

Audit & Beyond



AUDIT &
ASSURANCE
FACULTY

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MIXING IT UP

A LOOK AT THE
NEW ETHICAL
AND AUDITING
STANDARDS

RISK AND JUDGEMENT

CHANGING ROLES
UNDER THE SRA
ACCOUNTS RULES

ACCOUNT FOR SOMETHING

ACCOUNTANTS'
REPORTS AND
THEIR BENEFITS



UP AND AWAY

Exploring pastures new
with audit by choice

Fighting Expenses & Card Fraud

Abuse of Company Credit/Procurement Cards and Travel & Entertainment expenses still represents one of the largest areas of fraud suffered today.

Organisations should be taking a fresh review of their fraud risk and how they can detect and prevent this unnecessary revenue leakage with minimum effort.

Find out how in this step-by-step guide: www.acl.com/fraud



Visit acl.com/fraud to learn more about fighting expenses and card fraud

Get ready for reform

The European Union Audit Regulation and Directive (ARD) passed in 2014 has an effective date of 16 June 2016, changing standards for



accounting periods beginning on or after 17 June 2016. The UK government, through the Department for Business, Innovation & Skills, the Financial Reporting Council (FRC), ICAEW and the other recognised supervisory bodies, has been working towards this implementation as it changes the audit regulatory environment and the codes and standards that auditors have to follow – especially those relating to the audits of public interest entities (PIEs).

Mark Babington, the FRC's deputy director of audit policy, highlights the key changes in this issue of *Audit & Beyond*, not only for the audits of PIEs but also those which affect all statutory audits. Future editions will feature articles by Julie Long, the FRC's inspections director, on what to expect from an FRC Audit Quality Review (AQR) inspection (particularly for firms not previously inspected by AQR), and by Fiona Goh, project manager in the FRC's professional oversight team, on the new oversight arrangements.

The objective of all this change is to improve audit quality and perceptions of audit quality. The perceived inherent conflicts of interest through long audit tenure and the provision of non-audit services by auditors, particularly of PIEs, have been curtailed. The latest changes to the International Standards on Auditing have been adopted by the FRC.

The FRC wants to make a success of audit reform. As its CEO Stephen Haddrill has said: "The strategy for 2013/16 was informed by lessons from the financial crisis. There was a need to take robust action to restore confidence among the general public, and in particular investors. In our 2016/19 strategy, there is a change of emphasis. We will work with investors, businesses, professionals and professional bodies to ensure the changes already made are successful in securing the highest quality in reporting and governance."

The FRC's aim is that by 2019 at least 90% of FTSE 350 audits will require no more than limited improvements as assessed by the FRC's monitoring programme. While this statistic does not cover all PIE audits under the FRC's new remit, it is a promising direction of travel and this, together with a proportionate approach to regulation, should encourage auditors to stay in the market. This is important as competition and choice is a valuable component of the perception of audit quality at least. The FRC will work in collaboration with the profession to give assurance and confidence in UK audit to investors globally, and we at the faculty are looking forward to playing our part in helping it to achieve this goal.

Henry Irving
Head of faculty

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- 04 News and events**
Audit and assurance news from the faculty
- 06 New codes and standards**
After the FRC's consultation on the Ethical and Auditing Standards, Mark Babington explains the changes
- 08 The choice is yours**
Ruth Ward evaluates a Google Hangout session discussing changes to audit thresholds
- 10 Risky rules**
How will changes to SRA Accounts rules affect reporting accountants? Louise Sharp investigates
- 12 Anything to report?**
The faculty provides helpful information on accountants' reports
- 14 Q&As**
John Selwood answers questions on going concern and sheds light on some upcoming ethical considerations
- 16 Technical updates**
A roundup of the legal and regulatory changes affecting the profession
- 18 From the faculties**
Our round-up of articles from across ICAEW faculty titles



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News and events

BUSINESSES UNPREPARED FOR AUDIT CHANGE

Many listed companies remain unprepared for the changes to audit that will be introduced when the European Union Audit Regulation and Directive (ARD) comes into force on 17 June.

A recent poll by EY among chief financial officers, tax directors and audit committee chairs found that 58% did not have a full strategic plan in place, 19% did not know when their company needed to tender or rotate its audit, 28% did not fully understand the restrictions on non-audit services and 7% admitted to having no knowledge of the changes.

When the EU reforms come into force they will introduce a list of non-audit services that firms will not be able to carry out for audit clients; listed companies will need to tender their audit contract every 10 years

and rotate their auditor every 20 years.

The poll also found that 61% of FTSE 350 business leaders expect to invite tenders from at least one non-Big Four firm and that about 75% of them have yet to invite any tenders.

75%

of the FTSE 350 have yet to invite tenders

61%

of the FTSE 350 business leaders expect to invite tenders from at least one non-Big Four firm

UPDATED GUIDANCE ON COMPILATIONS...

Compilation reports are the subject of two new Technical Releases from the faculty: TECH07/16AAF Chartered Accountants' reports on the Compilation of Financial Information of Incorporated Entities (Revised March 2016), which replaces Audit 02/10, and TECH08/16AAF Chartered Accountants' reports on the Compilation of Historical Financial Information of Unincorporated Entities (Revised March 2016), which replaces Audit 03/10.

The guidance applies to the compilation of financial statements prepared in accordance with Companies Act 2006.

Learn more at tinyurl.com/AB-TechRel

CAA ATOL REPORTING REQUIREMENTS

The Civil Aviation Authority (CAA) has introduced changes to the reporting requirements for ATOL holders and their reporting accountants. From 1 April 2016 if you wish to act as an ATOL Reporting Accountant, you must be a member of an ATOL Reporting Accountant scheme. The CAA has approved ICAEW's Licensed Practice scheme, which is open for applications.

Learn more about the scheme and

how to become a licensed practice at tinyurl.com/AB-ATOL

By the time you read this, the faculty will also have published a new Technical Release. TECH09/16AAF Revised arrangements for ATOL reporting accountants reporting to the Civil Aviation Authority will provide guidance for ICAEW members on the new reporting requirements and will be available at tinyurl.com/AB-TechRel



FRC TO FOCUS ON CARROTS NOT STICKS

“Over the next three years, we intend to work with our stakeholders to encourage and nurture improvement rather than introducing new requirements that add to the regulatory burden,” Melanie McLaren, executive director in the Codes and Standards Division of the Financial Reporting Council (FRC) recently told an audience of internal auditors. To achieve this, the FRC has decided not to add to the Corporate Governance Code but instead to embed changes made since the crisis and promote better reporting against the Stewardship Code.

