Technical Release

Issues for auditors arising from the implementation of FRS 102

The Financial Reporting Standard applicable in the UK and Republic of Ireland

Guidance issued in September 2014 by ICAEW's Audit and Assurance Faculty.

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ISBN 978-1-78363-161-2

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1 Introduction

1. FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* is a single financial reporting standard which replaces almost all existing UK accounting standards. It is effective for accounting periods beginning on or after 1 January 2015, with early application permitted for accounting periods ending on or after 31 December 2012 provided that this does not conflict with the requirements of a current SORP or legal requirements for the preparation of financial statements.

2. FRS 102 will be applied by all entities which are neither required nor elect to apply: EU-adopted IFRSs; FRS 101 *Reduced Disclosure Framework*; or the FRSSE[1]. It will therefore be applied by the majority of large and medium-sized UK entities, including public benefit entities, retirement benefit plans and financial institutions.

3. FRS 102 is based on the IASB standard IFRS for SMEs but the text has been amended in some significant respects in order to: comply with the Companies Act; allow additional accounting policy choices so that, where a policy choice has previously existed in UK GAAP and this is aligned with IFRSs, the choice also exists in FRS 102; and reflect feedback during the consultation process.

4. As the new standard is based on the IFRS for SMEs, there are a number of key differences between previous UK GAAP and FRS 102. Areas where the accounting treatment under FRS 102 is substantially different from previous UK GAAP include – but are not limited to – financial instruments, investment properties, business combinations, deferred tax and defined benefit pension schemes. Which differences will have the biggest impact will depend entirely on the individual circumstances of each entity. This guidance covers some of the aspects of the FRS 102 requirements in a limited way, for example, to illustrate matters of concern to the auditor. However, **this guidance should not be regarded by auditors as a substitute for reading FRS 102 itself**.

5. As the standard is effective for periods beginning on or after 1 January 2015, and comparatives will be required, companies and other entities should be considering the options available to them and the degree of change to their financial reporting. In many cases, this will mean significant work and challenges for these entities.

6. There are also significant implications for the auditors of the entities subject to this change and this guidance addresses the key issues of concern to those auditors. It covers the technical and process challenges arising for them and the risks that they will need to address. Auditors should consider at an early stage both what they should expect the entities they are auditing to be doing (see section 3) and also what they should be doing themselves (see section 4). Auditors should take early action and advise the entities they are auditing to start preparing for transition as early as possible, if they have not done so already.

7. Many entities implementing FRS 102 are likely to benefit from the support of their auditors in the transition process. However, there are important ethical matters for auditors to consider if entities request assistance from them (see section 2). Many of these entities will be owner-managed businesses or other entities that may not have a clear and formal distinction between management and those charged with governance. As a result, this guidance normally refers to management, but this term should be taken to include those charged with governance where the context requires.

8. This guidance has been informed by experience of IFRS implementation and previous guidance issued on this, including the ICAEW Audit and Assurance Faculty Technical Release Audit 03/04 *Auditing Implications of IFRS Transition*. Audit 03/04 remains in place. For those entities applying FRS 101 *Reduced Disclosure Framework*, Audit 03/04 may be relevant. These entities will need to consider whether they are qualifying entities as defined by FRS 101 and have met the conditions for applying the standard.

9. This Technical Release intends to provide technical and practical guidance for members in the short term to assist them with their audits of entities implementing FRS 102 and, more broadly, it is hoped that it will contribute to successful FRS 102 implementation. However, it is also likely that many of the matters referred to in this guidance will remain relevant to future audits as well.

10. Appendix 1 covers technical issues for the auditor on compliance with specific ISAs and ISQC 1, and outlines what those issues are and what is required of the auditor with respect to them. The auditing standards featured in appendix 1 are key ones to consider as part of practical FRS 102 implementation, but appendix 1 is not intended to provide a comprehensive guide – it is necessarily limited in the standards it covers and in the way it describes the issues. **Appendix 1 should therefore not be regarded as a substitute for reading the ISAs and ISQC 1 themselves**.

11. ICAEW is providing members with support to help them with the implementation; in particular, the Financial Reporting Faculty is providing a range of resources to help members manage the changes that lie ahead. More specific information on this is provided in appendix 2.

12. A glossary of terms and abbreviations used is set out in appendix 3.

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1 The FRC has announced plans that may see the FRSSE withdrawn, with small entities – other than micro-entities – brought within the scope of FRS 102, albeit with reduced disclosures.

2 Ethics and FRS 102

13. In principle, the change to FRS 102 is no different from any other change in accounting framework, and many of the ethical issues that arise will be the same as those that have faced entities, and the auditors of those entities, that have moved from UK GAAP to IFRSs. However, the scope of the change to FRS 102 is far broader and, consequently, a much greater range of entities will be affected. While some of the entities moving to FRS 102 will have significant internal resources available to deal with the transition, many more will be relatively small, with limited accounting resources. For such entities, the prospect of moving to a different framework may appear daunting and many may look to their auditor for help in completing the transition.

14. Both management and the auditor have a role to play in achieving successful implementation of FRS 102, but caution is required where the auditor is involved. Auditors need to remain independent of audited entities, and are bound by the APB Ethical Standards (ESs) which place limits on the services they can provide.

15. For entities moving to FRS 102, the assistance that the auditor provides to facilitate the transition to FRS 102 with minimal disruption cannot compromise the requirement for the auditor to retain independence.

Services

16. For larger entities, the auditor may receive requests to audit, review or otherwise report on various forms of financial and non-financial information that has been prepared by management in the course of the transition process.

17. By contrast, smaller entities may be more likely to seek accounting advice or assistance on adoption of the new standard.

18. Whenever auditors are requested to provide non-audit services to audited entities, they are required to consider the potential for the provision of these services to create a threat to their objectivity or a perceived loss of independence. More specifically, the ESs require that before any non-audit service is provided, the auditor has to identify and assess the significance of any threats to the auditor's objectivity, including any perceived loss of independence. The threats that need to be considered are:

    - self-interest threats
    - self-review threats
    - management threats
    - advocacy threats
    - familiarity or trust threats and
    - intimidation threats.

19. If any threats are identified, then the auditor is required to identify and assess the effectiveness of any safeguards available to them that might eliminate or reduce those threats to an acceptable level. If adequate safeguards cannot be applied, the work cannot be performed.

Threats

20. While all of the threats listed above should be considered by the auditor when asked for assistance on an entity's transition to FRS 102, the two key threats are likely to be the self-review threat and the management threat.

    Self-review threat
    A self-review threat exists when the results of a non-audit service performed by the engagement team or by others within the audit firm are reflected in the amounts included or disclosed in the financial statements.

    Management threat
    A management threat exists when the audit firm undertakes work that involves making judgements and taking decisions that are properly the responsibility of management.

    For further information, see ES 1.

21. The following subsections deal with some of the services that may be requested, how threats may arise and, where possible, how they can be mitigated.

Non-audit services

22. The following services are those likely to be of particular relevance to auditors of entities transitioning to FRS 102:

- accounting services
- valuation services and
- tax services.

23. The ESs provide some specific requirements and guidance in relation to these services.

Accounting services

24. The basic requirement is that:

'… the audit firm shall not undertake an engagement to provide accounting services to an audited entity that is a listed company or a significant affiliate of such an entity [except in certain circumstances] or any other audited entity, where those accounting services would involve the audit firm undertaking part of the role of management.'

25. The ESs explicitly exclude advice on the implementation of current and proposed accounting standards from the definition of accounting services. This is a very helpful starting point in considering the provision of assistance in transitioning to FRS 102.

26. The ESs also note that it is usual for the auditor to provide advice to management on the accounting policies in use and on the application of current and proposed accounting standards. But this is in the situation where such matters come to the auditor's attention during the course of the audit and the advice is a by-product of the audit service rather than the result of any engagement to provide non-audit services.

27. The ESs recognise that the audit process involves extensive dialogue between the auditor and management. As part of this process, management may request and receive significant input on such matters as accounting principles and financial statements disclosures. Such advice to management may be seen as an appropriate part of the audit process that promotes the fair presentation of financial statements.

28. However, in providing such advice, the auditor should guard against giving bookkeeping advice and making specific accounting entries, where these go beyond the technical, mechanical or informative nature mentioned in ES 5 *Non-audit services provided to audited entities*, both of which create potential self-review threats to the auditor's independence. Accordingly, although such advice is important in many audits, and will assist with any issues identified once entities have moved to FRS 102, it does not mean that the auditor is permitted to make recommendations about the many policy and practice choices that might arise in the process of moving to that standard.

29. Some entities may opt to undertake their own impact assessments of the transition to FRS 102, select the accounting policies and transitional provisions to be applied on transition and decide on the form of presentation to be adopted, without reference to the auditor. Having done so, they will often (and indeed should) ask the auditor for the auditor's views on the accounting policies and other matters that they have considered.

