote to all authorised firms responsible for client money and assets in March 2009 about the FSA's intention to undertake visits in 2009. In January 2010 the FSA published its report *Client Money & Asset Report* (fsa.gov.uk/pubs/other/cass_risk.pdf). This included its findings from those firm visits, and a note that its intensive supervision of firms would continue through its visits in 2010. The report also refers to regulatory action taken against authorised firms that have failed to comply with the requirements.

If the FSA's findings raise concerns over the reporting to FSA by auditors on compliance with CASS, the FSA will raise those concerns with the auditor's regulatory body. So audit firms should be aware of the FSA's increased supervision in this area and the need to consider fully authorised firms' obligations under CASS.

If you have any ideas for future articles, please email peter.burton@icaew.com.

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