

Audit Regulation 3.09 – Successor auditor requests

In the last few months, there have been a number of queries relating to successor auditor requests. From discussion with audit firms on our monitoring visits, such requests are becoming more commonplace, and more firms are making requests as part of routine succession procedures. In this article, we will summarise the requirements of the regulations, and look to address some of the common queries from firms.

Background to the Regulation

The main purpose of the Regulation is to assist in the consistency of the audit process when there is a change of auditor, and is intended to facilitate and reduce any perceived risk from the process.

Audit regulation 3.09 (AR 3.09) details what could happen when there is a change of auditor. We use the words 'could happen' because it is ultimately up to the new auditor (successor) to decide if they want to review the files of the predecessor auditor.

The Regulation states the following:

'When a Registered Auditor (the 'predecessor') ceases to hold an audit appointment and another Registered Auditor (the 'successor') is appointed the predecessor must, if requested in writing by the successor, allow the successor access to all relevant information held by the predecessor in respect of its audit work. If relevant information is to be sought by the successor, it should be sought and provided in accordance with the following guidance. Any information obtained by the successor is for the purposes of its audit and must not be disclosed to a third party unless the successor is required to do so by a legal or professional obligation.'

Note that a successor is not required or expected to request information from a predecessor auditor on every appointment, however, remember there are specific considerations to reviewing predecessor audit work in the ISAs. This includes ISA(UK) 300 (Planning an Audit of Financial Statements); ISA(UK) 510 (Initial Audit Engagements - Opening Balances); and ISA(UK) 710 (Comparative Information).

AR 3.09 (and related guidance) does not duplicate any similar framework which exists alongside the audit regulations including the requirements of the ICAS Code of Ethics. The regulation is also in addition to any requirement to make a statement of circumstances, including where the predecessor has been removed as auditor, has resigned as auditor, or otherwise ceased to hold office.

Some of the common queries we have received from firms on meeting the requirements of the Regulation, either as a successor or predecessor auditor are as follows:

When can a request for relevant information be made?

A request for relevant information may be made by a successor once the successor has been formally appointed to the audit client.

How should a request for relevant information be made?

The Audit Regulation states that a request for relevant information should be made in writing. We are aware that some firms are framing their requests around 'all relevant information' however, this is not how we would expect the request to be worded.

The provision of this information will be achieved more efficiently where the request is as precise as possible, therefore the successor auditor should avoid a request for all relevant information held by the predecessor. As the information to be reviewed will likely be contained within the audit working papers prepared by the predecessor, the request will normally be for all or some of these working papers.

What is meant by "relevant information"?

As noted, the Guidance provided with the Audit Regulation indicates that 'relevant information' will normally be that contained in the audit working papers of the predecessor. This is an area of judgement for the successor auditor, and firms are advised to consider any request carefully as part of their planning process.

What period should the requested information cover?

Normally this is the period between the beginning of the last financial statements on which the predecessor reported and the date of cessation of the predecessor's audit appointment.

Where a successor requests further information in addition to this period, they should be prepared to justify that this additional information qualifies as "relevant information" under the Regulations.

What if the information related to audit work is not filed on the audit file?

If the relevant information requested is not filed on the current audit file e.g. on a permanent file, systems file, or referred to a prior year audit file, access to this information should be provided by the predecessor.

Is the predecessor required to answer queries on review of the information provided?

The guidance to the Regulation states: "The predecessor should be prepared to assist the successor by providing oral or written explanations on a timely basis to assist the latter's understanding of the audit working papers."

Note that questions should only be directed to clarification or explanation of the information accessed. ICAS AM recommends that any request of this nature be put in writing by the successor, and similarly, any explanation provided by the predecessor should be formally communicated.

The predecessor should keep in mind that its obligation does not extend beyond the relevant information provided.

On receiving a request for information, how long does the predecessor have to provide it?

Under the guidance, in all cases the provision of information should be on a timely basis. ICAS AM recommends that this is as soon as practicable after receiving the request.

Am I required to grant access to my working papers?

Firms should be aware that, where the successor decides to review the predecessor auditor's files, regulation 3.09 requires the predecessor to allow access. There are further considerations under the ICAS Code of Ethics with regard to requests from successor firms. Firms are reminded that a request for relevant information under the Regulation may only be made once the successor has been formally appointed as auditor.

Should the predecessor allow the successor auditor to copy audit working papers?