30. In such cases, when the auditor is asked to provide views, the communication should be restricted to a factual analysis of the entity's selected accounting policies and practices and whether they are consistent with the requirements of FRS 102. It should avoid including any statement that could reasonably be mistaken for an audit, review or other assurance engagement. For example, it would not be appropriate for the communication to include commentary that appears to express a conclusion on the application of the selected accounting policies because the auditor will not have obtained evidence regarding their application to actual transactions and events or the preparation of a complete set of financial statements.

31. Other entities may lack the resources to undertake a full impact assessment in relation to FRS 102 and may therefore expect to make use of their auditor for this purpose.

32. When considering the extent to which the auditor may provide advice on the transition to FRS 102, it should be clearly established that management retains full responsibility for all financial information and the basis on which it is prepared and presented. That responsibility includes application of the judgement required for the preparation and presentation of the financial information, including the selection and application of appropriate accounting policies and, where needed, the development of reasonable accounting estimates.

33. Consequently, entities cannot simply subcontract the transition to FRS 102 to their auditor and ask them to make decisions about the preparation and presentation of financial statements under the new standard. Management should retain overall control of the process at all stages and should make all of the relevant decisions.

34. In situations where entities do not employ a qualified accountant and management does not have significant accounting experience, they may not feel confident in undertaking an assessment alone. In such situations, the auditor should consider whether there is 'informed management'.

35. The ESs state that, in determining whether a non-audit service gives rise to a management threat, the auditor needs to consider whether there is informed management. Informed management is defined as follows.

Informed management
'… a member of management (or senior employee) of the audited entity who has the authority and capability to make independent management judgments and decisions in relation to non-audit services on the basis of information provided by the audit team.'

Example I – staff secondment to an audited entity

An entity has requested a secondee from its auditor to assist in the preparation of the FRS 102-compliant financial statements. The auditor is already engaged to audit the first financial statements prepared in accordance with FRS 102.

Such an assignment creates several threats to the auditor's independence. In particular, it creates a management threat – this loan staff assignment potentially involves the secondee taking management decisions or initiating transactions – and a self-review threat.

The safeguards employed by the auditor should be sufficient to reduce the threats to an acceptable level and should include:

- limiting the length of the secondment;
- asking management to undertake, in writing, to remain solely responsible for managing all aspects of its business and to represent that it has the requisite skill, availability and ability to supervise the secondee during the secondment;
- ensuring that the secondee does not perform any services that would not be permitted under ES 5;
- on return, the staff member should have no involvement in that part of the audit which may result in a self-review threat for an appropriate length of time; and
- ensuring that audit files demonstrate that the entity has taken all management decisions including determining the appropriateness of accounting policies, accounting journals and accounting estimates.

The auditor should clearly establish respective responsibilities in relation to the secondee's work through an engagement letter.

36. For accounting services, informed management is generally a prerequisite and other safeguards, as mentioned below, will be necessary. If ES *Provisions Available for Small Entities* applies, informed management may be a sufficient safeguard together with extended quality control inspections. Management must have the capability to make independent management judgements on the service, the authority to make any judgements and decisions required and receive an objective analysis of the issues the entity needs to consider, with reasonable alternatives, from which it can decide on an appropriate course of action.

37. In the context of the transition to FRS 102 this means that the auditor can assist in identifying the choices that need to be made and discuss these with management. What they should not do is make any of those choices for management. It should be clear that management has made all of the important decisions and consequently that the financial statements reflect management's accounting policies, management's transitional choices and management's preferred methods of presentation.

38. Even where the auditor has not made decisions on behalf of the entity and has acted within the parameters set by the ESs, this does not mean that the threats are eliminated entirely. The auditor should still consider any other safeguards that may be appropriate, depending on the auditor's level of involvement. The use of further safeguards will depend upon the extent of that involvement, but might include the use of different individuals to discuss the accounting policy choices from those involved in the audit, or the review of the financial statements on transition by a person not otherwise involved with the audit engagement.

Valuation services

39. On transition to FRS 102, many entities will be required to carry more items at a valuation than under their previous GAAP. For example, many financial instruments, including derivatives such as forward contracts or interest rates swaps, will need to be measured at fair value. This may mean that, where an entity is not familiar with the valuation techniques commonly used for such items, they may ask the auditor for assistance with the valuations (see example IV below paragraph 74 in section 4).

40. The ESs state that a valuation comprises the making of assumptions with regard to future developments, the application of appropriate methodologies and techniques, and the combination of both to compute a certain value, or range of values, for an asset, a liability or for a business as a whole.

41. There are strict prohibitions on provision of valuations by the auditor. The auditor shall not undertake an engagement to provide a valuation to either:

- an audited entity that is a listed company or a significant affiliate of such an entity, where the valuation would have a material effect on the listed company's financial statements, either separately or in aggregate with other valuations provided; or
- any other audited entity, where the valuation would both involve a significant degree of subjective judgement and have a material effect on the financial statements either separately or in aggregate with other valuations provided.

42. The main threats to the auditor's objectivity and independence arising from the provision of valuation services are self-review and management threats. In all cases, the self-review threat is considered too high to allow the provision of valuation services which involve the valuation of amounts with a significant degree of subjectivity and which have a material effect on the financial statements.

43. It is usual for the auditor to provide management with accounting advice in relation to valuation matters that have come to the auditor's attention during the course of the audit. Such matters might typically include:

- comments on valuation assumptions and their appropriateness;
- errors identified in a valuation calculation and suggestions for correcting them; and
- advice on accounting policies and any valuation methodologies used in their application.

44. Advice on such matters does not constitute valuation services.

45. Similarly, where the auditor is engaged to collect and verify the accuracy of data to be used in a valuation to be performed by others, such engagements do not constitute valuation services.

46. Where valuations are largely objective, for example valuing investments in a listed company's shares as market prices are commonly available, the auditor can discuss potential sources of data with management. Where valuations include more subjective elements, for example valuing investments in a private company's shares, the auditor can again discuss the basis of valuation but should not become involved in making any of the assumptions that need to be made in arriving at the valuation. This may involve discussions on the mechanics of valuations and then allowing management to make its own assessments. In some situations the auditor may advise the entity to use the services of a third party with appropriate expertise in the area.

47. It should be noted that, in some limited cases, FRS 102 does not require entities to obtain a valuation where one would normally be needed if doing so would involve undue cost or effort. For example, this exemption might be applied to certain investment properties and investments in associates and jointly controlled entities. In such circumstances the decision on whether the cost of obtaining valuations outweighs the benefit should be made, and supported, by management (see paragraph 111 fifth bullet in section 4 regarding the auditor's consideration of 'undue cost or effort').

Tax services

48. Other than in an emergency situation, the auditor is prohibited from providing tax services to a listed entity or a significant affiliate of a listed entity which would involve the preparation of current or deferred tax calculations that are, or may reasonably be expected to be, used when preparing accounting entries that are material to the financial statements of the audited entity.

49. For entities other than listed companies or significant affiliates of listed companies, the auditor may prepare current or deferred tax calculations for the purpose of preparing accounting entries, provided that those services do not involve initiating transactions or taking management decisions and are of a technical, mechanical or an informative nature, and appropriate safeguards are applied.

50. This means that most entities now applying FRS 102 will not be subject to the more stringent requirements described in paragraph 48 above. Nonetheless, the auditor should take care to ensure that the services provided are limited to the technical, mechanical and informative nature mentioned in the ESs.

51. In many cases there will be tax implications of transitioning to FRS 102, in that accounting policy choices made, both on transition and thereafter, may have an effect on tax liabilities. The auditor should bear this in mind when discussing the policy choices made on transition and ensure that those policies, with their attendant tax implications, really are those of management.

Example II – providing tax services to an audited entity

The entity has requested the firm to provide advice on the tax consequences that might arise on the adoption of FRS 102. The entity is an audited entity (but not a listed entity or a significant affiliate of such an entity) and the auditor is already engaged to audit the first financial statements prepared in accordance with FRS 102. The entity's activities are reasonably complex and there are a number of areas where there is a choice of accounting policy to be adopted. In some of these cases the choice of accounting policy adopted will affect the reported and/or taxable profits.

This situation creates threats to the auditor's independence, primarily a management threat but also a self-review threat. The management threat arises since the firm could be seen to be making management decisions in selecting accounting policies for the entity on the basis of their tax consequences. There is also a self-review threat, if the auditor was to be seen as having been involved in the selection and application of accounting policies, as it could then be required to consider the appropriateness of those policies as part of the audit.

The auditor should therefore apply safeguards to reduce these threats to an acceptable level. Having separate individuals, not part of the audit team, provide the advice would be an obvious first step but is unlikely to be considered sufficient. Of greater importance is ensuring that the nature of the advice provided is appropriate by, for example:

- setting out those areas where accounting policy choices are available and summarising for each policy the tax consequences on both transition and on an ongoing basis;
- making clear that the accounting policy choices should be those of the entity's management, and that if a policy is not specifically addressed in FRS 102 then it should be developed in accordance with the criteria set out in section 10 of that standard; and
- requesting that management provides a response detailing the accounting policy choices it has made including, where appropriate, the rationale for those choices.

