

Auditing FRS 102 – An Audit Monitoring Update

In a December 2016 Audit News article, we looked at the impact of FRS 102, noting common issues raised on monitoring visits to date, and we further considered this in our annual report issued earlier this year. The key issues identified included consideration of financing transactions, holiday pay, fixed asset residual values and revaluations.

The following article provides an update and summarises some of the key issues raised on monitoring visits so far in 2017.

As with all changes in accounting framework, the move to FRS 102 has not been straightforward. There have been a number of challenges and a steep learning curve for us all. While some firms prepared and audited a number of FRS 102 financial statements last year, some are tackling FRS 102 for the first time in 2017. The following is a summary of the main issues raised so far in 2017:

Technical issues

While the standard of FRS 102 documentation has generally improved, ICAS Audit Monitoring (AM) are still reviewing files where FRS 102 considerations have not been clearly recorded. The most common file issue is where ICAS AM have been unable to determine how the firm has concluded over certain technical areas. There are three key areas to consider on transition to FRS 102 or FRS 102 1A:

- *Audit risks* – There are specific audit risks in relation to transition arrangements, including auditor judgement and appropriate professional scepticism. The change in accounting framework should be recognised as an area of elevated risk at planning;
- *Potential ethics issues* - There are ethical matters for auditors to consider if involved in the accounts preparation process - clients may request your help and advice with transition. These considerations, together with applicable safeguards over self-review and management threats should be documented at planning; and
- *Potential auditing and accounting issues* - There are significant challenges for audited entities and the firms auditing FRS 102 disclosures and potential adjustments. Auditors should ensure that audit files can 'stand-alone' from the accounts preparation process and that any judgements and conclusions are adequately recorded.

These issues are most common where the firm has performed the work as part of the accounts preparation process or during the client planning process, but hasn't documented the extent of work performed or conclusion drawn on the file.

In addition, ICAS AM are identifying issues where firms have concluded that transition adjustments would not be material, but have not:

- quantified an unadjusted error; or
- documented the auditor's conclusion; or
- evidenced that these matters have been discussed with the client.

Some practical examples are provided as follows:

- *Holiday pay accrual* – the auditor reviewed whether an accrual was required and discussed this with the client at the planning meeting. Having determined a coterminous holiday year end, and confirming that employees cannot carry forward holiday entitlement, it was concluded that no accrual was required. This, however, was not documented on the file.
- *Financing transactions* – an audit client (a parent company) provided a loan to a subsidiary over a fixed term of three years. The loan was provided at an interest rate lower than the market rate. The auditor concluded that, after discounting, any fair value adjustment would not be material however this conclusion was not recorded on the file, supported by an appropriate calculation and the error not taken to the error schedule.

Some of the better documented files have included a schedule at planning, clearly setting out technical issues under the new standard, the potential impact on the financial statements, and a clear conclusion (i.e. that there is no impact; or, if there is an impact whether this will result in a transition adjustment or unadjusted error).

Accounting software and disclosure issues

In the last twelve months, reliance on accounting software has come under the spotlight and, from discussion with a large number of firms, there has been disappointment with the content and quality of disclosures produced by some software systems. That being said, while ICAS AM are still identifying disclosure issues on FRS 102 accounts, these are not so significant as in 2016, and firms are finding that the software is improving.

There are, however, still common issues within areas of more detailed disclosure under the new FRS. Common issues are as follows:

- Insufficiently detailed revenue recognition policies;
- Omission of a current tax policy;
- Omission of an appropriate financial instruments policy;
- Tangible assets accounting policies reflecting old UK GAAP with no reference to residual values or impairment;
- No turnover note as required by s23 of the Standard (not required under FRS 102 1A);
- Operating lease commitments not disclosing the total (rather than the annual) commitment due; and
- Key management personnel compensation not disclosed. It is recommended that where KMPs are restricted to directors' that this fact be disclosed.

Accounting policy disclosures remain an area where there are opportunities to make accounts more clear and concise. As noted, most firms rely on accounts production software to get accounting policies correct, however, there have been a number of issues where the software has produced the bare minimum, and what has been produced has subsequently not been tailored to the specific circumstances of the client.

Conversely, ICAS AM have reviewed FRS 102 financial statements which contain very lengthy accounting policies produced from the accounts software, or copied from model financial statements, without further tailoring. This has resulted in a number of examples of accounts with irrelevant policies, or policies which are needlessly repeated.

