



AUDIT NEWS

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Introduction

Welcome to this the latest edition of *Audit News*. This is my debut as editor following an illustrious tenure by my predecessor, Peter Burton, but for you the readers it's perhaps a case of Peter in and Peter out.

This edition is prompted by the amendments made to the audit regulations following negotiations with IAASA, the Irish regulator, to approve them. The changes are mainly ones of cross reference but there are one or two small procedural changes which are covered in the article. All audit firms registered with ICAEW now have a dual registration – UK and Ireland!

Our Quality Assurance Department has had some push back on the way you sign audit reports, and on the way your firm should be represented on stationery which are in part affected by these regulations. The articles below hopefully will shed a bit more light on these niceties.

Both the FRC and IAASA have intimated their concerns around the exercise of professional scepticism. The Audit and Assurance Faculty have penned an article around this subject drawing your attention to the various initiatives the faculty are running to address those concerns, and our Quality Assurance Department has highlighted this in a report on their 2011 monitoring visits.

Finally your attention is drawn to some concerns the ARC have expressed around undertakings made by member firms which are not always strictly honoured. An interesting mix then for this Jubilee edition!

Peter James

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Updated Audit Regulations

The Audit Regulations have been updated with effect from 1 June 2012 following their review and approval by the Irish regulator, the Irish Auditing and Accounting Supervisory Authority (IAASA). In 2010 the Irish government enacted SI 220 - European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010 of Ireland. This enacted various parts of the EC Statutory Audit Directive which, in the UK, had largely been achieved through the Companies Act 2006. The Audit Regulations were substantially reorganised in 2008 to take account of the changes brought about by the 2006 Companies Act, including the obligations under the Statutory Audit Directive.

As SI220 also enacts the Statutory Audit Directive, the changes to the regulations needed for SI220 are mainly ones of cross-referencing. However, a small number of our registered firms with only Irish

audits have, until now, been operating under the 1995 regulations. Those regulations are now replaced by these new regulations, which are significantly different in structure and content. This is reflected in the deletion of regulation 1.07 and the addition of 1.04A.

For all firms there are one or two additional nuances that are necessary and these are summarised below.

- a. 'Republic of Ireland' is now defined as Ireland.
- b. The UK Act requires the accountancy bodies to make regulations to implement a number of legislative provisions; in Ireland, where the requirement is included in the text of the Irish SI itself, there is no equivalent requirement for a regulation. Consequently, the relevant regulations are not applicable in Ireland. Guidance has been included in the regulations to explain this. In summary the relevant regulations are:
 - i. regulation 3.09- successor's access to working papers;
 - ii. regulation 3.14- transfer of audit working papers to another competent authority in an EEA member state.
- c. Regulation 3.15, Notification to a registration committee where the registered auditor is appointed as auditor of a 'major audit' client, does not apply to Irish entities.

A number of other changes have been made which affect UK audits, Irish audits or both.

- a. Definition of audit working papers- SI220 of 2010 includes a definition of audit working papers. As audit working papers are referred to in the SI the definition has now been included in the Regulations.
- b. Definition of appropriate qualification:
 - i. the definition has been expanded to ensure all references to the 2006 Act have been included; and
 - ii. a new definition for Irish entities as required by the SI220 of 2010 has been included.

Further guidance — through flowcharts on qualifications — is set out in a new schedule at the end of Chapter 4 to help you interpret the definitions.

- c. An obligation for registered auditors to provide returns and other information required by the registration committee under new regulation 2.10A.
- d. Email is now accepted as form of notice under the regulation 1.08 (formerly 1.09).
- e. There are some additional guidance notes around firm eligibility under regulation 2.03, in particular the continued prohibition in Ireland of audit firm body corporates acting as auditors for certain small entities outside the scope of SI220.
- f. Additional independence rules in Ireland set out in schedule 1 to Chapter 3.