Other non-audit services

52. The guidance in this section is not exhaustive and its addressing of non-audit services is limited to those issues that are considered to be most relevant to an entity transitioning to FRS 102. The auditor will also need to consider any other non-audit services which could create a threat to the auditor's objectivity or a perceived loss of independence, for example providing information technology services to an audited entity to design, provide or implement systems relating to the production of financial statements as a result of the introduction of FRS 102.

3 Issues for audited entities – what the auditor should expect management to be doing

Questions that the auditor might wish to ask management

53. The combination of complexity and potential lack of preparation for the transition to FRS 102 can result in an increased challenge for auditors as they prepare to audit an entity's opening balance sheet as of its date of transition and its first financial statements that conform to the standard.

54. In order to assess the quality of the entity's transition process and readiness and identify any key risk areas, the auditor may wish to ask the following questions of management at an early stage in the transition process.

- Has management laid out a realistic and achievable timetable for transition to FRS 102?
- Has management got commitment throughout the organisation as needed (eg, board, subsidiaries or other business units, IT)?
- Has management properly assessed the extent to which it has resource with the necessary skill and knowledge to manage the transition process?
- Does management have sufficient access to the specialist expertise that will be required in applying some of the accounting policies required by FRS 102, such as valuations?
- Has management rigorously evaluated the significance of the changes that will affect the entity on transition to FRS 102 (eg, identification and classification of financial instruments)?
- Is the entity undertaking a thorough exercise to understand the accounting policy changes necessary on transition to FRS 102?
- Have the wider impacts of transition (eg, dividend planning, profit-related remuneration schemes) been identified and assessed?
- Does management have records of their distributable reserves, separate to the financial statements?
- Has management consulted with advisers, including considering possible tax elections which may need to be made?
- Has consideration been given to whether or not systems and processes are able to capture sufficient, reliable data that will now be required in order to produce financial statements that comply with FRS 102?
- Has management communicated details of the change to shareholders and other stakeholders?
- Has management reviewed bank covenants whose terms are linked to the financial statements (eg, interest cover or gearing ratios) and contacted lenders to renegotiate the terms of such borrowings if necessary?

Implementation of the project plan

55. The auditor will need to gain an appropriate understanding of the following elements of management's implementation.

a) Clarification of the responsibilities of management

56. The auditor should remind management that it is responsible for the implementation of FRS 102 and management should have considered carrying out an analysis of the impact on the business. In addition, certain legislation for specific types of entity (eg, companies, charities and LLPs) imposes specific requirements on the management of those entities. Management will also need to ensure that there are appropriate plans to train staff, update accounting systems, and implement changes in reporting encompassing all significant business units.

b) Establishing a timeline for transition

57. Planning for the transition process at an early stage is essential and will help management to identify areas where additional external input may be needed and what form that might take. Management should produce an initial timeline in consultation with the auditor and other stakeholders mentioned below. In preparing the transition timeline, the needs of all external stakeholders and availability of advisers should be taken into consideration as well as those of staff of the entity.

c) Communicating the changes

58. Management is responsible for the timely and appropriate communication of any changes arising from the implementation of FRS 102 that could impact key stakeholders.

- Communicating with shareholders
  - Management should clearly explain the likely impact of FRS 102 on key metrics, distributable profits and future dividend plans. Certain new and sensitive disclosure requirements in FRS 102 should also be explained, such as the discussion of critical judgements and disclosure of key management compensation.
  - If the parent entity within a group, or any subsidiary, is planning to make use of any of the disclosure exemptions in FRS 102 that are available to qualifying entities in their separate financial statements, management must inform all shareholders of this in advance in writing and allow reasonable time for objections to be registered.

- Communicating with other stakeholders
  - Management should open lines of communication with third-party lenders early to explain the potential impact on net assets and profitability when transitioning to FRS 102 and identify whether the changes will affect any loan covenants in place, allowing time to renegotiate if necessary.
  - Where any contractual arrangements exist that specify that accounts are prepared under a specific GAAP, management should review those contracts and consider negotiating with the counterparty to amend the terms of the contract to remove any scope for confusion about the intended accounting framework.
  - Where an entity is the recipient of grants or other contracts that impose obligations on the entity, management should discuss the potential impact of transitioning to FRS 102 with the grantor or counterparty.

- Communicating with the auditor
  - It is critical that management understands the extent to which the auditor can and cannot assist with transition (see section 2), as this will affect the extent to which management may need to seek input from other external advisers. Detailed discussions between management and the auditor should therefore take place at an early stage in proceedings to establish the degree of support that the auditor will be able to provide throughout the transition process.
  - Where management has identified significant areas of accounting judgement, these should be communicated to enable the auditor to plan appropriate procedures for those areas.
  - Management should agree an appropriate timeframe with the auditor for the audit to take place, taking into consideration the additional procedures that may be required as a result of the transition (see section 4).
  - Management may seek consideration of the opening balance sheet and transitional adjustments prior to the audit of the first full FRS 102 financial statements. Where this is the case, the auditor will need to be notified at an early stage in order to plan the procedures to be undertaken for any such transitional adjustments. Depending upon the scope of the work to be undertaken, these procedures may form part of the audit or be a separate engagement. This will need to be agreed.

- Communicating with tax advisers
  - The assessment of the tax impact of transition can be complex and often requires early input and consideration, particularly in making any elections that may be available. Management should therefore involve tax advisers as early as possible in the transition process to ensure that the tax implications of transition are fully understood and any adverse implications are managed effectively.

d) Assessing the need for resource and identifying training requirements at an early date

59. The extent to which additional resources are required will depend on the complexity of the accounting and information systems issues. At the beginning of the process it is essential that management carefully assesses and plans for the number and skills of staff required for a timely and effective transition, and the extent to which support will be required from external advisers.

60. Management should assess the training required for employees, which may well extend beyond the finance function, and decide on the most appropriate approach to providing such training. For groups, the assessment should include the needs of the finance teams of individual entities within a group as well as the group finance function.

e) Identifying differences between current accounting policies and FRS 102

61. It is important that the transition process starts with a comprehensive assessment of the differences between the current accounting policies applied under existing GAAP and the requirements of FRS 102. Some policies will need to be changed and new policies will need to be adopted. In several cases, management will be faced with a choice in the selection of an accounting policy. There may also be instances where the standard does not prescribe a particular accounting policy. In such cases, management will need to develop an appropriate policy.

62. Once differences have been identified, management will need to understand the financial reporting impacts of the available accounting policy choices, so that informed decisions can be made. Management will also need to take responsibility for the decisions as to which accounting policies are selected and applied.

63. Other considerations for management will include:

- assessing the transitional exemptions available on first-time adoption of FRS 102 and deciding which, if any, will be applied;
- discussion of the selection of accounting policies with the auditor, particularly where FRS 102 is silent; and
- the need to obtain valuations eg, for certain financial instruments, and the cost involved in obtaining such valuations.

f) Identifying changes in financial data and additional information to meet the revised requirements

64. Once the accounting issues have been identified, the impact on systems and processes can be assessed. Any changes will need to be implemented in a sustainable and structured way to allow for ongoing capture of the requisite data, both for the purposes of preparing the primary statements under FRS 102 and to ensure that the information required to be disclosed in the notes to the financial statements is obtainable. The information might also be useful to the business on an ongoing basis.

65. Areas that management should consider include:

- disclosure requirements that might necessitate the capture of new or more detailed data – eg, financial instruments;
- whether the extent and level of data currently captured is sufficient to provide enough information to prepare financial statements that are compliant with FRS 102;
- whether the current accounting system(s) in place are capable of capturing the required data;
- whether the entity has resources with the appropriate level of skills and expertise to generate all the financial data required under FRS 102; and
- the extent to which assistance will be required from external advisers.

Example III – considerations for management on transition

When considering the effects of transition on other areas of the business, management may choose to revisit the existing reporting structure and consider whether the individual business units (subsidiaries or divisions) will report in accordance with FRS 102 or whether the business units will provide the information to a central team who will then convert this to FRS 102.

g) Identifying the impact on wider business issues

66. As well as the impact on the financial statements, the entity's other business needs should be considered at as early a stage as possible, including:

- reviewing bank covenant arrangements and negotiating amendments as required;
- preparing forecasts and budgets on an FRS 102 basis, with an understanding of the differences between previous GAAP and FRS 102, incorporating a consideration of the impact of inclusion of assets/liabilities not recognised within the previous GAAP;
- establishing the impact on reserves and reviewing dividend policy and plans, particularly where the adoption of FRS 102 will reduce or eliminate distributable reserves;
- considering the impact, where applicable, on the calculation of deferred consideration on recent acquisitions;
- assessing the impact of conversion and subsequent accounting on the entity's taxation;
- where relevant, considering the current group structure and planning for any reorganisations or corporate simplification;
- reviewing remuneration and employee incentive schemes to understand the impact of FRS 102 on these and, if necessary, make any required adjustments (this may include liaison with trustees and/or union representatives as appropriate);
- impact on regulated businesses; and
- evaluating the need for assistance from external advisers.

h) Planning the transition process

67. The following actions should be undertaken by management in planning for the transition to FRS 102:

- identifying the data needed to generate the adjustments that are required to the opening balance sheet under FRS 102 and to prepare the financial statements on an ongoing basis under FRS 102;
- training relevant staff in FRS 102 and the changes to systems and processes as a result of the standard;
- developing template or 'pro forma' accounts for financial statements, budgets/forecasts and reporting packages;
- adjusting systems to reflect new accounting policies (for example updating regular automatic journals) or developing pragmatic solutions as necessary;
- testing the systems;
- if making substantial changes, parallel running the new systems for the transition period; and
- reporting 'live' FRS 102 information.

i) Implementing the changes

68. The actual transition process will include:

- preparation of an opening balance sheet under FRS 102 (for example, for entities with December year ends, this will be as at 1 January 2014) with an explanation for each adjustment to opening equity;
- identification, to the extent practicable, of any adjustments to opening equity that are due to errors under previous GAAP and separation of these from transitional adjustments;
- preparation of the figures for the comparative balance sheet date under FRS 102;
- preparation of the figures for the comparative period under FRS 102; and
- preparing the first FRS 102 financial statements.