Firms are advised to review the accounting policies and make any relevant accounting policies client-specific rather than generic:

- Where policies are produced automatically but are not relevant, they should be removed (e.g. where the client does not have complex financial instruments, a policy would not be required); and
- Where "boilerplate" policies are produced, these should be tailored to the client (e.g. Turnover is stated net of VAT and trade discounts).

ICAS AM would remind firm's that there is an overriding requirement to ensure the disclosures in audited financial statements are correct, and the responsibility rests with the firm to review these in detail. In this regard, firms are encouraged to maintain staff and RI training in the requirements of the new standard, and expand the firms technical resource and reference material to include a robust and detailed disclosure checklist or model FRS 102 financial statements.

ICAS AM is focussed on the impact of FRS 102 on our firms, and where we consider it appropriate, we will conduct a restricted monitoring visit to consider how effectively financial statement disclosure requirements are being dealt with. Whilst these visits are restricted to FRS 102 aspects, they follow the same processes and reporting as other monitoring visits.

Revisions to International Standards on Auditing (UK)

- As noted in Audit News issue 62, the FRC issued revised Auditing Standards for accounting periods commencing on or after 17 June 2016.
- Further revisions have been made to ISAs (UK) 250A, 330 and 505 for periods commencing 15 December 2017.

The Financial Reporting Council (FRC) has issued a [revision of ISA \(UK\) 250 Section A](#) 'Consideration of laws and regulations in an audit of financial statements'. The revisions, which are limited in scope, reflect changes made to the International Code of Ethics issued by the International Ethics Standards Board for Accountants (IESBA). These changes provide a framework to support reporting by accountants where they identify non-compliance with laws or regulations in the course of their work.

This is supported by application material on laws and regulations that deal with fraud, corruption and bribery and money laundering, terrorist financing and proceeds of crime. The revised ISA (UK) 250A, and conforming amendments to other ISAs (UK), are effective for audits of financial statements for periods commencing on or after 15 December 2017.

Note that the FRC has also launched a [public consultation](#) on revised material to make auditors aware of their responsibilities under UK law with respect to money laundering. The existing material has been updated to take account of the new 2017 Money Laundering legislation, which come into force on 26 June 2017. The FRC has used the opportunity to change the format of the guidance provided to auditors – rather than having a stand-alone Practice Note 12, the FRC proposes incorporating the guidance as an appendix to ISA (UK) 250.

The FRC has also issued [revised ISA \(UK\) 330](#) The Auditor's Responses to Assessed Risks, with conforming amendments to [ISA \(UK\) 505 External Confirmations](#), also effective for audits of financial statements for periods commencing on or after 15 December 2017. The revisions have the effect of streamlining and integrating the guidance relating to obtaining bank reports for audit purposes into the auditing standards. Consequently, the FRC has **withdrawn Practice Note 16 Bank reports for audit purposes in the United Kingdom** from the date the revised standard is effective from.

Companies (Accounting) Act 2017 (Republic of Ireland)

- The [Companies \(Accounting\) Act 2017](#) was signed into law on 17 May 2017, and generally takes effect from 9 June 2017, with some exemptions.
- Among the key changes are the introduction of an optional, simplified regime for certain micro and small companies, and increased small and medium size thresholds for companies and groups.

The main purpose of the Act was to transpose the EU Accounting Directive 2013/34/EU into Irish law, amending the Companies Act 2014 to give effect to the provisions in the Accounting Directive relating to the statutory financial statements and related reports of companies.

The Act sets out new size criteria for companies and groups, and introduces a new "micro" category of company (old thresholds in brackets):

	Micro	Small	Medium
Net turnover	€700,000	€12m (€8.8m)	€40m (€20m)
Gross assets	€350,000	€6m (€4.4m)	€20m (€10m)
Employees	10	50	250

The new Act introduces a simplified regime for micro companies including exemption from disclosing directors' remuneration in the financial statements and from preparing a directors' report. Only small and micro companies are permitted to file abridged financial statements with the Companies Registration Office (CRO). Medium sized companies will be required to file full financial statements.

New ROI Section of the website

ICAS has set up a new [website](#) area to cover the main requirements for the accounting and auditing of Irish companies, including:

- Audit Regulations and Auditing Standards applicable in Ireland;
- Guidance on financial reporting requirements in Ireland; and
- Information on the Irish Auditing and Accounting Supervisory Body (IAASA).

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.

From 2018, there will be annual courses in Aberdeen; Glasgow; and Edinburgh, in addition to rotating various other locations. For further details, including dates and locations for all 2018 courses, please search for ‘*keeping audit on the right track*’ on [icas.com](#)