“We will concentrate on promoting a step change in audit quality and on driving up standards of reporting. Our goal is that reporting and audit in the UK are world-leading, to give the greatest possible confidence to investors globally,” she said. “We will seek to ensure that the framework established under the ARD serves the interests of investors in the reliability of financial statements and supports the UK audit profession in delivering statutory audit to the necessary high standards, with close regard to the public interest.”



IMPROVING ANNUAL REPORTS

Auditors must be more challenging and produce informative audit reports if we are to reduce the length and complexity of annual reports and make them more meaningful, according to the faculty’s latest report *Audit insights: corporate reporting*.

However, the ICAEW Audit Insights working group that compiled this report believe that the shortcomings of company reports can best be addressed by collective action. Auditors will need to do

their bit, but so will others.

The report calls for companies to be ruthless about what they throw out, for regulators to support initiatives that allow companies to publish information outside the annual report, and for investors to be clearer about what information they need.

We will consider the implications for auditors in the next edition of *Audit & Beyond*. Meanwhile, the report is available at tinyurl.com/AB-AICR



EVENTS UPDATE

HELP BUSINESS GET IT RIGHT

The next Audit Quality Forum (AQF) will look at the responsibility of business to society, particularly in terms of tax. This follows on from findings from a previous AQF, when we heard that ‘business gets it right’ when it pays tax, makes money, looks after people, is transparent, innovates, creates new jobs and cares for the planet – and that not one but all of these are important.

The event will be held at One Whitehall Place. The discussion will be chaired by political journalist Isabel Oakeshott, and will be followed by networking and refreshments. The forum will convene at 17:00 on 14 June.

Members who want to attend may be wise to book a place sooner rather than later, as AQF events are often oversubscribed.

For more information, visit icaew.com/events

WEBINAR ON SUBSTANTIVE ANALYTICAL PROCEDURES

Is there still a place for substantive analytical procedures? When might substantive analytical procedures be appropriate? How do auditors get substantive analytical procedures right? What often goes wrong? A faculty webinar will address these and other thorny questions around why these procedures are often identified by audit file reviewers as an area of weakness across firms of all sizes.

For details on timing, venue and to book a place visit icaew.com/events

NEW TO WEBINAR LIBRARY

We recently added some new events to the faculty library of recordings of webinars and Google Hangout discussions. They include:

- Reporting to the Solicitors Regulatory Authority. This covers recent changes to SRA Accounts Rules – and is also the subject of an article on pages 10 and 11.
- Audit by choice. This covers the technical and practical impacts of recent change to audit threshold changes – and is also the subject of an article on pages 8 and 9.

Recordings of webinars and hangouts are also available on subjects including: audit quality indicators, cyber security challenges, enhancing audit quality, professional scepticism and using data analytics in audit. icaew.com/aafwebinars



SOURCING A NEW STANDARD

The Financial Reporting Council has spent much of the last year consulting on its Ethical and Auditing Standards. **Mark Babington** explains the changes

Change can be a challenge, and dealing with multiple changes can be an even bigger one. Over the last year at the Financial Reporting Council (FRC) we have revised Ethical and Auditing standards to incorporate: changes to ethical standards resulting from a review carried out by the FRC; major revisions to International Standards on Auditing resulting from the completion of three significant projects by the IAASB; and the requirements of the EU Audit Regulation and Directive (ARD). The FRC ethical review was designed to develop a

more outcome-based approach.

Trying to incorporate the necessary changes - when a certain number of them overlap, or are not as clearly defined as we might wish - has been a major piece of work for the FRC's audit and assurance team.

The ARD is developing the FRC response to the financial crisis. Its focus is very much about how to strengthen auditor independence and remove the risks posed by conflicts of interest, particularly for those classes of entities considered to pose the greatest risk - Public Interest

Trying to incorporate changes - when a number of them overlap, or are not as clearly defined as we might wish - has been a major piece of work

Entities (PIEs). Implementation takes place partly at the EU level, and partly through being transposed into national law. The FRC has sought to relate the ARD ethical requirements to the new ethical outcomes required by the revised standard.

So, in revising the auditing and ethical standards, the FRC has incorporated all of the relevant requirements into the text of the standards, including all of the ARD requirements, plus revised IAASB requirements, plus changes following an FRC review of ethical matters. This will provide auditors with a single, authoritative source of guidance that if followed will allow auditors to meet all of their obligations set out in the new legislation, as well as those made in response to international and national changes other than those in the ARD.

The new ethical and auditing standards will apply to the audit of financial statements for periods commencing on or after 17 June 2016.

Changes to standards that affect all statutory audits, and not just those of PIEs, in summary are:

- the need for an auditor to be independent in order to undertake an audit engagement - this has always been the case, but now this is subject to a 'third party test'. Namely would an objective, reasonable and informed third party conclude that the auditor's independence had been compromised;
- a broadening of the personal independence requirements, where they cover a greater range of individuals in the audit firm, including those individuals placed at the disposal of or under the control of the firm;
- greater emphasis on the risks to independence posed where the auditor acts as an advocate of management;
- a need for the auditor to give an opinion on statutory other information published in or along with the annual report, and by exception reporting on going concern; and
- for listed entities, including AIM companies, a need for the auditor's report to include a description of key audit matters and other audit planning and scoping matters.

The main changes for the audits of PIEs are:

- a closer focus on reporting potential irregularities, including fraud, to authorities, and a greater focus on audit quality - for instance by requiring engagement quality control reviews for all PIE audits;

- additional reporting, in particular by the auditor to the audit committee, in which the auditor has to explain how the audit has been carried out, and what the results of the audit were. An additional reporting requirement for auditors to report to the supervisors of PIEs has also been included;
- a prohibition on the provision of certain non-audit services by the auditor - these are in the areas of: tax services; those which require playing any part in the management of an audited entity; bookkeeping or the preparation of accounting records; payroll services; design and implementation of risk management systems; valuation services; legal services; internal audit; financing and capital structure; promoting or dealing in shares of an audited entity; and human resources services (derogations exist, subject to conditions, for some of the tax and valuation services); and
- where non-audit services are permitted, they are limited to no more than 70% of the audit fee, calculated on a rolling three year basis - this applies at group and network level. Services that are required by EU or national law (for instance work required by the FCA or PRA) are exempt for the purposes of calculating the cap.