Ongoing considerations for management

69. It should be recognised that the transition is merely the start of reporting under the revised GAAP and the auditor should expect management to continue to consider the accounting and disclosure requirements on an ongoing basis, including the impact on:

- structure and accounting for acquisitions;
- maintaining up-to-date valuations (eg, financial instruments);
- suitability of existing systems as the business expands;
- new transactions within the wider group in group situations;
- distributable reserves and dividend policies; and
- covenants and financing plans.

4 What the auditor needs to consider

Knowledge and training

a) Understanding the requirements of FRS 102

70. The first set of financial statements prepared under FRS 102 will need to include comparative information that is restated in accordance with the new standard and auditors will need to refer to ISA 710 *Comparative information – corresponding figures and comparative financial statements*. Auditors will need to plan and prepare for the transition of audited entities to FRS 102 in a timely manner, and it is likely that the auditor will need to dedicate more time and resources to the planning and project management of the audit. In particular, the auditor will need to consider carefully the timing of their involvement in the transition process of the audited entity and be familiar with their client's impact analysis.

71. To this end, the auditor will need to establish a clear training plan for audit staff to ensure that they are well versed in the requirements of FRS 102 in advance of the first audit of financial statements prepared under FRS 102.

72. FRS 102 will sometimes involve more subjectivity and judgement on the part of the financial statement preparer, and consequently a more significant level of auditor judgement in reaching the audit opinion. For example, more subjectivity and judgement is likely to be involved in the recognition and measurement of intangibles acquired in a business combination, the fair value of unlisted equity investments and the fair value of those financial instruments that will be recognised in the financial statements for the first time.

73. The auditor should design and implement a plan that focuses the training at the appropriate levels of staff and should aim for the implementation of that training plan at a time that is likely to be of most assistance to entities going through the transition process.

b) Resource needs

74. The auditor will need to consider the availability of suitable resource (whether internal or external) in the following areas.

- Technical expertise – following suitable training (as per next bullet), does the auditor have staff with appropriate expertise in the new framework?
- Training resource – does the auditor have access to suitable training resources, internally or externally, to ensure that staff have sufficient knowledge to undertake their role as part of the audit team?
- Training resource to offer to the audited entity – does the audited entity require assistance with education for its own staff in relation to the preparation of financial statements?
- Fair value accounting specialists or experts – does the auditor have access to staff within the firm who have a specialism or expertise in determining, accounting for and auditing fair values? Does the auditor have access to external valuation experts where the firm does not have adequate internal resource? Are those specialists and experts suitably trained on the changes arising in their area of specialism/expertise?
- Other experts – does the auditor have access to other expertise in areas that may be required eg, deferred tax?
- Valuation techniques – are all relevant staff familiar with appropriate valuation techniques permitted under the new financial reporting framework?

Example IV – involvement of fair value experts

If expertise other than in the field of accounting and auditing is necessary to obtain sufficient appropriate audit evidence, auditing standards require that the auditor considers whether there is a need to involve an auditor's internal or external expert in the audit process in order to obtain that evidence. The auditor determines whether an expert is needed to obtain audit evidence in relation to fair values. From the outset, the auditor is clear that the involvement of the expert in this respect is to provide the auditor with sufficient appropriate audit evidence concerning a fair value used by management in the preparation of the financial statements. The responsibility for determining an appropriate fair value rests with management and the involvement of an auditor's expert is not a substitute.

FRS 102 will require more extensive use of a 'fair value' in certain circumstances when determining appropriate amounts to recognise in the financial statements eg, in the valuation of non-basic financial instruments, the valuation of intangible assets or the valuation of biological assets and agricultural produce where the fair value model is chosen.

Therefore, the incidence of situations in which it will be appropriate to involve an auditor's expert is likely to increase.

The auditor needs to consider:
- whether appropriate resources are available within their organisation or whether experts would need to be engaged externally; and
- whether appropriate policies and procedures relating to the use of such experts are in place.

Where the work of an auditor's expert is used to provide audit evidence, the auditor will need to ensure that they have complied with the requirements of ISA 620 *Using the work of an auditor's expert*, particularly in relation to evaluating the adequacy of the work performed for the auditor's purposes.

Engagement considerations

a) Nature of engagement and providing assistance with transition

75. As discussed in section 2, many entities are likely to ask their auditor to provide advice, guidance and support during the transition period through to preparation of the first set of financial statements prepared for audit in accordance with FRS 102.

76. Entities may expect the auditor to provide assistance in determining whether FRS 102 is appropriate in their circumstances (rather than adopting IFRSs, FRS 101 or the FRSSE) and what the impact on the financial statements will be following adoption of FRS 102.

77. The auditor will need to consider to what extent management's requests for 'early assurance' or private reports can be met through performance of enhanced, early or interim audit procedures, or whether a separate assurance engagement or an agreed-upon procedures engagement would be more appropriate in the circumstances.

78. Audit firms may also be called upon by management to offer early consideration of an entity's state of readiness on FRS 102 information that is produced prior to the entity's first FRS 102 financial statements. Management may seek:

- views from the auditor on the appropriateness of accounting policies and interpretation of FRS 102;
- the auditor's consideration of the appropriateness of additional disclosures in the first published financial statements relating to transition to FRS 102;
- a consideration of 'parallel' or 'dry-run', non-statutory financial information prepared in tandem with financial statements under existing GAAP;
- agreement to, or opinion on, a proposed accounting treatment for a transaction proposed in the first reporting period under FRS 102; or
- an assessment of the impact of the adoption of FRS 102 on existing banking covenants or profit-related contracts.

79. In considering the nature and timing of such peripheral engagements, the auditor should be conscious of the fact that there are inherent difficulties in undertaking such engagements and potential ethical concerns (see section 2). Where the auditor determines that such work can be accepted, respective responsibilities should be clarified in writing.

80. In addition, the auditor should remain aware of and alert to any changes in or clarifications as a result of emerging practice that may arise as a consequence of applying a new and evolving framework.

81. Particular concerns for the auditor to resolve when considering what additional services to provide and whether it will be appropriate to provide those additional services may include:

- difficulty in reporting at an early stage because of the impact of changing interpretations of FRS 102 prior to the entity's first FRS 102 reporting date (the FRC may issue further clarification statements);
- uncertainty around the quality of the base data from which the FRS 102 information has been prepared, and whether this has been audited;
- the scope, rigour and completeness of the entity's transition to FRS 102 at the time of the assignment;
- the absence of comparative data, which could limit the effectiveness of analytical review that the auditor is able to do as part of their work; and
- the possibility that the accompanying preliminary/initial balance sheet may have to be adjusted.

82. Management may also ask the auditor to provide staff on a secondment basis to help with certain aspects of the financial reporting process. In such circumstances there is a risk that the auditor's involvement in the financial reporting process and transition to a new standard may give rise to threats to the auditor's independence which may ultimately compromise the auditor's ability to provide the audit service. The ethical considerations arising from implementation of FRS 102 are addressed in section 2.

83. Audit firms may need to consider whether there is a need to revisit and clarify partner and staff understanding of relevant ethical requirements, and may need to implement or refresh policies and procedures relating to the non-audit services that an auditor will and will not provide to audited entities.

b) Agreeing the terms of engagement

84. In accordance with ISA 210 *Agreeing the terms of audit engagements*, the auditor should consider, for each audit to be conducted, whether the audited entity needs to be reminded of the engagement terms and conditions or whether those terms and conditions need to be refreshed.

85. The auditor will need to consider the extent to which:

- engagement letter templates and examples need to be updated for reference to a new financial reporting framework or whether existing terminology adequately reflects the new framework;
- existing engagement letters signed by audited entities are now out of date as a consequence of the application of FRS 102 and therefore need to be reissued; and
- new policies and procedures are required in relation to the update and reissue of engagement letters as a consequence of transition to a new framework.

86. The auditor should bear in mind that the standard(s) and related policy choices to be adopted under the new accounting framework will be a policy choice made by management (see section 2).