There is no obligation to allow the copying of working papers. While it is usual practice to allow the successor to copy extracts of client books and records contained in the audit working papers, the practical arrangements of access and copying of extracts from the audit file should be formally agreed between the successor and the predecessor.

The basis on which access etc is to be provided should be documented in writing. This can be achieved by an exchange of letters, and it is recommended that, once finalised, these are copied to the audited entity.

What if there are concerns regarding the quality of audit work on the predecessors file?

The successor should not comment on the quality of the predecessor's audit work unless required to do so by a legal or professional obligation.

UK charity regulators revise guidance for auditors and independent examiners

Revised guidance has been issued by the UK charity regulators, setting out what auditors, and independent examiners, must report to them.

The guidance revises the list of matters of 'material significance' that auditors and independent examiners should consider in understanding and complying with their statutory reporting duty.

The list has been published by the Office of the Scottish Charity Regulator (OSCR), the Charity Commission for England and Wales (CCEW) and the Charity Commission for Northern Ireland (CCNI).

Auditors and other examiners in all three jurisdictions have a statutory duty to report any matters of material significance to the regulator in relation to its regulatory powers or functions. The new guidance adds two new areas for reporting as follows:

- Where there are concerns regarding a charity's accounts, and a modified audit opinion report or qualified independent examiner's report is issued; and
- Where there are concerns that conflicts of interests or related party transactions have not been properly managed or declared.

The revised guidance applies to matters to be reported after 1 May 2017 regardless of the accounting period under audit or examination and is available from www.gov.uk. The guidance contains the full list of **nine** matters which are always considered reportable as matters of material significance. Note that, even though a matter may not be listed, a report must be made if the auditor or independent examiner considers it appropriate.

A matter becomes reportable as soon as the auditor or independent examiner:

- becomes aware of it through the course of their work, and which they believe is of material significance for the regulator;
- signs a modified audit opinion, an audit opinion with an emphasis of matter or material uncertainty regarding going concern; or
- signs a qualified independent examination report which identifies one or more concerns about the charity's accounts

Note that auditors and independent examiners are only expected to report matters which they identify in the normal course of their work. There is no expectation that they should undertake additional work to identify such matters. It is for auditors and independent examiners to exercise their own judgment when considering if they have a duty to report.

Auditors fall within the UK's anti-money laundering and counter terrorism financing (AMLCTF) reporting regime as do ICAS members who provide other accountancy-related services, including independent examinations, by way of business. Reporting to a UK charity regulator does not discharge an auditor or independent examiner from any statutory obligations under the AMLCTF regime.

Amendment to FRS 102: Directors' loans – optional interim relief for small entities

On Monday 8 May 2017, the Financial Reporting Council (FRC) announced that it is withdrawing the requirement for small companies to find a market rate of interest where a director's loan is made on an off-market basis under UK GAAP

What has changed?

Small entities can now initially measure a loan from a director at transaction price rather than at present value applying a market rate of interest.

Does the amendment apply to all directors' loans?

The director must be a natural person and a shareholder in the small entity (or a close member of the family of that person).

Note, the measure announced applies to credit loans only. The FRC has clarified that the interim measure will not apply to loans from small companies to their directors/shareholders i.e. debit loans.

When is this amendment effective?

This amendment is effective immediately with retrospective application available; however, it should not be applied to any other transaction, event or condition.

What if the small entity has already issued FRS 102 accounts?

Where small entities have already issued financial statements that comply with FRS 102, the exemption is available in subsequent financial statements with full retrospective application required.

Background

In March, the FRC published Financial Reporting Exposure Draft 67 (FRED 67) which set out changes to FRS 102 as a result of the first triennial review, outlining potential changes to be made to director's loans accounting.

FRED 67[2] proposes a number of amendments to FRS 102, intended to simplify it and make it more cost-effective. This includes permitting small entities to initially measure a loan from a director who is a natural person and a shareholder in the small entity (or a close member of the family of that person) at transaction price. FRS 102 currently requires such loans to be initially measured at present value, with the discount rate being a market rate of interest for a similar debt instrument.

While early indications are that the proposals relating to directors' loans are supported by stakeholders, finalisation of the proposed changes is not expected until December 2017, which is too late for the first FRS 102 1A financial statements of small entities reporting as at 31 December 2016. Consequently, there will be a number of small entities where the accounting for directors' loans will be finalised too late to avoid implementation for one year only.

In an unusual but positive move for the FRC, they have responded to calls to create an interim optional exemption for small companies, and have amended FRS 102 to allow measurement of a basic financial liability that is a director's loan initially at transaction price.