These changes, coupled with a statutory requirement for an audit tender to be carried out at least every 10 years, as well as mandatory rotation of an audit firm at least every 20 years, means that audit clients are going to need to carefully consider their strategy for the procurement of professional services. When tendering for an audit provider in future, they may find that their choice of audit firm is limited because the independence of that auditor was already compromised due to an existing non-audit services relationship.

In making the necessary changes to standards, we have also been very aware of the government's deregulatory challenge, and have revised separate ethical standards into a single document, including guidance applicable in the audit of smaller entities where the auditor is able to give more support. We have also proposed offering reliefs to some of the FRC's more stringent ethical requirements for those entities, defined by the MiFID II Directive as being small and medium-sized - with a market capitalisation of €200m (£156m) or less.

The proposed outright prohibition on contingent fees for tax services will apply only to listed entities above that threshold.

There will be ongoing questions of interpretation which will need to be resolved, and the implementation will require ongoing dialogue

For those that fall below that threshold, contingent tax fees may be allowed, where the fee is not material in the context of the audit firm, or to the remuneration of the audit partner, or partners concerned.

There is no doubt that the standards have been subject to major revisions. For our part, we have tried to balance the need to produce standards that support the auditor, and will not be unduly onerous to apply correctly, with the demands from investors to ensure that we protect auditor independence and make the work of the auditor even more transparent and accessible.

As a competent authority for audit, the FRC will work with the market and with other European regulators to address issues that emerge when the standards come into use. There will be ongoing questions of interpretation which will need to be resolved, and the implementation will require an ongoing dialogue. The challenge awaits! ■



Mark Babington,
deputy director of
audit policy, FRC



THE WAY FORWARD

Ruth Ward joins faculty volunteers on an exploration of the brave new world of audit by choice

Some changes to audit exemption thresholds come with a fanfare; some do not. When thresholds changed on 1 January 2016 some members may have been taken by surprise. Because, after a government consultation, the latest increases were confirmed in a written statement that was laid before the House of Lords on 26 January 2016 - members who would like a little more background on this will find it in a Q&A we featured in the March edition of *Audit & Beyond* (tinyurl.com/AB-MarchQA).

Clearly, audit exemption is here to stay, which means that audit by choice will be the future for most UK companies - and auditors. So after the latest changes to audit exemption were confirmed, the faculty broadcast a live webinar using Google Hangouts (see box, below) and I discussed the implications of audit exemption with faculty volunteers Nigel Hughes, managing director of Totteridge Associates and chair elect of ICAEW's Practice Committee, and David Gallagher, technical director at MHA MacIntyre Hudson.

Before we join them on this exploration of those changes and what they might mean in practice, let's recap the details.

AUDIT THRESHOLDS

Small companies in the UK are exempt from audit, and that doesn't change when the definition of 'small' changes. Two of the three thresholds that mark the boundary between small and medium sized have increased for periods starting on or after 1 January 2016:

- turnover threshold has increased from £6.5m to £10.2m; and
- total asset threshold has increased from £3.26m to £5.1m; while
- the employee numbers threshold remains the same at 50 employees.

Broadly speaking, any company that falls below two of those three thresholds is considered small and, barring complications from group membership or public interest entity requirements, can claim exemption from the annual statutory audit.

The vast majority of businesses in the UK are small or micro already, but the Department for Business, Innovation & Skills estimates that 7,400 additional companies will be exempt from audit under the new regime.

There will be a demand for audits, particularly from smaller charities, and it is in the public interest for the accountancy profession to meet that demand

THE ROLE OF THE AUDITOR

These changes will raise many questions for auditors and audit firms. Should the firm retain its registered auditor status? Will I still be an auditor five years from now? How many newly exempt entities will choose voluntary audit? Will they continue to do so after the first year? The list goes on. However, as the faculty webinar was just 30 minutes long, the main focus was on the questions that members most frequently ask - the ICAEW Technical Enquiries Service - and the volunteers delivered some quick-fire answers:

1. Can the new thresholds be early adopted?

Hughes: For the audit exemption thresholds, no. For accounting purposes, yes.

2. When adopting the new thresholds, which should apply to the prior year - the old or the new?

Gallagher: Imagine a company with a December year end which since 2013 has been medium in size under the old thresholds but would be small under the new thresholds. Although it was treated as medium in 2015 under the old thresholds, for comparison purposes the new thresholds should be used. On that basis it counts as small

in 2016 and (retrospectively) 2015 and therefore can claim audit exemption for its first accounting period starting on or after 1 January 2016.

3. If a company becomes part of a non-small group or leaves a non-small group during the year, do they have to have an audit?

Hughes: If a company is part of a non-small group for any part of the year, then they need to have an audit - unless the group exemptions apply.

4. Is there any way of avoiding an audit if a group goes over the small company limits?

Gallagher: A subsidiary of any size can be exempt from an audit if it meets the criteria, which include unanimous approval of the members and a guarantee from the parent company to meet that subsidiary's liabilities. We have found *TECHO7/13BL Exemption from audit by parent guarantee* useful (tinyurl.com/AB-TRLegal).

5. If one company in a small group voluntarily has an audit, do they all have to?

Hughes: No. It's a voluntary audit.

Moving away from technical questions, the latest increases to audit exemption thresholds also throw up some practical and existential questions.

AUDIT EXEMPT CLIENTS

Just because an organisation is exempt from mandatory audit doesn't mean that it will take up that exemption. Both Hughes and Gallagher have seen many small companies keep up their annual audit despite becoming audit exempt - and not always because of other requirements, such as bank covenants, either. So the volunteers were happy to broaden the webinar discussion to encompass this.

For some the audit gives a useful framework for deep engagement between the business and its external accountant. Having scheduled conversations allows management to talk through all their concerns with an external expert.

Those who do decide to opt out of an audit often maintain a relationship with the same firm of accountants, benefitting from other services. Management advice, tax, payroll - there are lots of things still to do.

Staying with a chartered accountant is likely to be a wise move for small businesses in 2016 and 2017, as Gallagher

pointed out that many will be transitioning to the new financial reporting regime (albeit with reduced disclosures) for the first time.

REGISTERED AUDITOR STATUS

From the perspective of an accountancy firm the important thing is to identify what you want to offer - and to be confident that you have value to add. A long history of working with the same client gives an accountant an important asset: knowledge of that business. It is also important to remember that what might seem obvious to an accountant with years of practice is not necessarily obvious to their clients.

