



AUDIT NEWS

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Introduction

In this issue there is a change to audit regulation 3.14. In practice, this change may only affect a few firms but all firms should be aware of the requirements in case they apply to you in the future.

Clarified ISAs are in force for audits of financial statements for periods ending on or after 15 December 2010 but you may not be using them yet, so some more articles to assist firms.

There's a wealth of other articles as the contents list shows.

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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

Audit regulation 3.14 concerns requests made by a non-EU audit regulator to access the audit working papers of a UK audit firm. The most common situations are inspections by the US Public Company Accounting Oversight Board (PCAOB). Firms register with the PCAOB if they audit a company listed on the US stock exchange or a significant part of such a company. Registering commits the firm to PCAOB reviews of the relevant audits.

The overall process for allowing such reviews is set out in the EU Statutory Audit directive, which is transposed in to UK law in the Companies Act 2006, section 1253. Because of the way in which the UK law is drafted, audit regulation 3.14 is effectively a 'copy-out' of the law.

Most EU countries prevented external inspections until the directive requirements for the non-EU regulator to be approved by the EU were dealt with. As a result, the PCAOB was banned from continuing reviews in the UK. These matters are now close to resolution and a commission decision will allow inspections by the PCAOB and some other non-EU regulators.

The commission decision has resulted in changes to section 1253. The Department for Business Innovation and Skills has issued a statutory instrument (2537/2010 - Companies Act 2006 (Transfer of Audit Working Papers to Third Countries) Regulations 2010) which replaces much of s1253. The SI is effective from 15 November 2010. These changes then have to flow into audit regulation 3.14.

Rather than make detailed changes to the existing regulation and guidance, it has simply been deleted and replaced with the new text set out below. For those firms that may be within the scope of this regulation, there is no practical change in the effect of the regulation. That said, two changes that firms may wish to note are:

- because of the way the law is drafted, the regulation now refers to 'may transfer' instead of 'must provide'; and
- the requirement to notify the registering institute is removed.

The implementation date of this change has been set as 15 November 2010, the date of the change in the law. This has no practical effect as the amended regulation does not impose a new requirement on firms.

This regulation does not apply to auditors of Irish companies, although Irish company law has similar requirements.

You can download a revised copy of the *Audit Regulations and Guidance* from icaew.com/auditnews. The revised text of audit regulation 3.14 and associated guidance follows.

- 3.14 If requested by a competent authority of a country that is not an *EEA member state*, a *Registered Auditor* may transfer to that body its *audit working papers* provided:**
- a the papers relate to the *audit* of a body that either:**
 - 1) has listed securities in the country of the competent authority; or**
 - 2) forms part of a group issuing statutory consolidated accounts in the country of the competent authority;**
 - b the competent authority has requested the transfer of the audit working papers for the purposes of:**
 - 1) carrying out its functions in respect of quality assurance or public oversight; or**
 - 2) an investigation initiated by itself or another competent authority established in the same country;**
 - c the competent authority has given the *oversight body* notice of its request;**
 - d there is an agreement between that competent authority and the *oversight body*; and**
 - e the *oversight body* has confirmed in writing that where the request is for the purposes of:**
 - 1) paragraph b(1) above, that it approves the transfer;**

2) paragraph b(2) above, that it is not prohibiting the transfer on the grounds set out in section 1253E(7) of the 2006 Act.

For the purposes of this regulation:

- a 'competent authority' is a body that is designated in the law of the relevant country as having responsibility for the regulation or oversight of auditors; in most cases the body would be the equivalent of an RSB or an oversight body;
- 'transfer' means the physical or electronic transfer of audit working papers (or a copy) or allowing access to such papers;
- 'audit working papers' are any documents which are held by the registered auditor and are related to its audit of the financial statements of the body referred to in (a) above.

There may be occasions when a competent authority in a country (that is not an EEA member state) requests to see a registered auditor's audit working papers that relate to that audit. If this is so, the competent authority can carry out its function of reviewing the quality of audit work, then the competent authority has to be 'an approved third country competent authority', as listed in section 1253D(2) of the 2006 Act, as amended. If the request relates to an investigation that the competent authority is conducting in its own country, then the competent authority does not have to be approved.

If a request is received, then before complying with the request, the registered auditor must obtain written confirmation that the oversight body either has approved the transfer or is not prohibiting it. The oversight body can prohibit a transfer if it considers the transfer would affect the UK's national interests or there are legal proceedings related to the transfer. So if the firm is aware of any legal proceedings in the UK, even if now finished, regarding any of the persons or matters to which the request relates, the firm should inform the oversight body.

If the request is granted, it will only be granted in respect of audit working papers relating to the audit of a body that either:

- has listed securities in the country of the competent authority; or
- is part of a group issuing statutory consolidated accounts in the country of the competent authority.