In terms of what the new regulations mean for existing practices in the UK, there are not many changes needed, but the guidance in firm disclosure at the start of Chapter 2 may require some amendments. Registration with ICAEW as an audit firm enables that firm to express opinions as a statutory auditor in both the UK and Ireland, and stationery, marketing materials and websites need to be amended to that effect. If, however, audits are unlikely to be undertaken in Ireland, the sole UK reference is acceptable on stationery but the Irish registration needs to be disclosed somewhere, usually on the firm's website or office wall in the reception area.

The new regulations can be found at icaew.com/en/members/regulations-standards-and-guidance/audit

Signing audit reports

Although we have given guidance on signing audit reports in *Audit News 44* and *Audit News 45*, we continue to receive queries on how exactly the provisions apply in practice. The requirements are set out in the Companies Act 2006 sections 503 to 505 and guidance was given by the APB in their *Bulletin 2008/6*. The *Audit News* articles sought to clarify this further.

In short, the details of the registered auditor and responsible individual that are typed into the audit report must mirror those contained in the national audit registers of the UK and Ireland - which can be checked at www.auditregister.org.uk and www.cro.ie/auditors. On the other hand, the responsible individual can sign freehand with their usual signature. So in the William Smith example given in *Audit News 45*, if he is shown on the register as William Smith FCA, that name has to be typed on the audit report, even though he may sign freehand as Bill Smith.

If Mr Smith wishes to have Bill Smith as his formal name on the register, he can email regulatory.support@icaew.com asking for the change to be made, but he needs to do this personally and not through third parties. In addition, he needs to note that this change will be reflected on ICAEW's member record so all his ICAEW correspondence will, in future, be addressed to Bill Smith.

The question is also asked, 'Which location of the registered auditor should be reported?' For example, our good friend William Smith may be based in London and Manchester, servicing clients in each of those offices. Does he sign the Manchester client reports out of the Manchester office, and the London ones out of his London address?

The requirements set out in section 503 of the Companies Act do not specifically require anything with regard to location, and the nearest authoritative text seems to be ISA700 where paragraph 42 requires the auditor's report to 'name the location in the jurisdiction where the auditor practises'. This seems to leave the matter open to discretion.

The content of the audit registers is nevertheless instructive; registered individuals can be only registered in one location. In the context of that register, therefore, location on an audit report ought perhaps to be an attribute of the registered individual, not the client, and that location should be used for all audit reports regardless of the client location or the location of the underlying staff that may perform the work.

As best practice it would appear that registered location information should be what is disclosed on the face of the audit report. Nevertheless the auditor does have the discretion to vary this if they consider it necessary.

Irish third country auditors

Statutory auditors that express an audit opinion on an entity incorporated outside the EU but which is quoted on the Irish stock exchange are (with certain exceptions) required to register separately with IAASA in accordance with Regulation 113(1) of SI 220 2010. **FAQ3** on IAASA's website gives more details about the exceptions to registration.

There's a series of **application forms** for those statutory auditors that are required to register.

If, however, those statutory auditors are already registered with ICAEW as Irish statutory auditors, then a streamlined approach is applied and the auditor will only need to write to IAASA detailing:

- the entity involved
- the names of the engagement partner(s) and
- requesting registration under Regulation 113.

Registration needs to be effected before the audit report is signed. Further detailed guidance, including copies of the relevant application forms, is given on IAASA's website, www.iaasa.ie

Professional scepticism

ICAEW's Audit and Assurance Faculty has issued a set of online training videos examining professional scepticism and other key audit issues. The videos feature short talks by:

- Professional Oversight Board chairman, John Kellas, based upon audit inspection findings; and
- ICAEW audit experts;

and are intended to help with training and reinforce best practice.

The ten short videos are designed to be relevant to auditors from all sizes of firm, at any stage in their careers, undertaking a wide variety of audit work. As well as prompting discussions of professional scepticism and its application, they look at audit planning, good documentation, training and development needs, personal qualities necessary in a good auditor and best practice for group audits. Responding to Audit Inspection Unit reports and findings, they are designed to be a helpful coaching and discussion tool for both firms and individual auditors.