The question of whether to remain a registered auditor is not one-size-fits-all. Hughes emphasised that every accountancy firm needs to have an understanding of its own business model and business plan.

There will still be a demand for audits, particularly from smaller charities, and it is in the public interest for the accountancy profession to meet that demand. On the other hand, the need for independence when providing an audit can prevent practitioners from providing the full range of other services that a business might benefit from. Some practices have developed a strategy of providing a client with everything but the audit.

It is also worth bearing in mind that audit has been a mechanism for accountancy firms to train new staff members to understand different aspects of a business. It could be wise to have alternative training strategies in mind before giving that up. Any decision about registered auditor status can be the right one, so long as it is made with a sensible plan for the future of the practice in mind.

Audit exemption is here to stay, which means that audit by choice is the future for most companies in the UK. Those who think through the implications and articulate their own business plans are best placed to thrive in the new world. ■

FACULTY RESOURCES

A recording of the full Google Hangout webinar is available to watch at tinyurl.com/AB-Webinar
More resources on audit exemption are available at icaew.com/auditexempt



Ruth Ward,
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ASSESSING THE RISKS

SRA Accounts Rules changes mean greater focus on risk assessment and judgement, says **Louise Sharp**



Accounting firms with law firm clients will be thinking about how the recent changes to the accountant's report requirements by the Solicitors Regulation Authority (SRA) affect the work they perform under the SRA Accounts Rules. This may mean bigger changes for some than for others, depending on the nature of their clients and the work previously performed.

We have set out some markers to help members get to grips with these changes. These were covered in the recent faculty webinar, *SRA Accounts Rules and the role of the reporting accountant*, by Janet Taylor, a specialist on SRA Accounts Rules at Taylor Mowbray and a member of the ICAEW Solicitors Special Interest Group. Detailed interim guidance has also been published in ICAEW Technical Release TECH 16/15AAF (see box, opposite).

KEY CHANGES

Since 1 November 2014, law firms have only been required to submit qualified accountant's reports. Prior to this all accountant's reports were filed with the SRA.

For law firms with financial year-ends ending on or after 1 November 2015, the SRA has introduced two key changes:

- Additional exemptions from the requirement to have an accountant's report for low risk law firms. However, all law firms need a final report if they cease to hold client money - even for moving from a sole trader to a partnership; and
- SRA Accounts Rule 39 has been replaced with Rule 43A.1 and a new accountant's report form ARI.

NEW RULE 43A.1

The old prescriptive testing in Rule 39 has gone, taking with it the reporting accountant's checklist and the requirement to specifically check two reconciliations in detail.

New Rule 43A.1 expects reporting accountants to take a risk-based approach to their work and to their reporting. No sample sizes are given and so reporting accountants must use their judgement to determine the amount of work they need to do as well as what problems identified require a qualification.

Firms should note that the report wording isn't exactly the same as Rule 43A.1. The report wording makes specific reference to material breaches and/or significant weaknesses in the systems and controls for compliance with the Accounts Rules. It also refers to the SRA published guidance – so it is important for reporting accountants to have read this.

While the Accounts Rules remain highly prescriptive, and reporting accountants are still expected to sample check compliance with them, the SRA expects that the volume of qualified reports will reduce as reporting accountants must now consider the 'materiality' of the breach and the 'significance' of the weakness in systems and controls. Gone are the days where all breaches (except those that were deemed 'trivial') were reported to the SRA for the SRA to determine where the risks to client money lay. The reporting accountant must now determine these risks.

WHISTLEBLOWING

There is a new duty to report to the SRA if the reporting accountant discovers a failure by the law firm to submit a previously qualified report.

Reporting accountants will need to update engagement letters to deal with these changes (Rule 35 is still relevant

here) and they will also need to retain these terms for six years now.

ASSESSING RISK

As we highlighted in TECH 16/15AAF, the SRA doesn't expect the new requirements to increase the role of the reporting accountant and has pointed to the historical evidence indicating how rare it is for the SRA to take action against a reporting accountant.

However, if you are a reporting accountant who hasn't really considered risk assessment before on these engagements you are going to need to rethink your approach here. The reporting accountant should focus on the following:

- the risk of material breaches and significant system weaknesses by the law firm; and
- the risk that the reporting accountant doesn't carry out the work and report to the SRA appropriately.

TECH 16/15AAF highlights example risk factors in law firms that reporting accountants should be thinking about and their assessment of risk will need to be clearly documented.

PERFORMING THE WORK

Substantive testing is still likely to be a significant part of the work procedures performed as the SRA is not expecting reporting accountants to move to just a controls-based approach. Reporting accountants should therefore be thinking about the order in which the work is performed. Both the webinar and Technical Release give more guidance here, including possible higher or lower risk areas.

MATERIAL OR SIGNIFICANT?

The nature of the breach/control weakness may be far more important than the amount. The SRA's guidance gives a list of serious factors that are likely to be deemed reportable and also moderate factors that may lead to a qualification. Reporting accountants need to think about the type of breach/weakness, how and why it arose, number of instances, amount and how they have been dealt with by the law firm.

One particular concern among reporting accountants is the reference to significant weaknesses in systems and controls. "Although the AR1 asks the reporting accountant to report any significant weaknesses in the firm's systems and controls this has to be considered in relation to the size of the firm", says Taylor.

Long gone are the days where all breaches were reported for the SRA to determine where the risks lay. The reporting accountant must now determine these risks

"Signing off on this without qualification does not mean that the reporting accountant has formed the view that there are no risks, merely that given the size and nature of the firm the system they have is reasonable." For example, a sole practitioner solicitor with a part-time bookkeeper is unlikely to have a myriad of internal procedures to authorise payments and it would seem unlikely for a reporting accountant to qualify on these grounds alone. What is more important here is whether breaches have occurred and if they are material.

The clear message is that if a reporting accountant does not think that something is reportable then they will need to document why.

EXERCISING JUDGEMENT

The reporting accountant ultimately needs to demonstrate that he/she has sensibly exercised his/her judgement. To help, reporting accountants may want to ask themselves the following questions:

- Have you used people with the appropriate skills and training to do this work?
- Can you demonstrate that the work has been appropriately planned?
- Did you properly consider the risks and can you demonstrate that the work performed relates back to the risks identified?
- Where relevant, have you had a robust internal review process and second partner/hot partner review?
- Can you demonstrate that there is evidence on file to support the conclusions reached?