The transfer must then be in accordance with any requirements contained in the agreement between the competent authority and the oversight body. The current agreements can be viewed at frc.org.uk/pob.

If the transfer is to be by way of an inspection in the UK by an approved competent authority, then the oversight body, in practice through its Audit Inspection Unit, must participate and must lead the inspection, unless it decides not to do so.

This regulation only applies in respect of appointments for the audit of UK entities and only for requests received after 15 November 2010.

While this regulation does not apply to the audit of Irish entities, regulation 109 of SI No. 220 of 2010 imposes similar obligations on the auditors of Irish entities.

Clarified ISAs now in force

In the August 2010 edition of *Audit News* we reported on a variety of clarified ISA developments, and in particular on:

- clarified ISA technical and compliance issues;
- efficiency;
- the support materials available; and
- approaching the clarified ISAs with the right mind-set.

Clarified ISAs, as practitioners know, are in force for audits of financial statements for periods ending on or after 15 December 2010. Software and methodologies for 2010 audits provided by training providers and consortia should now be available, as should material produced internally by firms. Those with responsibility for the implementation of ISAs should now be chasing this, if it is not yet available, with some urgency.

ICAEW issued a press release on 15 December in which Gerry Murphy, chairman of the Audit and Assurance Faculty noted that, under the clarified ISAs, auditors will be provided with the tools they need to be more robust in addressing key audit areas such as group audits, related parties and the management override of controls, and to fully exercise an appropriate level of professional scepticism to all audit areas. Martyn Jones, Chairman of ICAEW's ISA Implementation group noted that ICAEW has urged providers of training, software and methodologies to take an active part in helping smaller firms improve audit quality in implementing clarified ISAs, and that the all-important implementation process must minimise unnecessary costs, particularly in the area of audit documentation, especially for smaller firms, and maximise audit efficiency, effectiveness and overall audit quality.

There is now even more support material for clarified ISAs. In addition to the Audit and Assurance Faculty publications on related parties, group audits and quality control, noted in the August article, there is the recently issued 10-module, *Right First Time with the Clarified ISAs*, publication covering, among other things, internal control in smaller audits, management override, materiality, accounting estimates, documenting significant audit judgements, confirmations and written representations. It can be found at icaew.com/index.cfm/route/174862. This publication is freely available for download by ICAEW Audit and Assurance Faculty members who will receive a printed copy early in 2011, as will all responsible individuals registered with the ICAEW. The International Federation of Accountants has produced videos on clarified ISAs which are free to download. More were added recently at <http://web.ifac.org/clarity-center/index> covering materiality, misstatements, written representations, using the work of an auditor's expert, and auditor reporting. Practice Note 26-style audit documentation examples for charities are now available on the Audit and Assurance Faculty's website at icaew.com/index.cfm/route/174790.

Other material on clarified ISAs can be found at isaaudit2010.com, and at <http://web.ifac.org/clarity-center/index>. These are good starting points for practitioners who are not yet up to speed in this area and new material is frequently added to both.

CPD aide memoire

As we announced in the last *Audit News*, to assist members in planning their programme of development activities, we produced a CPD aide memoire (icaew.com/auditnews) which includes the key technical changes and developments. This covered the period 1 July 2009 to 30 June 2010 and is relevant to auditors and those who prepare financial statements. It has now been updated to reflect changes issued over the 12-month period to 31 December 2010.

Clarified ISAs: guidance on small charity audit documentation

The last issue of *Audit News* (No. 47, September 2010) carried an article entitled 'Countdown to implementing clarified ISAs: ten questions we all need to answer', covering firms' preparations for the implementation of the revised ISAs for audits of periods ending on or after 15 December 2010.

This article is about a new guidance note published by the Audit and Assurance Faculty entitled *Guidance on small charity documentation*. The faculty has developed practical examples of audit documentation for small charities to reflect update documentation requirements contained in the clarified ISAs (UK and Ireland). The examples are based on the free-form documentation examples in APB PN26, *Guidance on smaller entity audit documentation*.

The illustrative examples in the appendix to PN26 are based on a fictitious for-profit company that has turnover of £3 million. The statutory audit threshold for charities is income exceeding £500,000. The income threshold goes down to £100,000 if gross assets exceed £2.8 million. If the charity is a limited company, the income threshold reduces to zero if gross assets exceed £3.26 million. In addition, many charities with income below these thresholds require an audit, for example as a condition of grant funding, or as part of the governance strategy adopted by the trustees.

Besides a lower audit threshold, charities may differ in qualitative ways from small owner-managed businesses; for example, in a separation of management (paid staff) from those charged with governance (trustees) and in being regulated.