Henry Irving, head of ICAEW's Audit and Assurance Faculty said: 'Professional scepticism is a key element of every audit, and although auditors are trained to apply it, it's not necessarily easy to define. These videos examine how a properly sceptical attitude is developed and maintained and offer a great opportunity to discover some of the regulator's concerns and explore ways to address them. We hope these videos, which are presented in easy-to-use bite-size chunks, will prove useful to auditors across the board and will become a valuable discussion tool as well as providing training materials.'

As well as looking at POB concerns, the videos discuss how ACA training and continuous professional development can help foster and develop a robust attitude and approach to audit.



John Kellas said: 'The POB recognises that auditors can and do perform good work, but there are important messages coming out of the AIU's inspections of audits. In particular, we would like to see more positive evidence of appropriate professional scepticism on all audits. We look to the profession to promote best practice with the aim of ensuring consistently high standards of auditing. I was therefore pleased to be given this opportunity by ICAEW to relay some of the messages from audit inspections in this way. I hope the videos will help auditors at any stage of their careers to understand the regulatory perspective.'

The videos can be found at icaew.com/en/technical/audit-and-assurance/professional-scepticism

QAD publishes report on audit monitoring 2011

We have recently published our second annual QAD report on audit monitoring activities. During 2011, through visits, roadshows and conference calls, we had contact with over 1,000 of the 3,800 ICAEW registered audit firms. Although 69% of our 716 audit visits were closed without further action our report highlights common areas of weakness that we see in the audit files we review.

The most challenging audits tend to be those where the most important areas are not clear-cut and which involve considerable judgement. A good auditor will quickly identify these risks to their audit opinion, dealing with them through detailed audit work and robust challenge of their client. This is where professional scepticism is key; the objective challenge of assumptions and circumstances encountered during the audit is the foundation of the auditor's role.

Substantive analytical review is one of the areas that we focus on as illustrating the importance of professional scepticism. Substantive analytical review is difficult to do well; sometimes because it is not the most appropriate strategy, but also because the corroborative enquiries made to investigate variances need to reflect a high level of professional scepticism. Audit teams may

obtain and document what appear to be reasonable explanations from management, but they sometimes appear to accept them at face value without doing further work to corroborate them.

We found that our firms and the training providers were well prepared for the challenges of clarified ISAs when we started to review these audits in 2011. There are some common points that we raise – particularly on related parties and accounting estimates. However, these are not fundamental weaknesses and we do not usually have doubts over the quality of otherwise sound audit work.

Firms need to have their own arrangements in place to monitor their compliance – effective cold file reviews are the first line of defence! We recommend that all firms consider whether external reviews would strengthen their quality control procedures.

For more on professional scepticism, clarified ISAs, and our audit quality project you can read the full report at icaew.com/auditnews

Failing to honour undertakings

The Audit Registration Committee (ARC) takes very seriously cases where firms fail to honour undertakings or assurances they have given to ICAEW, including those given to the Quality Assurance Department during visits, and in subsequent correspondence with the audit regulation section.

Typical undertakings include agreeing to:

- obtain external hot or cold file reviews and submit the review results to ICAEW within an agreed timescale;
- reply to correspondence within an agreed timescale;
- complete accurate annual returns in future (and submit them to ICAEW on time); and
- carry out specific training or other CPD.

Additionally, firms that wish to retain registered auditor status but which do not currently have any audit appointments, may be required to undertake to notify ICAEW if they subsequently accept an audit appointment.

The ARC takes appropriate action against any firm that does not fulfil its obligations. Depending on the seriousness of the circumstances, this could be in the form of the withdrawal of a firm's audit registration and/or a regulatory penalty.

When the committee decides on the level of regulatory penalty, it uses ICAEW's *Guidance on Sentencing*. The starting point for an inadvertent breach of an undertaking is £3,000, which may be increased or reduced depending on aggravating or mitigating factors. In 2011 the ARC offered eight regulatory penalties to firms that failed to comply with assurances given to ICAEW, averaging £2,700 each.

In addition, the ARC refers more serious cases of deliberate or reckless breaches for disciplinary action. It made seven such referrals in 2011.

If your firm is experiencing difficulties in meeting undertakings given, please contact the audit regulation section (+44 (0)1908 546 309 or +44 (0)1908 546 311) as soon as any problem becomes apparent.