The SRA's move to a more risk-based approach gives reporting accountants plenty to think about. ■

GUIDANCE AND SUPPORT

Solicitors Regulation Authority (SRA) guidance is available at sra.org.uk/ar1
ICAEW Technical Release TECH 16/15AAF *SRA Accounts Rules: interim guidance for reporting accountants following changes to the accountant's report requirements* is at tinyurl.com/AB-TechRel

To listen to the recent Faculty webinar visit tinyurl.com/AB-Webinars

REPORT SOMETHING

Accountants' reports can be an opportunity for auditors to develop new revenue streams and provide valuable services to clients. Audit & Beyond outlines the options, the issues to think about and the support available from ICAEW



The professional life of an accountant does not begin and end with audit - even if it sometimes seems this way. As well as being engaged to perform financial statement audits, firms offer general accounts preparation and tax compliance work, and many will also get requests for other types of accountants' reports from a variety of sources and on a variety of matters. They may be produced purely for the client or because a third party (who has a relationship with the client) has requested them. Some of these may be required by a government, trade body or regulator to meet legislative or regulatory requirements - and it is mainly these types of regulatory report that this article focuses on.

These accountants' reports can take the form of assurance reports where an

opinion is provided, or they may take the form of a report based on a set of agreed-upon procedures (AUP). An AUP engagement involves performing certain specified procedures on factual information and reporting the findings without giving any form of opinion on the implications of the work performed. Management or other users of the AUP report are able to draw their own conclusion on the basis of the work performed by the accountant. Some engagements with clients and other third parties may contain a mixture of AUP reports and reports with an opinion, such as in the case of Air Travel Organisation's License (ATOL) reporting to the Civil Aviation Authority (CAA) (see box, right).

So the list of possible report requests is long and varied and we have seen a fair few examples in the faculty over the

years. They include accountants' reports on government grants and loans, applications for other facilities and funding, charity street collections, service charge accounts, mortgage references, profit forecasts and the safeguarding of client monies, to name but a few.

Some of these accountants' reports are bound up with legislation and regulations, so the form and requirements of the report and the terms of engagement may offer little flexibility for change as the regulators specify the form and content of the report. Examples include reporting to the Solicitors Regulation Authority (SRA) under the SRA Accounts Rules and to the CAA in relation to the ATOL regulations. Others, particularly those of a non-regulatory nature, may offer more flexibility in the manner of reporting.



SUPPORT FROM THE FACULTY

ICAEW provides Technical Releases for guidance (see box, right). Because of the sheer volume of reports requested, it is not always possible to engage with each and every regulator, trade body and other type of organisation to develop and issue guidance for every report. However, ICAEW has issued generic guidance on reporting to third parties to help members approach these types of engagements and manage their risk (see TECH10/12AAF and AAF 04/06, right).

These two Technical Releases offer a lot of useful information. The guidance in AAF 04/06 covers accepting an engagement, managing professional liability, agreeing the terms of the engagement and the form of the report. Among the guidance in TECH 10/12 AAF there are examples of wording and opinions that we consider unacceptable to accountants providing special reports, as well as example extracts for an AUP engagement letter.

ICAEW has also produced a helpsheet *Registered auditor signing requirements PAS1 / HS21* which is available for download by ICAEW members and students (see tinyurl.com/AB-Requirements). As the title indicates, this provides guidance on some of the more common reports prepared by accountants which require the signature of a registered auditor. It also offers examples of reporting engagements that they may perform only as a registered auditor and highlights the danger of inadvertently carrying out engagements which require registered auditor status when a firm does not hold an audit registration.

To further assist members, the faculty

Firms need to make sure they have the relevant expertise to do the work and are eligible to provide the report

has run a number of related webinars. These range from a recent webinar on SRA Accounts Rules and the role of the reporting accountant (see icaew.com/aafwebinars) to an earlier webinar, *The trouble with mortgage references*, which serves as a reminder of the need for the practitioner to be aware of the risk, liability and duty of care implications of providing accountants' reports (in the context of mortgages). There has also been a Q&A in *Audit & Beyond*; see tinyurl.com/AB-Mortgage.

The faculty also keeps members informed on developments relating to accountants' reports with updates in the news section of *Audit & Beyond* and in articles such as the one on pages 10 and 11, which highlights some of the key points from the recent SRA webinar. There will also be more coverage in future issues of *Audit & Beyond*, such as an article on Regional Growth Fund grant reporting.

PROCEED WITH CAUTION

While requests for reports such as these can open up valuable revenue streams, firms need to make sure that they have the relevant expertise to do the

TECHNICAL RELEASES

Among the Technical Releases members will find the following:

- TECH09/16AAF *Revised arrangements for accountants reporting to the Civil Aviation Authority*
- TECH02/16AAF *Reporting to regulators on regulatory accounts (an update to Audit 05/03)*
- TECH16/15AAF *Solicitors Regulation Authority (SRA) Accounts Rules: interim guidance for reporting accountants following changes to the accountant's report requirements*
- TECH07/14AAF *Assurance reporting on master trusts (Master Trust Supplement to ICAEW AAF 02/07)*
- TECH10/12AAF *Reporting to third parties (Audit 1/01 updated)*
- AAF 01/11 *Reporting to the Audit Bureau of Circulations Limited (ABC)*
- AAF 01/10 *Framework document for accountants reports on Grant Claims*
- AAF 04/06 *Assurance engagements: Management of risk and liability*

For more information on Technical Releases from the faculty visit tinyurl.com/AB-Technical

work and that they are actually eligible to provide the report. For instance, be aware that ATOL reporting work now requires membership of an ATOL Reporting Accountant Scheme. Guidance is available on how to join the ICAEW Licensed Practice Scheme (see tinyurl.com/AB-License).

Also, reporting accountants need to be very clear about the scope of the engagement. You need to think about what you are being asked to do, for whom and what report is required, and this should also be reflected in the engagement terms. Make sure you can actually provide the required report: the work being performed must give you the evidence you need to give the opinion or the factual findings required in the report. You may need to negotiate changes to the report wording or the associated work, in order to deal with any risks identified and where this is not possible, you will need to consider whether you can perform the engagement. Further support is available in the relevant ICAEW guidance (see box above) and members can also contact the Technical Enquiries Service for additional help. ■

John Selwood's Q&As



John reminds us why going concern is important and explores some emerging ethical and independence challenges

Q I am auditing a charitable company that has lost its main source of funding. The trustees are executing a plan to curtail approximately 90% of the charity's activities. The charity will survive but it will be operating entirely differently. What are my responsibilities as auditor in respect of going concern? The company is still a going concern so how do I address this unusual situation?