The objective of the faculty guidance is, therefore, to help members by providing charity-specific examples. Where documentation considerations are the same as they would be for a small entity in any sector, there is no charity-specific guidance as auditors can refer to PN26.

The documentation examples are intended to illustrate best practice and, like model answers to exam questions, may be more detailed and extensive than would be found in practice. The key point is to ensure that the audit documentation provides a sufficient and appropriate record of the basis for the auditor's report; and evidence that the audit was planned and performed in accordance with ISAs (UK and Ireland) and applicable regulatory and regulatory requirements. The application of auditing standards is the same whether the audit is carried out under the Companies Act 2006 or Charities Act 2006, and APB has published audit report examples for both in Bulletin 2009/3, *Supplementary guidance for auditors of charities with accounting periods beginning on or after 6 April 2008*.

The documentation examples do not cover every stage of the audit process for a charity. Instead they focus on particular elements of audit planning, including understanding of the entity, internal control and risk assessment/response to assessed risks. These represent the areas where feedback on the introduction of ISAs (UK and Ireland) in 2004 indicated that further guidance on documentation would be particularly helpful. The material incorporates new documentation requirements introduced in the clarified ISAs relating to materiality and there is also an example of documentation of going concern considerations to reflect the circumstances of small charities that rely heavily on voluntary donations.

The examples are published on the website at isaaudit2010.com. It is intended that they can be updated with additional material or revised as necessary to reflect members' own practical experience. Comments and suggestions will be welcomed and should be addressed to anne.davis@icaew.com, Head of Charities.

Audit and Assurance Faculty roadshow spring 2011

The first roadshow of 2011 from the Audit and Assurance Faculty will consider a number of topical issues which will be of interest to practitioners. The topics have been identified from comments and observations made by practitioners, so there should be something for everyone.

The aspect of accounting for service charges has proved to be very topical. ICAEW issued its draft guidance in October 2010 and this is likely to be in its final version by the time of the roadshow. The event will remind delegates of the legal requirements, the possibilities that arise, the reporting requirements, risk management issues, and practical considerations. It appears likely that many companies in receipt of service charges will need to amend their financial statements to reflect the requirements and practical advice will be provided in this area.

According to the QAD, there are still misunderstandings in respect of the requirements for external scrutiny and reporting for charities and pension schemes. The roadshow will include a summary of the requirements and discuss the practical aspects in both of these areas. Also, the introduction of the clarity ISAs will require some additional considerations. This will include new style audit reports and further consideration in certain areas of the audit. The roadshow will draw on revised pronouncements from the APB and guidance issued by ICAEW.

XBRL tagging will be a requirement in 2011 for all financial statements submitted to HMRC. With this requirement in place, it is likely that more companies and LLPs will file electronically at Companies House. The roadshow will consider this from the aspect of practitioners' responsibilities in these circumstances.

Grants can be a practice management and risk issue for some firms. The requirement to confirm certain information to third parties can give rise to risk management issues. The roadshow will look at this in the context of reporting to third parties.

We will be holding roadshows in the following locations. You will find further details at www.icaew.com/aaf and you can also book online.

DATE	TIME	LOCATION
09 May	09:30 – 12:30	Southampton
11 May	14:00 – 17:00	Manchester
12 May	09:30 – 12:30	Liverpool
13 May	09:30 – 12:30	Newcastle
16 May	09:30 – 12:30	Luton
24 May	14:00 – 17:00	London
26 May	09:30 – 12:30	Birmingham
06 June	09:30 – 12:30	Exeter
08 June	09:00 – 12:00	Wakefield
08 June	14:30 – 17:30	Derby
10 June	09:30 – 12:30	Bury St Edmunds
17 June	09:30 – 12:30	Maidstone
22 June	14:00 – 17:00	London
24 June	09:30 – 12:30	London
27 June	09:00 – 12:00	Cardiff
27 June	14:30 – 17:30	Bristol

Attendance at these roadshows is for Audit and Assurance Faculty members only. Others can attend, but need to register as a faculty member when booking. Faculty membership will be offered at a discounted price.

Listed audits: prepare before you propose

Listed entities may be fully listed, AIM, Plus-listed or Plus-quoted. Audit regulations, ISAs and APB Ethical Standards (ES) impose additional requirements on auditors of listed entities.

The QAD reviews many listed audits each year in all sizes of audit firm. Our conclusions can be mixed. Not all firms understand fully the implications that these high profile audits have on the firm's audit processes and procedures.

Preparation is the key to success. If you're properly prepared, a new listed audit should be cause for celebration; if not, you may unwittingly have accepted significant regulatory and commercial risk.

So, what should a firm do before deciding to propose for a listed audit? There is no substitute for thorough research and consultation but we think that it may be useful to consider the following.

Do you have the relevant technical knowledge and audit procedures?

