



# AUDIT NEWS

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## Introduction

This issue includes details of a change to the definition of audit in the audit regulations. Although we think it will have no consequences for most firms, you need to be aware of the change.

There's also a reminder from the Audit Registration Committee on undertaking complex audits. Before smaller firms accept a new appointment or continue to act for an existing audit client, they need to make sure they have the right resources, particularly where complex clients are concerned.

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## Audit regulations – change to the definition of audit

The EU Statutory Audit Directive includes provisions to deal with the audit of non-EU companies listed on an EU stock exchange. These provisions include various arrangements relating to the equivalence of the monitoring of audits, discipline and oversight of the audit regulatory system.

The auditors of these non-EU companies are commonly known as third country auditors and have to register with the 'audit competent authority' of the EU country in which the non-EU company is listed (for example, the Professional Oversight Board (POB) in the UK).

### Arrangements in the UK

When these arrangements were drafted, it seems to have been assumed that the auditor would not be an EU auditor and would be based in that third country. That is not the case, and in the UK there are a number of non-EU companies, listed on the London Stock Exchange, whose audits are undertaken by UK registered auditors.

UK law partly recognises this and does not require a UK registered auditor to register as a third country auditor if it accepts a third country audit appointment. Nevertheless, because the audit is a not UK company, and the firm is not a third country auditor, there is no provision under UK law for these audits to be monitored.

### Effects of amending the Companies Act

The Companies Act has now been amended to deal with this and, to implement this requirement, the definition of an audit in the audit regulations has been changed. This means that such audits will be subject to the audit regulations. As these are listed audits, the monitoring will be undertaken by the AIU.

The law contains a provision that allows POB (using delegated authority from the Secretary of State) or the AIU, to scope individual audits or classes of audit out of these new arrangements. This has happened in the case of companies incorporated in the crown dependencies of Jersey, Guernsey and the Isle of Man.

The change to the law is effective from 1 October 2011. However, as the change only applies to audit periods beginning on or after 1 October 2011, the regulation change is effective from 1 January 2012.

ICAEW has published a revised copy of the Audit Regulations and Guidance at [icaew.com/regulations](http://icaew.com/regulations)

### **Amended definition of audit**

Here is the revised text of the definition of audit. **New text is shaded in grey.** Audit Regulation 3.15 has also been amended as a result of the change to the definition.

**a) (i) any function in respect of a company incorporated in the United Kingdom or the Republic of Ireland which is required to be performed by a *Registered Auditor* as auditor of that company;**

**(ii) any function in respect of any of the following entities constituted in the United Kingdom or the Republic of Ireland which is required to be performed by a *Registered Auditor* as auditor of that entity:**

- a building society;
- a credit union;
- a charity;
- an industrial and provident society;
- a friendly society;
- a pension scheme;
- a limited liability partnership;
- a partnership;
- an open ended investment company;
- a unit trust;
- a Lloyds' syndicate;
- a mutual life office; and
- a person authorised under legislation relating to the conduct of investment, insurance or mortgage business;

where such function is expressly required to be discharged either by or under United Kingdom or Republic of Ireland legislation.

**(iii) any function in respect of a United Kingdom traded non-EEA company which is required to be performed by an auditor and which is performed by a *Registered Auditor* as auditor of that company.**

**b) any function in respect of a company incorporated in the United Kingdom or the Republic of Ireland which is included on the official list which is performed by a *Registered Auditor* following appointment as auditor of that company in relation to its financial statements or extracts of financial statements as required by a listing authority or a recognised company stock exchange in either of those jurisdictions.**

The reference above to an 'official list' is to the official list as defined in the Financial Services and Markets Act 2000, Part 6 or to the official list of the Irish Stock Exchange in the Republic of Ireland. It therefore does not include companies whose shares are publicly traded but that are not included in the official list.