A This question forces auditors to examine the reasons why going concern is important.

I think that going concern needs to be viewed from two different angles:

- First, the user of the financial statements wants to know whether the entity can and will continue to operate. If there are significant uncertainties the user wants to understand these also. This is necessary for a true and fair view.
- Second, going concern forms the basis on which the financial statements are prepared. If the entity is not a going concern then a basis other than going concern is usually more appropriate for the accounting, and assets and liabilities may need to be carried at different values.

Clearly, as auditor you should be concerned with both of these issues. You should review the disclosure that the trustees have made in the financial statements and consider whether the uncertainties have been properly explained. If the disclosures are inadequate then you should consider the impact on your audit report.

Also, the trustees should have included more information on the charity's position in the Trustees Annual Report (TAR). If the financial statements are prepared under one of the new Charity SORPs then this disclosure should be extensive, particularly covering the risks that the charity faces and how the trustees intend to address those risks.

This is where determining the nature of your responsibilities as auditor becomes a little more complicated. Prior to periods commencing 1 January 2016, you read the TAR and report on misstatements and inconsistency with the financial statements. You will also have to consider whether the company's TAR complies with applicable legal requirements, to comply with SI 2015/980. This applies for periods commencing from 1 January 2016, although early adoption of SI 2015/980 is available for periods commencing from 1 January 2015.

In any event, as auditor, you will encourage the trustees to produce the right narrative reporting.

The other issue is the valuation of assets and liabilities relating to activities that are being wound up or reduced in scope - if the charity owns an asset that will no longer be used in its operations, it would be inappropriate to continue to measure this asset at depreciated historic cost. Instead it should be revalued to residual value or recoverable amount. Equally, if there are liabilities arising from the cessation, such as redundancy payments or penalties on leases, these should be recognised.

Where the accounts are not prepared on a going concern basis

this should be disclosed.

In summary, going concern is not only about whether an entity survives or not, but also the impact on the financial statements and the needs of the users.

Q One of my unquoted audit clients has issued preference shares with very unusual terms and I am struggling to determine whether these are basic or non-basic financial instruments under FRS 102. In the draft accounts the shares are measured at the transaction price. I identified this during the review stage of the audit, and I am looking for some urgent assistance in determining the nature of these financial instruments.

A Before I answer this question, please note that there is a good reason why I have not reproduced the details of the question regarding the terms of the shares. You will simply have to trust me: they were complicated and determining their nature was challenging.

The complexity doesn't end there. The accounting issues here are difficult and it is not entirely clear whether the preference shares are basic or non-basic. Unfortunately, this is not the right publication in which to further explore this question, fun though it might be. What does worry me is whether management is sufficiently involved in this process.

I accept that it is very common for auditors to provide accountancy services as a non-audit service, as you clearly are. My concern is that in all of

the excitement of trying to solve this tricky accounting question, it has been forgotten that there is requirement for there to be informed management. Moreover, it is possible that in this scenario the threats to independence might be so significant that they cannot be adequately addressed with safeguards.

Dealing with this can be tricky. However, management is responsible for issuing the shares and management must take responsibility for identifying the right accounting treatment under FRS 102. If it proves impossible for management to obtain an understanding of the technical issues - and it might - then I suggest that there is no informed management for the purposes of this non-audit service.

If management can climb the learning curve and become appropriately informed then they should be able to make an informed decision on the nature of the shares for accounting purposes. Then, the next problem will be the valuation of these financial instruments under FRS 102.

The valuations on initial recognition and/or re-measurement of these financial instruments could be very complex, involving net present value or fair value calculations. In my view, these valuations are likely to involve a significant degree of subjectivity and be material, which would make this a prohibited valuation service.

Given the magnitude of the independence issues associated with all of this, the simplest (and safest) approach might be to encourage management to engage a third-party adviser to assist with the process.



On a course I recently attended I was stunned to hear that the Financial Reporting Council is redrafting the Ethical Standards to prohibit auditors from charging contingency fees for tax services and to prohibit auditors from assisting with tax enquiries. This does not make any sense to me. Is this really happening?



I am including this question to highlight the recent FRC consultation that proposes these radical and, I suspect, unpopular changes.

They emerged as part of a September 2015 consultation (now closed) on *Enhancing Confidence in Audit: Proposed Revisions to the Ethical Standard, Auditing Standards, UK Corporate Governance Code and Guidance on Audit Committees* (see tinyurl.com/AB-FRCcons).

It's worth noting that the matters raised in this question are not the only ethics-related changes proposed by the FRC in this consultation. The regulator has issued its proposed Ethical Standard as an annexe to the consultation *Integrity, Objectivity and Independence*. This single standard is intended as a replacement for the APB's *Ethical Standards for Auditors 1 to 5* and the *Ethical Standard for Reporting Accountants* and to apply to audit engagements and other public interest assurance engagements.

The specific changes that are being referred to in this question are:

- The Ethical Standards currently restrict the specific prohibition on advocacy services provided by auditors to those provided "before

an appeals tribunal or court". These words have been removed, which might be interpreted as very significantly extending the advocacy prohibition to include services such as assisting audit clients with certain HMRC enquiries.

- The current prohibition on contingency fees arrangements for non-audit services has been extended to include all contingency fees for taxation services.

There is some room for differences in interpretation. It seems unlikely that all forms of assistance will count as advocacy, but it is not yet clear which forms of assistance will count as advocacy and hence be prohibited.

So my answer to the question: 'Is this really happening?' is 'Yes, probably. But...'

When this edition of *Audit & Beyond* went to press, the contents of the FRC consultation remained proposals and not the final standard. The ICAEW representations to the FRC on this do point out that there is little evidence to support the need for these changes and that they will have additional cost implications for business.

We will have to wait for the FRC to publish its final decision before we can be certain whether the proposals make it into the new and revised Ethical Standard. Meanwhile, ICAEW is working on producing supplementary guidance. So watch this space... ■

John Selwood is a member of the faculty's Practitioner Services Committee

Technical updates

Our roundup of legal and regulatory changes



FINANCIAL REPORTING: UK & IRELAND

STATEMENTS OF RECOMMENDED PRACTICE

(March 2016)

The Financial Reporting Council (FRC) has published *Policy on Developing Statements of Recommended Practice (SORPs)* with effect from 3 March 2016. To be recognised as a SORP-making body, a particular industry or sectoral body must meet criteria set by the FRC and must agree to develop SORPs in accordance with the Policy on developing SORPs.