87. The auditor will need to ensure that they understand this policy choice and the implications of the choice of standard(s) to be applied. The auditor's work will involve ascertaining whether the entity has complied with all requirements and relevant conditions in relation to the use of a chosen framework.

Example V – group opts to apply FRS 102 reduced disclosures in the financial statements of a subsidiary

In order for a qualifying entity to take advantage of the disclosure exemptions, its shareholders must be notified in writing and no objections received from shareholders permitted by FRS 102 paragraph 1.11 to prevent the use of disclosure exemptions.

In such circumstances the auditor should ensure that they have established the actions that management have taken to notify the entity's shareholders and consider any responses received in relation to this notification, as this may have implications for their opinion if the auditor is unable to determine whether the entity has taken exemptions to which it is not entitled.

Some of the disclosure exemptions are also conditional on equivalent disclosures being provided in the consolidated financial statements of the group in which the entity is consolidated. Again, the auditor needs to obtain evidence that the conditions have been met. Where the consolidated financial statements have been issued, the auditor should obtain a copy of those financial statements and ensure the appropriate disclosures have in fact been provided. Where the consolidated financial statements have not yet been issued it will be more difficult to obtain sufficient appropriate evidence. The auditor may be able to rely on a representation received from the directors of the subsidiary, obtained after those directors have consulted with the parent company's directors that disclosure is to be included in the consolidated financial statements. In assessing whether such a representation is to be treated as sufficient, the auditor may need to consider the issue of materiality in relation to the group. Where disclosure is not, or will not be, included in the consolidated financial statements on the grounds of immateriality to the group then the disclosure exemptions are not available under FRS 102.

88. Before an auditor commences any entity-specific audit work relating to transition, they need to ensure that they have identified:

- the entity's previous accounting framework and understand the legal and regulatory bases of that framework; and
- the framework to which the entity will be transitioning and understand the interrelationship with any existing accounting, legal and regulatory requirements including any relevant SORPs.

This is necessary to identify relevant reporting differences, any potential reporting conflicts, and reporting requirements that an entity should continue to comply with.

Example VI – unincorporated entities

Most entities not incorporated under the Companies Act 2006 will, under their current reporting framework, have historically had some flexibility in the presentation of the balance sheet and income statement as they are not required to apply the formats set out in the Accounting Regulations made under the Act. The auditor will need to be clear that should entities opt to apply FRS 102, section 4 and section 5 of the standard require that primary statement formats laid out in the Accounting Regulations are followed unless prohibited by any statutory framework under which the entity reports.

89. There may also be some additional reporting requirements that apply as a consequence of the entity's legal or registration status.

Example VII – special accounting requirements

Accounting requirements that have effect under existing law will continue to apply irrespective of the accounting standard the entity chooses to adopt. For example, a registered social housing provider should still ensure that it complies with, and applies the requirements of, the accounts direction made under relevant housing law.

Planning and project management

90. When planning their work, the auditor should:

- agree with management the nature of, and timetable for, auditor involvement and reporting throughout the transition process;
- determine the nature, extent and quality of audit evidence needed in relation to the judgements made and conclusions reached by management in the transition to FRS 102 and in their preparation of the first set of FRS 102 financial statements;
- consider any changes to the audit plan that may be required as a result of transition to FRS 102, such as those that make use of audited comparative numbers to set expectations, etc.;
- communicate any information needs to management on a timely basis; and
- explain to management how transitioning to a new financial reporting framework will affect the audit.

Risk assessment

91. In performing the risk assessment for the audit of the first set of financial statements prepared in accordance with FRS 102, the auditor will need to consider carefully the specific circumstances of the entity and the sources of possible risks of material misstatement that may exist in order for the audit team to consider and conclude their assessment at the engagement team discussion of risk.

92. The auditor should aim to consider the following matters as early as possible in the audit process to determine the sources of significant risk of material misstatement on transition to FRS 102.

a) Materiality

93. The auditor should consider the extent to which unadjusted misstatements at the transition balance sheet date and for the comparative period, which were identified during prior audits, and that do not eliminate on transition to FRS 102, impact on the audit opinion on the first FRS 102 financial statements.

94. In so doing, the auditor will need to consider the level of audit materiality in respect of FRS 102 financial statements in accordance with ISA 320 *Materiality in planning and performing an audit*. The auditor may need to reconsider how materiality is determined, as the benchmark on which materiality was previously calculated may have moved eg, as a result of higher or lower reported profits.

95. The auditor may also need to consider whether the chosen materiality level suggests that additional work on opening balances is required compared with the work that may have been performed on comparative information under a previously assessed level of materiality. In addition, as FRS 102 also requires that more fair value movements are reported in the profit calculation, the auditor should consider whether adjustments are required to determine an appropriate level of normalised profits.

96. Depending on the circumstances, as a consequence of the additional risks involved, the auditor may adjust the performance materiality levels or apply specific materiality thresholds to particular areas of the financial statements.

b) Choice of accounting policies, management bias and fraud risk factors

97. As FRS 102 will often result in a greater level of subjectivity and judgement on the part of the financial statement preparer, the auditor should consider the increased risk of management bias and/or fraudulent financial reporting. Adoption of a new accounting framework may introduce additional scope for management to manipulate the financial statements through application of bias in their choice of accounting policies. Therefore, the auditor should consider whether the incentive, the motivation and the opportunity for such manipulation exists and tailor the nature, timing and extent of the work accordingly.

98. The auditor will need to identify the accounting policies to be adopted by management in the preparation of the first FRS 102 financial statements and consider the appropriateness of those policy choices.

99. In particular, the auditor should be alert to changes to accounting policies that are presented as a consequence of a change of financial reporting framework but in reality have changed for other reasons.

100. Equally the auditor should take the opportunity presented by the transition process to challenge whether established and long-running practice continues to be appropriate.

c) Accounting estimates and use of fair values

101. The requirements of ISA 540 *Auditing accounting estimates, including fair value accounting estimates, and related disclosures* are likely to be of even more relevance to many audits under the FRS 102 framework than to audits under the previous UK GAAP.

102. This is particularly the case because FRS 102 will require more extensive use of fair values in determining amounts to be recognised in the financial statements. Determining what is a 'fair' value is subjective and likely to be subject to estimation uncertainty (although FRS 102 provides some guidance).

103. For accounting estimates that give rise to significant risks, the auditor is required under ISA 540 to evaluate how management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed measurement uncertainty in making the accounting estimate.

104. As a subjective, judgemental area the auditor may wish to explain the responsibilities for determining an appropriate fair value to management of audited entities.

d) Changes to the entity's system of internal control

105. As a consequence of transition, management may have established new systems or implemented new controls relevant to the financial reporting process. The auditor will therefore need to:

- update any existing systems notes;
- assess the design and implementation of controls relevant to the audit (particularly those that relate to significant risks);
- reconsider the consequences for the extent of assurance derived from tests of operating effectiveness of controls, particularly those that may have been tested on a cyclical basis or those that may not have operated throughout the entire period under review;
- give consideration to whether or not to plan to derive assurance from any new controls over the preparation of financial statements under FRS 102; and
- report to management, on a timely basis, any weaknesses that are identified.

e) Changes to the entity's IT environment

106. In determining where risks of material misstatements might arise, the auditor should consider the continuing appropriateness of an entity's existing IT-related information systems (including choice of accounting software) and the possibility that material misstatement could arise from continuing to use such information systems that have not been suitably updated to reflect the requirements of a new accounting framework. The risk of misstatement could also be exacerbated through any amendments made to information systems.

107. The risk is likely to be increased where the IT systems and controls are:

- bespoke systems, designed specifically for the entity being audited;
- complex, involving multiple applications and interfaces;
- networked or involve connectivity across multiple sites;
- part-manual or require manual intervention; or
- easily overridden by management.

108. The auditor will need to consider how management has controlled changes to the IT systems and how management has ensured that any upgrades or updates have been properly performed.

Risks relating to transitional arrangements

109. The audit of financial statements prepared under FRS 102 for the first time will create additional risks where management is inexperienced in preparing financial statements under FRS 102 and/or the auditor is unfamiliar with the new challenges of auditing such financial statements.

110. The auditor should be mindful of the need to give greater consideration to any new, first-time and/or non-recurring accounting adjustments that arise on transition, which may be more susceptible to material misstatement.

111. The following examples provide guidance on some of the areas that may give rise to risks of material misstatement on transition and the auditor's related considerations.

- **Transitional requirements**
  The auditor will need to ascertain whether the entity has applied the transitional requirements, set out in section 35 of FRS 102, appropriately and has only taken advantage of any elections or exemptions on transition to FRS 102, if the standard permits.

- **Previously unidentified misstatements**
  In performing their work on opening balances and comparative information, the auditor may identify errors in the financial statements that have not previously been reported. The auditor should be mindful that such prior-year misstatements should be dealt with as such and may not be presented as adjustments required as a result of transition to the new framework.

- **Restatement of comparative information**
  The auditor will need to perform additional procedures to determine whether comparative information has been appropriately presented within the financial statements. This is likely to involve the performance of additional audit procedures to assess whether the comparative information has been accounted for and presented in accordance with FRS 102 in all material respects.