Are you familiar with the relevant listing rules and any corporate governance requirements? What is the relevant accounting framework?

Most listed companies produce group accounts under IFRS. If these are the only IFRS accounts that the firm audits, there will be specific costs relating to CPD, disclosure checklists, and additional time to review accounts with unfamiliar disclosures.

Consider your current audit system. Most commercially available systems include procedures for listed audits but check this with your supplier. Not all IFRS disclosure checklists are the same; some of the freely available checklists deal only with pure IFRS requirements and do not consider the interaction between IFRS, EU endorsed IFRS and Companies Act 2006.

The firm will also need to check whether the transparency reporting requirements apply.

Are you allowed to provide all of the services that our prospective client requires?

Accounting and some other services are prohibited for listed audits under ES 5. You need to assess whether your prospective listed client has appropriate knowledge and resources to produce complete financial statements ready for audit. If not, the client may need to engage another accountancy firm for non-audit work.

Generally, in order to comply with ES 5, the firm must not be involved in:

- calculating current or deferred tax figures for the purpose of preparing accounting entries; or
- drafting disclosures for inclusion in the financial statements.

There is some relaxation for exceptional circumstances but these should be very rare.

There may be some cases where the tax department can help review or comment on figures during finalisation of the corporation tax returns later in the year. Tax services are a complex area and, if in doubt, you should consult.

Do you have adequate staff resources?

All listed audits require an Engagement Quality Control Review (EQCR) in accordance with ISA 220. The individual who does this review must be independent of the audit engagement team and, critically, have the appropriate level of expertise to conduct an effective review.

From the very start, firms should consider the partner and EQCR rotation requirements. It will be rare that an engagement partner can act for longer than 5 years. In practical terms, a firm with fewer than four responsible individuals could struggle to resource a listed audit engagement over the longer term.

Other areas of the audit may be less problematic but may still require additional resources. For instance, the auditor must produce more detailed reports to those charged with governance. Firms should consider how much time they will need to invest in order to meet the expectations of the audit committee.

What about overseas audit work?

Many listed companies have significant overseas operations. Even if you have access to an international network of firms, you must ensure that you can control the overseas audit work effectively. Some business travel will often be necessary to fulfil ISA 600 requirements.

Is it a major audit client?

Major audit clients include:

- fully listed entities (including Plus-listed);
- large AIM or Plus-quoted companies; and
- large charities, pension funds and private companies.

The Audit Inspection Unit of the Professional Oversight Board (AIU) is responsible for the review of these audits. The current scope of audits within the AIU's remit can be viewed at www.frc-pob.org.uk. You will need to inform ICAEW within 21 days of taking on a major audit (audit regulation 3.15).

What is the impact of audit regulation?

Auditors with listed audits receive more frequent QAD visits and those with major audit clients also see the AIU. There are additional registration fees payable by auditors with listed clients to finance this additional scrutiny.

So, are you ready to propose for this work?

That is the big question and the points above are not a complete list of all the matters to consider.

Listed audits in your client portfolio may be a double-edged sword and you should ensure that your fee takes account of all of the requirements. Then, all you will need worry about is doing the audit itself!

Useful contacts

ICAEW technical advisory services: +44 (0)1908 248 025

ICAEW regulatory support: +44 (0)1908 546 302

Abbreviated and exempt?

Companies that are 'small' can file abbreviated accounts at Companies House.

Companies that are 'small' may also be exempt from audit.

So far so good, but the definition of 'small' used in each case is subtly different.

Section 382 of the Companies Act 2006 sets out the definition of a small company for the purposes of abbreviated accounts. Ignoring references to the preceding financial year, s382 requires two of three conditions to be met:

- turnover not more than £6.5m;
- balance sheet total not more than £3.26m;
- no more than 50 employees.

If the conditions are met, the company can file abbreviated accounts at Companies House, if it wishes.

Whether or not the accounts also need an audit is determined by section 477. This sets out three conditions, which took similar to those for abbreviated accounts but there is a subtle difference. The three conditions are:

- the company qualifies as small in relation to that year;
- turnover not more than £6.5m; **and**
- balance sheet total not more than £3.26m.

The key point to note is the 'and'. All three criteria have to be met.

For example, a property company may have less than 50 employees and turnover less than £6.5m, but its balance sheet total, because of the properties, exceeds £3.26m. It could file abbreviated accounts, as two of the three criteria are met. For audit exemption it qualifies as a small company, has turnover less than £6.5m but its balance sheet total exceeds £3.26m, so all three conditions are **not** met and audit exemption is **not** allowed. Although abbreviated accounts may be filed, they must be audited, abbreviated accounts.

This article does not deal with ineligible companies or groups but there are two technical helpsheets to help:

- [Small, medium and large companies thresholds](#);
- [Audit exemption thresholds for companies](#).

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