A SORP must also carry a statement by the FRC confirming, as appropriate, that the SORP does not appear to contain any fundamental points of principle that are unacceptable in the context of current financial reporting, auditing or actuarial practice, nor does it conflict with an FRC standard or undermine the FRC's broader objectives.

The policy on developing SORPs also describes the role of the FRC in relation to SORPs.

tinyurl.com/AB-SORPs

'SETTING THE STANDARD' NEWSLETTER

(March 2016)

The FRC has published the next issue of its quarterly eNewsletter on financial reporting - *Setting the Standard* - the aim of which is to give stakeholders an insight into the FRC's key projects, outreach and consultation.

tinyurl.com/AB-Standard

FRS 102 AND AMENDMENTS TO FAIR VALUE DISCLOSURES

(March 2016)

The FRC has issued *Amendments to FRS 102 - Fair value hierarchy disclosures* to simplify the preparation of disclosures about financial instruments for financial institutions and retirement benefit plans (other entities applying FRS 102 are unaffected by these amendments). These amendments also more closely align the relevant disclosure requirements with those in IFRS 13 *Fair Value Measurement*.

They are effective for accounting periods beginning on or after 1 January 2017 and early application is permitted. This means that entities can apply the changes in financial statements for accounting periods that ended on 31 December 2015, if those financial statements have yet to be approved.

tinyurl.com/FRC-FairValue

FRC GUIDANCE ON VOLATILITY AND UNCERTAINTY FOR CORPORATE REPORTING SEASON

(March 2016)

In a letter to audit committee chairs, the FRC has responded to requests for guidance on how matters such as volatile asset prices and uncertainty over interest rates in certain jurisdictions should be dealt with in annual reports and accounts.

tinyurl.com/FRC-Guidance



AUDITING AND ASSURANCE: INTERNATIONAL

IAASB HIGHLIGHTS HOW EXPECTED CREDIT LOSS MODELS WILL AFFECT AUDITORS

(March 2016)

The International Auditing and Assurance Standards Board (IAASB) has issued *An update on the project and initial thinking on the auditing challenges arising from the adoption of expected credit loss models*. It highlights the audit issues arising from the shift to Expected Credit Loss (ECL) models when accounting for loan losses. ECL models are, or will be, required by some financial reporting frameworks, including IFRS 9, *Financial Instruments*, which comes into effect from 1 January 2018.

The publication includes initial thinking on how these audit challenges may be addressed under the current International Standards on Auditing. It has been developed by a task force of IAASB members and technical advisers, representatives from the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, bank auditors and an observer from the US Public Company Accounting Oversight Board.

This publication also discusses how the IAASB's project to revise ISA 540, *Auditing Accounting Estimates, including Fair Value Accounting Estimates and Related Disclosures*, will seek to address challenges that have been noted in respect of auditing accounting estimates.

tinyurl.com/IAASB-Credit



INTERNATIONAL FEDERATION OF ACCOUNTANTS

GLOBAL SURVEY: ACCOUNTANTS' PERFORMANCE EXPECTATIONS FOR COMING YEAR

(February 2015)

According to the latest Global SMP Survey from the International Federation of Accountants (IFAC), accountants working in small and medium-sized practices (SMPs) are generally optimistic about performance in 2016, as a majority predict revenues will stay the same or increase across all service lines. However, optimism is not at the same level as a year ago as growth projections across service lines have dropped since 2014.

The survey suggests that, while performance expectations decreased from a year ago, SMPs indicate that their challenges are somewhat less acute than last year. As in 2014, the most pressing challenges for SMPs in 2015 were: attracting new clients (47% high or very high challenge), keeping up with new regulations and standards (44%), differentiating from the competition (43%), and pressure to lower fees (41%).

The 2015 IFAC Global SMP Survey received 6,725 responses, representing 169 countries and more than 800,000 SME clients around the world, making it the largest survey of SMPs. The survey was conducted between October and November 2015 in 22 languages. tinyurl.com/IFAC-Survey



INTERNATIONAL FORUM OF INDEPENDENT AUDIT REGULATORS

FOURTH ANNUAL SURVEY OF INSPECTION FINDINGS

(March 2016)

The International Forum of Independent Audit Regulators (IFIAR) has released its fourth annual survey of findings identified by its members in their individual inspections of audit firms affiliated with six large, international audit firm networks.

Consistent with the results of its prior surveys, the current survey reveals high frequency and number of findings in key aspects of the audit and in the inspected audit firms' systems of quality control. The survey indicates that 43% of inspected audits of listed public interest entities had at least one finding. Inspection findings are deficiencies in audit procedures that indicate that the audit firm did not obtain sufficient appropriate audit evidence to support its opinion, but this does not necessarily imply that those financial statements are also materially misstated.

IFIAR says that the pace of audit quality improvement is too slow and has agreed a new initiative with the six largest audit networks to achieve a measurable reduction in findings by 2019. The working group that engages with these firms has set a measurable target of a reduction of at least 25% in the next four years in audits with at least one finding as reported by the members of this working group.

IFIAR plans to continue its annual

inspections survey, knowledge-sharing and collaboration among members, and intensify its engagement with the six largest international audit firm networks to advance IFIAR's goal of high quality audits. tinyurl.com/IFIAR-Survey



FEDERATION OF EUROPEAN ACCOUNTANTS

FEE POSITION PAPER ON EU DIRECTIVE ON DISCLOSURE OF NON-FINANCIAL AND DIVERSITY INFORMATION

(March 2016)

This position paper highlights the requirements of the EU Directive on disclosure of non-financial and diversity information, which is due to be transposed into member states' national laws by 6 December 2016. This will require certain companies to disclose information on environmental, social and employee-related matters, as well as on respect for human rights, anti-corruption, and bribery issues and diversity in their board of directors.