ICAS has published guides for members which aim to help in the application of the new financial reporting requirements for small and micro-sized entities, and with the new filing options for small entities.

The guidance on new financial reporting requirements for small entities can be found at www.icas.com/technical-resources/new-guide-for-small-and-micro-sized-entities-helps-with-financial-reporting-requirements

The guide to small company filing requirements can be found at www.icas.com/technical-resources/filing-options-a-guide-for-small-companies

FRS 102 Videos and podcasts

The ICAS Monitoring & Policy Leadership teams recently ran a programme of free FRS 102 events to support our practitioners in the implementation of the new UK GAAP. A video of the Aberdeen event is now available on the ICAS website at www.icas.com/regulation/frs-102-videos-and-podcasts

The programme is split into four separate presentations (available each as video or podcast) as follows:

- Practical Issues being Experienced in Applying FRS 102;
- Charities Technical Update: FRS 102 SORP;
- Common FRS 102 Issues Found on Audit Monitoring Visits; and
- Common Issues with Charity Accounts and Independent Examinations.

FRC Audit Quality Thematic Review – Quality Control

All firms must have in place quality control procedures and dedicated resources to ensure audit quality.

To promote improvement and consistency of audit quality, strong leadership and promoting the right culture, the Financial Reporting Council (FRC) has called upon on audit firms, in its latest thematic review, to build on the examples of good practice identified.

The review focussed on key aspects of the audit quality control systems used by firms to support their audit teams in delivering quality audits, and covered six of the largest audit firms. From these firms, 26 audits were selected for review from FTSE 100, FTSE 250 and other listed companies.

The review identified a that one-third of the audits required more than just limited improvements, suggesting that the quality control procedures adopted by the firms had not been effective. The FRC also identified procedures by some audit firms that require focus going forward. These included:

- The involvement of specialists in the audit with sufficient reporting of their work where this was important to achieve audit quality.
- That firms consider any insights arising from their root cause analysis, where quality control procedures could be enhanced to improve audit quality.

The review also identified a number of areas of good practice, including:

- Firms with a dedicated board or committee to oversee all matters relating to audit quality. In firms where this was identified, audit quality was allowed to have specific prominence and in the firm's leadership agenda.
- Two firms set out their audit quality procedures in a 'three lines of defence' model, helping to understand how these audit quality procedures interact together to achieve audit quality and minimise the risk of inconsistency.
- Firms developing their own initiatives to achieve consistent audit quality, including identification of areas for improvement, and monitoring the effectiveness of training.
- Audits with a higher level of partner and director involvement had a greater likelihood of achieving a high quality outcome prior to issue of the audit report.

A copy of the full thematic review can be found on the [FRC website](#).

ICAS issues guidance for ATOL Reporting Accountants

The ATOL Reporting Accountants Scheme, which forms part of the Civil Aviation Authority's ("the CAA's") review of ATOL regulation, was launched on 1 April 2016. From that date, only registered and designated ARAs working in registered firms can sign ATOL Accountants Reports.

ICAS is an Approved Professional Body for this scheme and we have produced guidance for ICAS members undertaking this type of work, or considering becoming registered to do so. The guidance can be found by searching for "[ATOL](#)" on icas.com.

Reminder – “Keeping Audit on the Right Track” Mandatory course for ACPs and RIs

As part of the ICAS developmental approach to regulation, this course aims to educate Audit Compliance Principals (ACPs) and Responsible Individuals (RIs) in developing a strong compliance function and preventing some of the recurring issues identified on audit monitoring visits.

As of 1 January 2016, there was an increase in the mandatory requirement of this course, where the Authorisation Committee has considered that the course will be beneficial to a wider audience.

The resulting requirements are that:

- Each ACP will be required to attend at least once in the three-year period from 1 January 2016 to 31 December 2018;
- Each RI will be required to attend at least once in the five-year period from 1 January 2016 to 31 December 2020;
- Newly approved RIs will be required to attend the course within 12 months of approval; and
- Previously inactive RIs (i.e. approved RIs who are not signing audit reports), who have recommenced the role, will be required to attend the course within 12 months of becoming active.

The remaining courses in 2017 are as follows:

- Carlisle – 13th September 2017
- Aberdeen – 4th October 2017

We also confirm that there will be annual courses in Aberdeen; Glasgow; and Edinburgh, in addition to rotating various other locations.

For further details, please search for '*keeping audit on the right track*' on icas.com