The reference above to a 'listing authority' is to the Financial Services Authority in the UK and the Irish Financial Services Regulatory Authority in the Republic of Ireland.

The reference above to a partnership is to a partnership where all the partners are companies or Scottish partnerships and in the latter case, each partner in the partnership is a limited company.

The reference to a United Kingdom traded non-EEA company means a body corporate:

- which is incorporated or formed under the law of a third country (other than Jersey, Guernsey and the Isle of Man) that is not an EEA member state;
- whose transferable securities (eg, shares) are admitted to trading on a regulated market situated or operating on the United Kingdom (eg, the London Stock Exchange); and
- which has not been excluded (either as an individual company or class of companies or by country) by an order made under the 2006 Ac, or by a direction or decision of the oversight body.

Companies incorporated in Jersey, Guernsey and the Isle of Man have already been excluded, so this definition does not apply to them. The latest list of excluded companies can be viewed at [www.frc-pob.org.uk](http://www.frc-pob.org.uk).

Should a registered auditor consider that there is a conflict between the requirements of these regulations (as applied to a particular UK traded non-EEA company) and the non-EEA country law, then the firm should consider seeking a dispensation under audit regulation 2.17 from the Registration Committee.

Part a(iii) of the definition applies in respect of audits of accounting periods starting on or after 1 October 2011.

The definition does not extend to reports relating to entities other than those specified.

(Remainder of guidance is unchanged and not shown here.)

### **Amended regulation 3.15**

**3.15 If a Registered Auditor is appointed to a ‘major audit’ client (or a Registered Auditor becomes aware that an existing audit client is now a major audit client) it must inform the Registration Committee in writing as soon as practicable, but not later than 21 business days after the event, of the name of the audit client, unless the Registration Committee has given the Registered Auditor a waiver from compliance with this regulation.**

The Audit Inspection Unit of the Professional Oversight Board is responsible for the review of audits of major audit clients. These include listed companies and other very large companies, pension funds, charities and others. Also included are the audits of United Kingdom traded non-EEA companies (see the definition of an audit). The current list of entities for the purpose of this regulation can be viewed at [www.frc-pob.org.uk](http://www.frc-pob.org.uk). The Registration Committee must be informed if a registered auditor gains such an audit client or an existing audit client becomes a major audit client. Registered auditors may also find it useful to inform the Registration Committee if a client ceases to be a major audit client even though there is no cessation of office. It would also be useful if, when providing this information, the notification contained details of the financial year end of the first or last audit that the firm undertakes.

The remainder of the guidance is unchanged and not shown here.

### **ARC’s advice to smaller firms on undertaking complex audits**

**Before smaller audit firms accept a new appointment or continue to act for an existing audit client, they need to make sure they have the right resources.**

The Audit Registration Committee (ARC) is keen to highlight the need for smaller firms to ensure, when accepting a new audit appointment or continuing to act for an existing audit client, that they have adequate competence and capabilities to undertake the engagement.

This is particularly important if the client (or proposed client) is complex or higher-risk, such as:

- a UK-based parent company of a large, multi-national group with overseas material subsidiaries; or
- any client whose shares are listed on a recognised stock exchange (including the Alternative Investment Market and PLUS markets).

### **AIU publishes its findings**

The Audit Inspection Unit's 2010/11 public report on inspections of firms auditing 10 or fewer entities within its scope highlighted a specific concern involving the audits of multi-national groups, where the majority of the operations are based and managed outside the UK.

In a number of instances, the AIU found that the firm undertaking the audit in the UK was, due to its size, not usually affiliated to an overseas firm. As a result, the overseas operations were audited by other firms (component auditors) and the extent of participation of the UK auditor in the group audits was generally limited.

### **Reminder from the ARC**

The ARC reminds firms (as required under ISQC1), that they must establish policies and procedures for acceptance and continuance of client relationships which give reasonable assurance that the firm will only undertake the engagement if it has the capabilities, including time and resources, to do so.