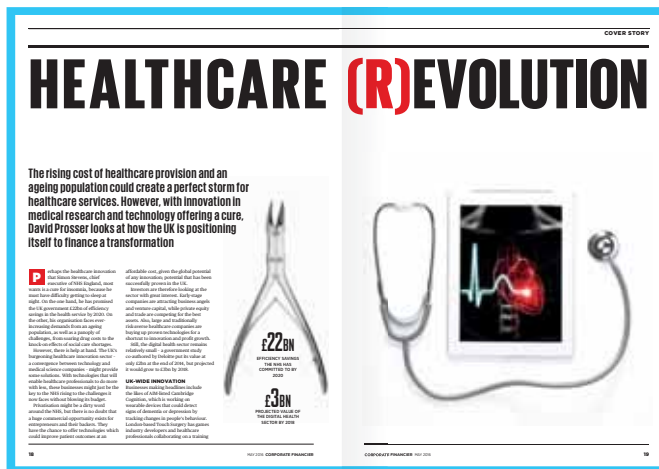
This paper from FEE sets out what the directive means in practice, discusses the key issues around implementing the requirements and provides some illustrations of how the requirements can be met. tinyurl.com/FEE-Directive



Louise Sharp produces Technical updates. She is a technical manager at the Audit & Assurance Faculty

From the faculties

Keep in touch with our selection from ICAEW's other faculty magazines



SET IN STONE CHARTTECH

This issue of *Chartech* looks at the main features and uses of the publicly visible and editable ledgers known as blockchains.

Adapted from the technology that underpins bitcoin, blockchain uses complex mathematics to ensure that all parties agree on the current version of the ledger. But although they can be used for many purposes, there are technical challenges to overcome before the most promising implementations can become reality.

The most exciting features of blockchain technology are its resistance to tampering and its decentralised nature. Users can post transactions between each other without waiting on a middleman and system failures can't happen as the ledger is spread out over all users.

But in order for blockchain to work as a major element of the financial system, the market needs to invest in research. It's not yet known how the complex work of processing transactions in a blockchain can be scaled up to the volumes and timescales necessary.

Issues that need to be resolved through extensive focused R&D include problems with blockchain scalability and, as all ledgers contain all transactions, what can be done as the file sizes get ever larger? While transactions are impregnable, there is room for hackers to hijack the user's details with a so-called "man-in-the-middle" attack.

For more from the IT Faculty, visit icaew.com/itfac

HEALTHCARE REVOLUTION CORPORATE FINANCIER

Is technology the answer to saving money in the NHS? That's a question posed in this month's *Corporate Financier* cover story about the UK's burgeoning healthcare innovation sector.

The digital health sector was valued at £2bn in 2014 and by 2018 this is set to climb to £3bn as investors cast an eye over the opportunities. Early-stage companies are attracting angel investors and venture capital, while private equity and trade are already competing for assets.

So what are some of the innovations? Cambridge Cognition is working on wearable devices that could detect signs of dementia or depression; Inhealthcare provides telemedicine tools that connect patients and doctors remotely; and DeepMind has begun working with the NHS on a range of initiatives.

"The application of wearable technology in healthcare is exciting, but it's also pretty nascent," says Martin Gouldstone, head of life sciences at BDO. "It is disappointing to note that start-ups are really struggling to commercialise, let alone to attract funding."

In addition there are difficulties with regulation and payment, says Andrew Elder of Albion Ventures: "It's not clear who is going to pay for digital health in the UK - unlike in the US, where people are used to paying for health, consumers here just aren't familiar with that idea."

For more from the Corporate Finance Faculty, visit icaew.com/cff

CULTURE CLUB FS FOCUS

The past few years has seen a shift in emphasis at financial institutions as they address their behaviour in order to restore their reputations after the financial crisis. Culture, standards and professionalism are the new preoccupations, as the *FS Focus* cover story reveals.

Reshaping culture is a complex business, and controlling and managing it can be difficult, however some industries may have lessons to offer. Industries such as aviation, nuclear energy and oil and gas have evolved strong safety cultures, and pharmaceutical manufacturers have become very focused on ethical behaviour.

Mark Dawson, leader of PwC's financial services conduct and culture practice, says research demonstrates two things about a strong culture - it can increase productivity and predictability. "But productivity is the real prize in a lot of organisations."

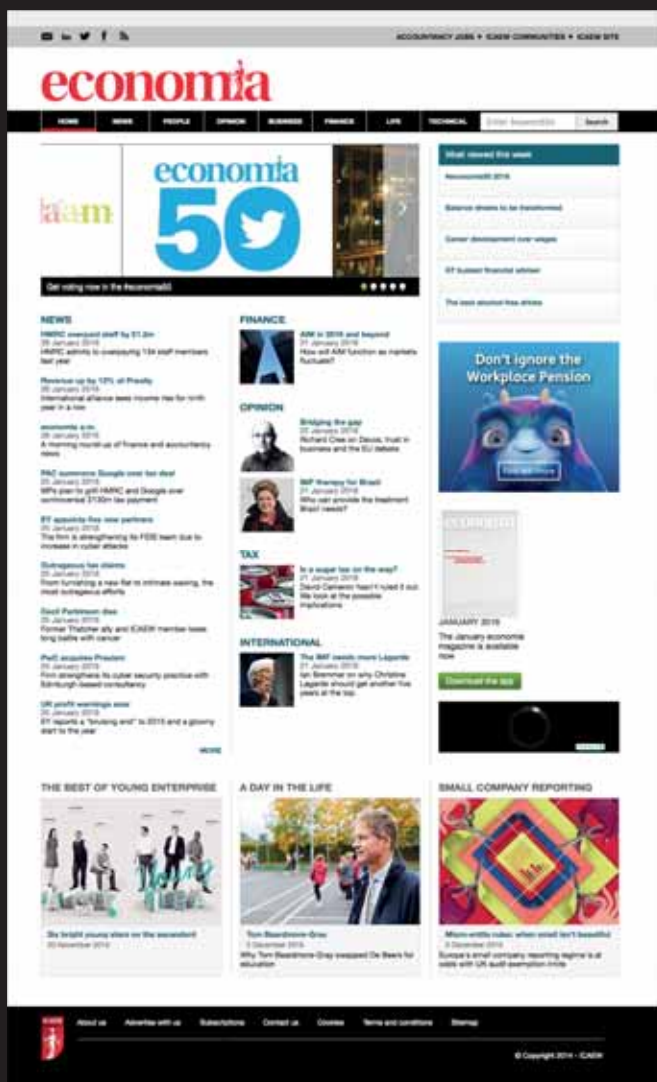
Measurement is regarded as key to culture at Old Mutual, the FTSE 100 international financial group, which began a culture change programme in 2010. "Measurement makes culture explicit and discussable," explains Liz Murphy, group head of talent and culture.

There is always a risk of over-complicating culture change which, at least in part, comes back to leading by example. On one important level, culture is no more than "the way we do things around here".

For more from the Financial Services Faculty, visit icaew.com/fsf

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