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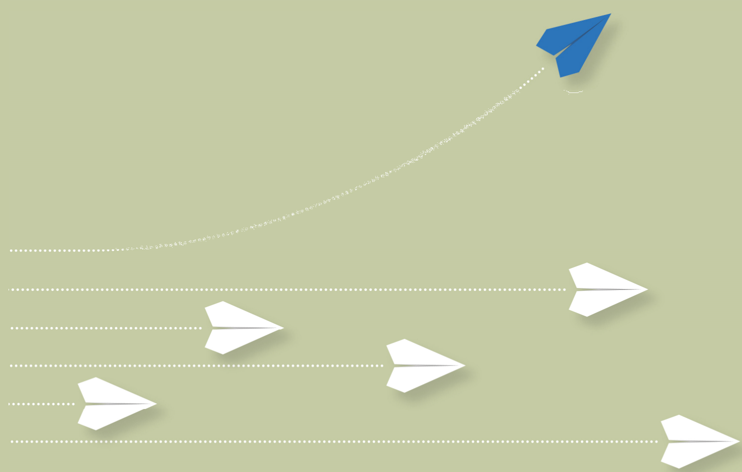

Changes to UK Ethical and Auditing Standards

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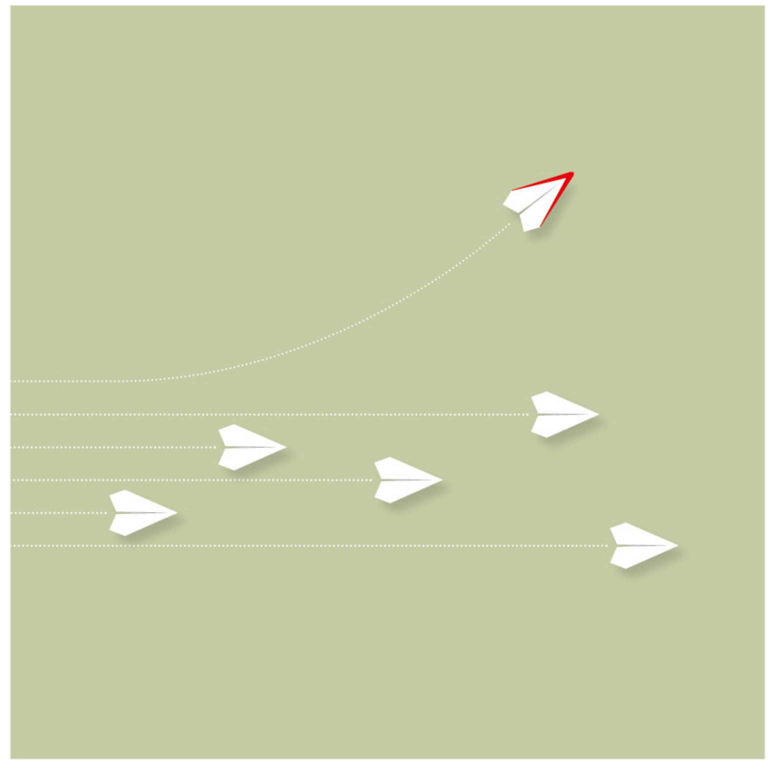

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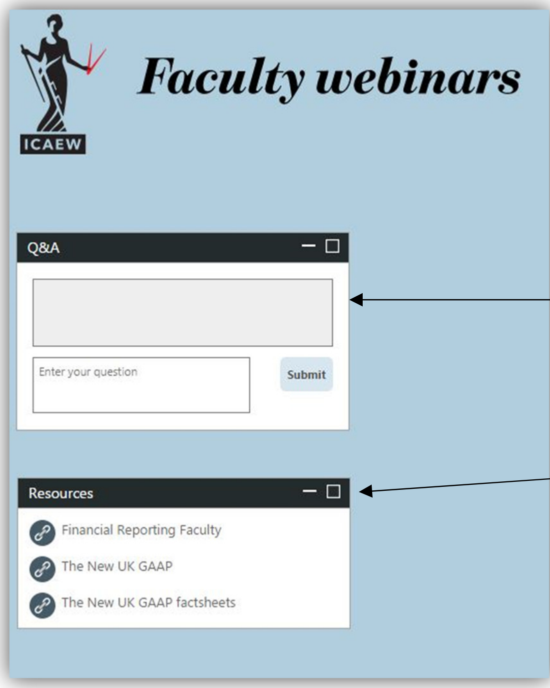

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Type your question into the question box then click submit.