- **Disclosure of reconciliation from old to new framework**
  In the first set of financial statements prepared under FRS 102, preparers are required to make a number of disclosures explaining the effect of the transition to FRS 102, including a reconciliation of its equity determined under previous GAAP to equity under FRS 102 as at the transition date and the comparative period end. As a non-standard disclosure item, there may be a risk that misstatements exist within the reconciliation.

- **Application of 'undue cost or effort'**
  The auditor should endeavour to ascertain, at an early stage, any intention by management to claim 'undue cost or effort' as a rationale for non-compliance with certain requirements of FRS 102. The auditor will need to consider whether such an assertion is reasonable and appropriate in the circumstances. The auditor may need to obtain evidence from management to support such an assertion and be prepared to challenge it if appropriate. Using undue cost or effort may be a way of introducing management bias.

Example VIII – investment property

FRS 102 permits recognition of investment property using the cost model where obtaining a reliable fair value would involve undue cost or effort.

Where management claims that obtaining a reliable fair value would involve undue cost or effort the auditor should consider:

- whether management has previously obtained a reliable fair value (or equivalent) for investment property and why it considers that this is no longer possible;
- the materiality of the investment property;
- the context of the investment property in relation to the business or operations as a whole and any changes therein;
- the users of the financial statements and the extent of their interest in fair value of investment property and their understanding thereof;
- management's rationale for concluding that cost or effort involved is 'undue' in this case; and
- what alternatives are available and permitted under the framework.

The auditor should be aware that non-compliance on the grounds of undue cost or effort may be appropriate for particular reporting entities in certain circumstances but not for other reporting entities, although some similarities between those circumstances may exist.

- **Classification of financial instruments**
  FRS 102 requires that most financial instruments that meet the definition of basic financial instruments are accounted for at amortised cost, while most financial instruments that are not basic (and certain equity instruments) are measured at fair value through profit or loss. In many cases, the determination of whether a financial instrument is basic or not will be straightforward. However, certain financial instruments may be difficult to categorise and judgement is needed.

  The auditor should consider whether the nature of the financial instruments held by the entity is such that an inappropriate categorisation will result in material misstatement in the carrying value of the instrument in the financial statements.

- **Financing transactions**
  FRS 102 requires that an entity should measure a financial asset or financial liability that constitutes a financing transaction at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

  It will therefore be necessary for both the lender and the borrower separately to determine the market rate of interest for a similar debt instrument.

  In such circumstances, and particularly in group situations where there may be more opportunity for the introduction of bias or for manipulation of amounts to be reported in the financial statements, the auditor should seek to understand whether the terms and conditions of the financing transaction are sufficiently formalised so as to be clear on whether any resultant financial instrument is repayable on demand or not and, where relevant:

  - determine the materiality of any discounting to be applied;
  - ascertain how management will determine a market rate of interest for a similar debt instrument and the availability of such information;
  - ascertain how management will determine such a market rate at the transition date; and
  - consider the extent to which the auditor intends to use the work of a third party as audit evidence and whether the auditor needs to involve an internal or external expert.

- **Financial instruments measured at amortised cost**
  Key considerations for the auditor in this respect are likely to centre on management's ability to calculate the effective interest rate and the use of certain assumptions within the calculation.

  The auditor will need to ascertain whether they are satisfied with the validity of the information included within the calculation.

- **Financial instruments measured at fair value**
  Key considerations for the auditor in assessing the risk of material misstatement in this area may include the following.

  - How material are such financial instruments to the financial statements?
  - The source of the valuation, including, where relevant, asking who has conducted the valuation.
  - What qualifies that valuer to do so and is that valuer independent and objective?
  - How has the valuation been carried out and how will the auditor obtain this information directly from the valuer eg, an issuing banker?
  - Does the auditor need to involve their own internal or external expert to determine whether the valuation (or the underlying model or technique) is appropriate?

  Obtaining sufficient appropriate audit evidence relating to the fair value of financial instruments is likely to be a particular concern to the auditor where management has been provided with a valuation of financial instruments by the same institution who issued the financial instruments to the entity (usually the entity's banker).

  It is unlikely that the auditor will be able to rely solely on a counterparty valuation report, although the decision of the extent to which to do so is influenced somewhat by materiality and/or risk and whether the entity maintains its own independent record of valuation.

  In situations where the issuer provides the entity with a year-end valuation for an instrument that it has issued to the entity and management use that information as the basis for the measurement of the instrument in the financial statements, that issuer is, in effect, acting as a management's expert.

  This means that the auditor, where they choose to use the work of the management's expert as audit evidence, will need to ensure that they comply with the requirements of ISA 500 *Audit evidence*. In particular, the auditor should understand how the valuation has been determined (technique), the competence and capabilities of the issuer in forming such valuations and the assumptions that were involved.

  The auditor should also consider whether information around key judgements and sensitivity in valuation is adequately disclosed in the financial statements, where relevant.

- **Use of fair values for the first time**
  As part of the responses to the requirements of ISA 540, the auditor will need to consider how management has determined the amounts to include where FRS 102 requires the use of fair values.

  Where the auditor considers that a particular fair value accounting estimate involves high estimation uncertainty, this will often be identified as a significant risk of material misstatement.

  Where a valuation technique is used by management, the auditor should understand that valuation technique (involving an auditor's expert where appropriate) and aim to conclude on the appropriateness of the use of that technique in providing a valuation that accords with FRS 102. In subsequent accounting periods, the auditor should pay attention to the outcomes of prior-period estimates and valuations and whether there is any indication that the entity's technique is producing values that are later found not to approximate the actual values at the reporting date.

  As part of the auditor's response to risk in this area and the requirements of ISA 540, the auditor may develop a range of possible appropriate outcomes against which they will assess the value provided by management. In forming this range, the auditor should not accept or assume responsibility for determining the appropriate fair value and should be clear that responsibility for this rests with management. However, in the transitional period the auditor can expect that entities may require additional support in this area and may need to consider the extent to which they can become involved (see section 2).

- **Residual values**
  Under FRS 102, preparers of financial statements should consider depreciable amount through comparison of cost to a residual value which is based on the estimated amount that an entity would currently obtain from the disposal of an asset, after deducting the estimated costs of disposal, if the asset were already in the age and condition expected at the end of its useful life. The auditor should therefore assess both whether the residual value used in calculating the annual depreciation charge is appropriate at transition and the risk that current prices at each reporting date will have changed such that depreciation is materially misstated. The auditor will also need to consider how best to obtain evidence that establishes what a current price for an asset at the reporting date should be.

- **Intangibles and goodwill**
  FRS 102 requires that intangible assets and goodwill be amortised over the useful economic life of the asset. The useful economic life of intangible non-current assets and goodwill is not more than five years unless a reliable estimate of their useful economic lives can be made.

  Under the existing financial reporting framework, many entities have opted for significantly longer useful economic lives for intangibles and goodwill and may wish to continue to amortise intangibles and goodwill over the previously determined useful economic lives because they do not believe there is any new evidence to justify making a change. Provided that management can justify a longer useful economic life, there is no need to accelerate the period over which goodwill is written off. However, indefinite lives will not be permitted.

  The auditor should ensure that they understand the rationale for management's decision either to continue amortisation under the previously assessed useful economic life or to reconsider the useful economic life on transition to FRS 102.

  The auditor should also remain alert to the possibility that investigations into the appropriateness of the useful economic lives of goodwill and intangibles may give rise to evidence that the useful economic life, as previously assessed, was not appropriate.

- **Defined benefit schemes**
  Under FRS 102, entities are no longer required to involve an actuary when determining net liabilities arising from an entity's obligations under defined benefit schemes.

  What the auditor should conclude on is whether the figures included in the accounts and/or the disclosures are materially misstated. Not involving an actuary in obtaining those figures may increase the audit risk if management is not suitably competent to prepare a valuation.

  Where an actuary is not involved, the auditor would need to form a particularly robust assessment of:

  - how the value of the assets and liabilities involved had been determined and the assumptions used in making that determination;
  - the evidence available to be able to determine whether the amounts included within the financial statements and the related disclosures are appropriate; and
  - whether the auditor will need to involve their own expert and ultimately charge that cost to the entity.

  Based on this assessment, the auditor would reach a conclusion on whether it is appropriate that management has not involved an actuary.

  Where management does not involve an actuary in such circumstances and the auditor is unable to obtain sufficient appropriate audit evidence through alternative means, the auditor will need to consider modification of the auditor's report in relation to this limitation of scope.

- **Going concern**
  Transition to FRS 102 may result in more volatility in reported profits presented within a statement of comprehensive income as in some instances fair value adjustments and revaluation movements will be presented in determining profit for the year. Such volatility could have implications for loan covenants and other agreements with an entity's stakeholders. The auditor needs to establish whether and how an entity's agreements and contracts with third parties have been reconsidered and renegotiated where necessary.

  Where possible breaches of terms and conditions of such agreements have been identified, the auditor should perform procedures designed to check whether the possible implications for the going concern status have been appropriately considered by management in its assessment of going concern and adequately disclosed in the financial statements. The auditor may also need to consider any implications for the audit report.

- **Hedge accounting documentation**
  To qualify for hedge accounting an entity must fulfil certain conditions specified within FRS 102. One of the criteria specifies that certain information needs to be documented by management.

  Where an entity is to apply hedge accounting, the auditor needs to establish that management has put in place the appropriate documentation as required by FRS 102 and reach a conclusion on whether the documentation in place specifically addresses the requirements of FRS 102 and has been approved by appropriate individuals within the organisation.

- **Disclosures**
  The auditor should either have access to a suitable financial statements disclosure checklist or establish policies and procedures to determine how they will assess whether the disclosures are complete.

  In addition to completeness of disclosures, the auditor will need to design audit procedures that address the quality of the disclosures.

Communication with those charged with governance

a) Clarification of respective responsibilities of transition to new framework

112. In establishing respective responsibilities the auditor should consider whether it is necessary to communicate responsibilities in relation to the FRS 102 transition to those charged with governance, and whether those charged with governance need to acknowledge that they understand those responsibilities, particularly in relation to:

- preparation of the financial statements;
- establishing an adequate system of internal control;
- determination of appropriate accounting policies to be applied;
- framework decisions (eg, that management or those charged with governance are not aware of any objections to application of the reduced disclosure framework);
- forming judgements, estimates and fair values; and
- any assertion of undue cost or effort.

113. The auditor may also wish to obtain specific representations from management and/or those charged with governance in relation to certain matters (including for policy choices adopted in relation to a new accounting framework) in order to ensure that all involved acknowledge and have understood certain specific responsibilities (see matters raised in appendix 1 on ISA 580 *Written representations*.

b) Communication of deficiencies in internal control

114. Aspects of an entity's system of internal control that have been updated or developed in response to the adoption of a new financial reporting framework are more likely to be deficient by virtue of the fact that they are more likely to be untried, untested and carried out by members of staff who are building experience with unfamiliar processes. Where, as part of the auditor's work, deficiencies in internal control are identified, such deficiencies should be communicated to those charged with governance. If the deficiencies are considered to be significant, the auditor should communicate them in writing as soon as is practicable.

c) Reporting misstatements

115. All factual, judgemental and projected misstatements (except for those that are clearly trivial) identified as part of the auditor's work in relation to transition to FRS 102 should be communicated to management and those charged with governance with a request that those misstatements be corrected.

116. Where misstatements are not corrected, the auditor should consider the implications for the audit opinion with reference to the materiality of uncorrected misstatements. In forming this conclusion, the auditor should be taking into account the effect of any apparent misstatements that exist within the comparative information and the consequences on the current year financial information.

Documentation

117. The auditor will need to consider whether the audit approach and any audit work programmes need to be amended and updated for FRS 102, dealing particularly with the transitional issues. This will be particularly relevant where an auditor's work programmes provide details of the requirements of accounting standards.

118. Audit documentation needs to provide a clear audit trail of the judgements and conclusions reached in relation to the transition to FRS 102.

119. Where the auditor has challenged management and/or those charged with governance in relation to judgements and estimates made, evidence of that challenge should be documented in the audit file.

Reporting

120. The auditor will need to consider the possible effects on the audit opinion and audit report, including any qualifications or modifications, that may result from:

- the framework to be applied – the auditor should consider whether specific reference needs to be made to the relevant accounting standard(s) applied;
- non-compliance with the financial reporting framework – including inappropriate application of particular standards;
- inappropriate application of transitional arrangements; and
- insufficiently robust transition processes and procedures implemented by those charged with governance.

121. Where the auditor’s opinion is ultimately modified, the auditor should consider how they will describe the basis for that modification with reference to the requirements of the new financial reporting framework.

Ongoing issues post-transition

122. In periods subsequent to the initial transition period, many of the ongoing requirements of FRS 102 will continue to provide challenges for auditors in practice.

123. At a high level, a feature of the environment in which auditors will operate will be the establishment of accumulated familiarity with FRS 102. It will take time before there is an instinctive understanding of FRS 102. Auditors should expect interpretation, common practice and application of the requirements of the standard to evolve in the accounting periods that follow transition and should take measures to ensure awareness of new developments and emerging practice. Areas that are expected to be of particular interest include, but are not limited to:

- undue cost or effort – and circumstances in which it may be appropriate to claim undue cost or effort;
- fair values – and, in particular, the application of techniques for determining fair values of particular assets and liabilities;
- hedge accounting – and, in particular, whether the entity has the required documentation in place at the time required;
- financial instruments – and, in particular, common practice in terms of instruments identified as basic and those that are not;
- the need to involve experts and/or specialists in the audit process and how the auditor will determine the appropriateness of their work for audit purposes;
- business combinations – identification and valuation of intangibles, useful economic life of intangible assets, useful economic life of goodwill; and
- establishing the recoverable amount in an impairment review.

Appendix 1: Technical issues on compliance with specific ISAs and ISQC 1

This appendix highlights some of the specific issues raised in this Technical Release/by the implementation of FRS 102 in the application of ISAs and ISQC 1. As stated in paragraph 10 of the Technical Release, this appendix should not be regarded as a substitute for reading the ISAs and ISQC 1 themselves.

Subject dealt with	FRS 102 implementation issues	Application/action required
ISQC 1 *Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements*		
Competence and capabilities of engagement partner and engagement teams.	• Detection of improper or incorrect reconciling items on transition such as changes in previous estimates, policies or correction of errors. • Identification of items that have been incorrectly included within other reconciliation amounts and should be in reconciling items. • Identification of incorrect FRS 102 figures (where previous GAAP figures are unchanged).	• Audit staff require knowledge and understanding of FRS 102. • In the year of transition, audit staff require sufficient knowledge of previous GAAP and FRS 102 to audit the completeness and accuracy of reconciliations between the two, as required by FRS 102. • Firm policies and procedures should ensure sufficient understanding is obtained by all levels of audit staff including engagement partners.
Engagement quality control review.	• Increased likelihood of engagement quality control review.	• Consider the need for engagement quality control review in accordance with the firm's policy. • Other ISQC 1 matters are addressed in other topics within this appendix eg, acceptance, ethics, consultation.
ISA 200 *Overall objectives of the independent auditor and the conduct of an audit in accordance with ISAs* **and ISA 220** *Quality control for an audit of historical financial information*		
Compliance with relevant ethical requirements.	• Increased likelihood of threats arising from the provision of non-audit services (ES 5) relating to transition eg: – valuation services – accountancy services – tax advisory services and – secondment of staff.	• Assessment of implications for auditor independence and objectivity prior to undertaking non-audit services, and documentation of this. • Documentation, assessment and communication of threats and safeguards prior to acceptance of appointment as auditor. • Ensure final decisions on the appropriateness of accounting policies to be adopted are those of the directors. • See section 2 of this Technical Release.
Plan and perform an audit with professional scepticism, recognising that circumstances may exist that cause the financial statements to be materially misstated.	• Increased focus on management judgement and risk of bias. • Undue cost and effort assessments may be used inappropriately. • Accounting policy and estimate choices on implementation of FRS 102. • Application of transition options and exemptions.	• Gain an understanding of the motives of management on implementation. • Assessment of accounting estimates (see ISA 540) and appropriate challenge. • Ensure the team is competent and capable of identifying items requiring critical assessment (see ISQC 1). • Clear documentation of significant professional judgements and demonstration of scepticism. • See also ISA 240.
Consultation within engagement team and others.	• Increased likelihood of internal consultation with those responsible for technical financial reporting issues or externally where technical expertise not available.	• Assessment of need for consultation on critical transition matters. • Documentation of nature, scope and conclusions resulting from consultations. • Firm policies and procedures adhered to where differences of opinion exist.

Subject dealt with	FRS 102 implementation issues	Application/action required
ISA 210 *Agreeing the terms of audit engagements*		
Obtain agreement from management that it acknowledges and understands its responsibility.	• Clarification of directors' responsibilities.	• Early communication to clarify expectation that management will be properly prepared and will have an appropriate plan in place. • Engagement letter may clarify that the directors are responsible for: – analysing the impact of the introduction of FRS 102 on the business; – developing plans to mitigate the effects identified; – assessing any impact on the going concern assessment; and – preparation of financial statements under FRS 102, including comparative figures, and the disclosures needed to give a fair presentation and true and fair view.
ISA 230 *Audit documentation*		
Audit documentation outlines nature, timing and extent of the audit procedures performed; the results and audit evidence obtained; and significant matters, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.	• Areas where significant professional judgements are more prevalent in the year of transition.	• Ensure there is clear documentation of procedures undertaken and rationale for conclusions when assessing transition and accounting under FRS 102. • See also other areas where documentation is appropriate – essentially there needs to be clear documentation for all the matters highlighted in this appendix where applicable.
ISA 240 *The auditor's responsibilities relating to fraud in an audit of financial statements*		
Fraud risk assessment and discussion.	• Changes to accounting systems may provide increased opportunity for aggressive earnings management/fraud. • Opportunity for manipulation of transition accounts regarding: – restatement of opening balances; – increased choices under FRS 102; and – increased use of fair values.	• Ensure the assessment of risk related to fraud includes relevant consideration of application of new accounting standards. • Make teams aware of new areas of financial statements which are susceptible to manipulation. – Discussion among the engagement team, with emphasis on how and where the financial statements are susceptible to material misstatement due to fraud, may include increased risk of fraud and non-detection arising from transition to FRS 102. • See also ISA 200 and ISA 450.
Audit procedures responsive to risks related to management override of controls.	• Potentially increased incentive and opportunities to manipulate financial information by overriding controls.	• Test of appropriateness of journal entries may include specific enquiries of individuals and testing of journals related to FRS 102 adjustments. • Review of accounting estimates for bias includes: – clear evaluation of judgements and decisions made on implementation; – retrospective review of prior year judgements and assumptions for significant accounting estimates in light of management decisions in transition period. • Clear documentation of the above.