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- Other changes

Questions

Changes to the Ethical Standard

Changes to the Ethical Standard

Overview

- In December 2019 the Financial Reporting Council published an updated Ethical Standard.
- It aims to further strengthen auditor independence and enhance confidence in the profession.
- Many of the changes reflect matters identified in the recent debate surrounding the Kingman, Brydon and CMA reviews, or have been driven by stakeholder sentiment.
- The Standard became mostly applicable from 15 March 2020.

Changes to the Ethical Standard

Third party Test

- Clearer and stronger objective, reasonable and informed third party test
- Ethical principles take priority over rules
- Greater focus on the spirit and the principles of the Standard

Changes to the Ethical Standard

Public Interest Entities (PIEs)

- The definition of a PIE in the UK has remained largely unchanged since June 2016. A PIE in the UK is:
  - An entity with listed securities, shares or debt, on an UK Regulated Market
  - A Credit Institution; (e.g. banks and building societies).
  - An insurance undertaking, other than mutual insurers and insurance brokers.

Changes to the Ethical Standard

Public Interest Entities (PIEs)

- ‘List’ of permitted non-audit services
- Services expected to be provided by the auditor – required by law and regulation
- Reporting accountant services still permitted – but fee cap applies to certain services

Changes to the Ethical Standard

- **Other entities of public interest (OEPIs)**

  - PIE permitted list of NAS applies to OEPIs
  - Effective date – 15 December 2020

Changes to the Ethical Standard

New restrictions applicable to all audited entities

- Prohibition on contingent fees
- Prohibition of secondments to audited entities (loan staff)
- Prohibition on Internal Audit services

Changes to auditing standards

Changes to the ISAs

Overview

- FRC have made a number of amendments to the ISAs for periods commencing on or after 15 December 2019
- These are in addition to the revisions to ISA (UK) 540 on auditing accounting estimates (and the conforming amendments)
- Need to consider the impact for short periods
- Some of the requirements are relatively minor, such as removing references to EU Regulations and Directives
- Other changes are more substantial – for example the updates to ISA (UK) 570 Going Concern

Going concern

New, stronger standard

- Issued in response to recent enforcement cases and well-publicised corporate failures
- Increases the work auditors are required to do when assessing whether an entity is a going concern
- Introduces more transparency in reporting
- Includes a stand back requirement
- For entities applying the UK Corporate Governance Code, more guidance on expected procedures to perform in relation to the principal risks and viability statement

Going concern

More focused risk assessment procedures

- More detailed requirements around the auditor's risk assessment and obtaining an understanding of:
    - the entity and its environment
    - applicable financial reporting framework
    - the entity's system of internal control
    - the entity's risk assessment process
    - the entity's information system and related business processes
- Management is required to perform a going concern assessment for all audits – not just those where events or conditions are identified that could indicate a material uncertainty

Going concern

More focus on evaluating management's assessment

- As part of evaluating management's assessment, the auditor is required to:
  - Evaluate management's method to assess going concern
  - Evaluate the relevance and reliability of the underlying data
  - Evaluate the assumptions on which the assessment is based – including whether appropriate in the context of the financial reporting framework, whether consistent with each other and related assumptions used in other areas
  - Evaluate plans for future actions
  - Consider whether any additional facts or information have become available since the date management made its assessment
  - Request written representations
- Again, the above are required for all audits – not just those where events or conditions are identified that could indicate a material uncertainty

Poll

Do you think the above change will lead to a significant increase in the work required on going concern for ALL audits?

- Yes
- No

Going concern

Reporting implications – Listed, PIE and large private

(d) For public interest entities, other listed entities, entities that are required, and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code, and other entities subject to the governance requirements of The Companies (Miscellaneous Reporting) Regulations 2018,[4c] an explanation of how the auditor evaluated management's assessment of the entity's ability to continue as a going concern and, where relevant, key observations arising with respect to that evaluation.

Essentially means report in a similar manner to key audit matters (although it may not be a KAM). Guidance in para A27-1 states:

[T]he auditor may describe:

- *Aspects of the auditor's response or approach that were most relevant to the evaluation of management's assessment.*
- *A brief overview of the procedures performed by the auditor.*
- *An indication of the outcome of the auditor's procedures.*

Going concern

Reporting implications – Listed, PIE and large private

An entity is subject to the governance requirements of The Companies (Miscellaneous Reporting) Regulations 2018 if it meets either or both of the following criteria:

- more than 2,000 employees,
- has turnover of more than £200 million and a balance sheet of more than £2 billion,

but is not:

- required to make a Corporate Governance Statement under DTR 7.2, or
- a community interest company, or
- a charitable company.

Going concern

Reporting implications – unlisted, non-PIE and small private

More positive conclusion related to going concern:

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis

Going concern

Reporting implications – unlisted, non-PIE and small private

More positive conclusion related to going concern:

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the director's use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the [entity]'s ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Reporting on irregularities

Focus on fraud and non-compliance with laws and regs

ISA (UK) 700 has a new requirement that applies to <u>all entities</u>:

The auditor's report shall explain to what extent the audit was considered capable of detecting irregularities, including fraud.

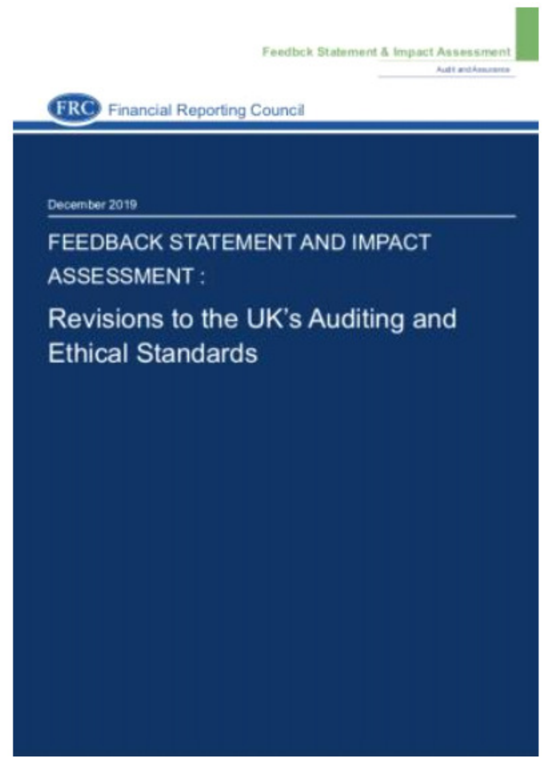
Previously this requirement only applied to (EU) Public Interest Entities

Reporting on irregularities

FRC position

FRC's feedback statement stated:

The FRC does not envisage that the additional requirements in ISA (UK) 700 should automatically lead to a prevalence of 'boilerplate' language. Where audit firms feel that the language in their reports is becoming 'boilerplate' in nature, they should seek to review and improve their reporting processes so that audit reports provide salient information to users.



Reporting on irregularities

PIE examples

EXPLANATION AS TO WHAT EXTENT THE AUDIT WAS CONSIDERED CAPABLE OF DETECTING IRREGULARITIES, INCLUDING FRAUD

The objectives of our audit are to identify and assess the risks of material misstatement of the financial statements due to fraud or error; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud or error; and to respond appropriately to those risks. Owing to the inherent limitations of an audit, there is an unavoidable risk that material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs (UK).

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- We obtained an understanding of the legal and regulatory frameworks applicable to the Group and parent company and industry in which it operates. We determined that the following laws and regulations were most significant: IFRS, Companies Act 2006, UK Corporate Governance Code, Statement of Recommended Practice and the relevant provisions of HMRC's regulations applicable to an Investment Trust Company;
- We understood how the Group and parent company are complying with those legal and regulatory frameworks by, making enquiries to the management. We corroborated our inquiries through our review of board minutes and papers provided to the Audit Committee.

We assessed the susceptibility of the Group and parent company's financial statements to material misstatement, including how fraud might occur. Audit procedures performed by the Group engagement team included:

- identifying and assessing the design effectiveness of controls management has in place to prevent and detect fraud;
- challenging assumptions and judgments made by management in its significant accounting estimates;
- identifying and testing journal entries, in particular any manual journal entries made at the year end for financial statement preparation;
- assessing the extent of compliance with the relevant laws and regulations as part of our procedures on the related financial statement item.

We did not identify any key audit matters relating to irregularities, including fraud.

Reporting on irregularities

PIE examples

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Group and industry, we identified that the principal risks of non-compliance with laws and regulations related to compliance with the Real Estate Investment Trust (REIT) status section 1158 of the Corporation Tax Act 2010 and the UK and European regulatory principles, such as those governed by the Financial Conduct Authority, and we considered the extent to which non-compliance might have a material effect on the financial statements of the Group and Company. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006 and the Listing Rules. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or reduce expenditure, and management bias in accounting estimates and judgemental areas of the financial statements such as the valuation of investment properties. Audit procedures performed by the Group engagement team included:

- Discussions with management and internal audit, including consideration of known or suspected instances of non-compliance with laws and regulations and fraud, and review of the reports made by management and internal audit;
- Understanding of management's internal controls designed to prevent and detect irregularities, risk-based monitoring of customer processes;
- Assessment of matters reported on the Group's whistleblowing helpline and the results of management's investigation of such matters;
- Reviewing the Group's litigation register in so far as it related to non-compliance with laws and regulations and fraud;
- Reviewing relevant meeting minutes, including those of the Risk Committee and the Audit Committee;
- Review of tax compliance with the involvement of our tax specialists in the audit;
- Designing audit procedures to incorporate unpredictability around the nature, timing or extent of our testing of expenses;
- Testing transactions entered into outside of the normal course of the Group's and Company's business;
- Procedures relating to the valuation of investment and development properties, either held directly or within joint ventures, described in the related key audit matter below; and
- Identifying and testing journal entries, in particular any journal entries posted with unusual account combinations, posted by unexpected users and posted on unexpected days.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Reporting on irregularities

Practical challenges

- Need to avoid boilerplate but what to say and how long?
- Need to identify relevant laws and regulations as well as fraud issues
- No option to refer to KAMs for more detail for unlisted entities
- If matters to be disclosed are identified, what to say in response
- Perception issue – eg could use of the term “fraud” in this section be misinterpreted?
- Will this lead to a change in approach – need to consider as part of planning – eg not rebutting the presumed risk of fraud in revenue recognition, potentially more fraud risks
- Additional review processes – can’t assume all non-listed reports will be the same

Other changes

- ISA 701 requires the disclosure of performance materiality and the judgements made when determining both materiality and performance materiality
- A key reason for the change to disclose performance materiality was that the FRC thought this provides important insights into the auditor's assessment of the effectiveness of internal control in an audited entity.
- ISA 720 has more guidance on the expectations of auditors in respect of other information

Summary

- Talk to management now about the increased expectations on them in respect of going concern and make them aware of the reporting changes
- Expect more focused and granular work on going concern for all audits
- Consider for irregularities whether the risk assessment needs to be revisited and how to tailor the audit report to the circumstances of the entity

Any questions?

Upcoming faculty webinars

Date	Title
17 August	Remote auditing in practice
17 September	Identifying and assessing risk under ISA 315 (Revised)

For details, please visit **icaew.com/aafevents**

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