Subject dealt with	FRS 102 implementation issues	Application/action required
ISA 250A *Consideration of laws and regulations in an audit of financial statements*		
Obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements.	• Increased potential for non-compliance with some laws and regulations, for example: – the requirement to keep adequate accounting records may be impacted by lack of familiarity with financial reporting framework; – the FRS 102 transition may affect distributable profits and the basis of assessment of distributable reserves; and – impact on tax payable and compliance with tax laws.	• Documentation of consideration/impact of specific laws and regulations that may be impacted by FRS 102 implementation, for example: – whether changes in accounting systems and controls made are sufficient to maintain adequate accounting records; – confirmation with directors of understanding of legal/fiduciary duties relating to distributions; and – consideration of whether a separate tax review is required. • The team should have sufficient understanding of affected laws and regulations in order to consider them when auditing assertions related to the determination of amounts to be recorded and disclosures made. • Consideration of the impact of non-compliance on the audit report.
ISA 260 *Communication with those charged with governance* **and ISA 265** *Communicating deficiencies in internal control to those charged with governance and management*		
Communicate views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.	• Management may not have fully considered the potential impact of FRS 102. • Changes of accounting policy driven by FRS 102-related matters may lead to specific communication requirements.	• Communication with those charged with governance prior to implementation of areas where FRS 102 may impact on accounts and the need for an appropriate action plan. • Communication of significant accounting practice, that is acceptable under FRS 102, though not considered to be most appropriate to the particular circumstances of the entity. • Communication when an entity has applied different accounting policies to those applied under old standards but old policies are acceptable under FRS 102. • Consider whether the approach to disclosure provides clear information, given the relative complexity of the transition exercise, and communicate findings as appropriate.
Communication of deficiencies and significant deficiencies in internal control to management and those charged with governance (verbally or in writing, as required).	• Resultant changes to accounting systems and controls may give rise to deficiencies in internal control that require communication.	• Written communication to those charged with governance is required where significant deficiencies are identified. (See ISA 265, paragraphs 9–10 for specific communication requirements.)

<table>
<tr><th>Subject dealt with</th><th>FRS 102 implementation issues</th><th>Application/action required</th></tr>
<tr><td colspan="3">ISA 315 Identifying and assessing the risks of material misstatement through understanding the entity and its environment and
ISA 330 The auditor's responses to assessed risks</td></tr>
<tr><td>Risk assessment procedures, related activities and the required understanding of the entity and its environment, including the entity's internal control.</td><td>• Implementation of FRS 102 may increase risk of material misstatement at the financial statement and assertion level due to:
– limited practical experience of application;
– insufficient assessment of completeness of transition adjustments and ongoing accounting differences;
– opportunities for aggressive earnings management;
– incorrect disclosure regarding adjustments to historical errors; and
– impact on going concern (see also ISA 570).
• Changes may be required to accounting systems and controls to produce necessary FRS 102-compliant information.</td><td>• As part of planning, enquiries of management regarding:
– major changes to financial statements due to implementation of FRS 102;
– the impact of FRS 102 on key systems which generate specific accounting information;
– the extent of fair value accounting;
– whether the risk of error is increased;
– the potential impact on going concern basis; and
– other relevant areas of enquiry, as included within section 3 of this Technical Release.
• Information on understanding of the entity and its environment, including internal control, may require a more comprehensive update than in GAAP-consistent periods.
• Assessment of design and implementation of controls relevant to the audit may include specific controls designed in response to FRS 102 implementation.
• Analytical procedures as part of risk assessment may be based on incomplete or inconsistent data on the year of transition.</td></tr>
<tr><td>Design and implement responses to address the assessed risks of material misstatement at the financial statement and assertion level.</td><td>• The audit approach should be responsive to risks identified, including those due to change in financial reporting framework.</td><td>• The auditor will need to tailor planned approaches to the entity's circumstances, taking into account risks relating to FRS 102 implementation arising on risk assessment.
• Clear documentation of all of the above.</td></tr>
<tr><td colspan="3">ISA 320 Materiality in planning and performing an audit and ISA 450 Evaluation of misstatements identified during the audit</td></tr>
<tr><td>Determine level of materiality for financial statements as a whole; levels to be applied to those particular classes of transactions, account balances or disclosures; and performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures.</td><td>• Increased risk of material misstatement in areas subject to significant FRS 102 impact.
• Increased sensitivity over certain accounts disclosures including reconciliation of transitional adjustments.
• Items on which the attention of the users of the particular entity's financial statements tend to be focused (for example, for the purpose of evaluating financial performance, users may tend to focus on profit, revenue or net assets) may be impacted by implementation of FRS 102.</td><td>• The level of performance materiality may need adjustment in areas where there is significant FRS 102 impact.
• The auditor should be mindful of sensitivity of transition or additional accounts disclosures when assessing materiality level or levels for particular classes of transactions, account balances or disclosures.
• Where a percentage is applied to a chosen benchmark as a starting point for determining materiality, consideration of normalisation where appropriate.</td></tr>
<tr><td>Determine whether uncorrected misstatements are material, individually or in aggregate.</td><td>• Consideration includes:
– the effect of uncorrected misstatements related to prior periods;
– FRS 102 requirements to perform prior period adjustment where there is a 'material' error compared to FRS 3 'fundamental' error; and
– the size and nature of misstatements.</td><td>• Consider whether uncorrected misstatements of prior periods are impacted by FRS 102 implementation.
• Consider whether errors discovered during the audit of the first FRS 102 accounts, which relate to prior periods, should result in a prior period adjustment.
• Consider whether errors identified in certain transactions, account balances or disclosures are material by nature.
• Clear documentation of all of the above.</td></tr>
</table>

Subject dealt with	FRS 102 implementation issues	Application/action required
ISA 500 *Audit evidence* **and ISA 620** *Using the work of an auditor's expert*		
Determine adequacy/ appropriateness of the work of the expert.	• There are likely to be more circumstances giving rise to the use of management's or auditor's experts due to increased prevalence of fair value measurements.	• Evaluation of the expert, understand their work and evaluate its appropriateness in line with requirements of ISA 500/620 and document accordingly. • Consider the need to engage the auditor's expert prior to engagement.
ISA 505 *External confirmations*		
Evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary.	• Increased instances of recognition and measurement of financial instruments.	• Consider the need for direct confirmation from third parties where the reply is sent direct to the auditor for evidence over completeness and accuracy of financial instruments amounts and disclosures.
ISA 510 *Initial audit engagements – opening balances* **and ISA 710** *Comparative information – corresponding figures and comparative financial statements*		
Obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements.	• Transitional adjustments are likely to render usual levels of audit work on continuing engagements insufficient to ensure that opening balances on year of transition to FRS 102 are not materially misstated to the extent that they affect and determine the amounts in the current period's financial statements.	• Consider the availability of transition information and adjustments. Retain relevant information on preceding audits. • Encourage completion of transition calculations prior to the first application of FRS 102. • Encourage the entity to consider the need for a separate assurance engagement on transitional adjustments prior to first application.
Determine whether financial statements include the comparative information required and whether this is appropriately classified.		• Consider the completeness and accuracy of disclosure of exemptions and options on transition, and consequential implications on opening balance sheet position (and current period financial statements). • Consider whether errors are included in the reconciliation between opening FRS 102 and historic GAAP, and conclude accordingly.
ISA 520 *Analytical procedures*		
Evaluate the reliability of data from which expectations are developed.	• Additional care is needed when using analytical techniques where significant change is driven by FRS 102 or a lack of comparable information.	• Consider whether the effectiveness of analytical procedures is reduced and the consequential effect on the audit approach.
Design and perform analytical procedures near the end of the audit to assist in forming an overall conclusion.	• Effectiveness of final analytical procedures may be inhibited.	• Consider the design of final analytical procedures and whether additional alternative procedures are necessary. • Clearly document justification for the approach and procedures undertaken.

Subject dealt with	FRS 102 implementation issues	Application/action required
ISA 540 *Auditing accounting estimates, including fair value accounting estimates, and related disclosures*		
Obtain an understanding to provide a basis for the identification and assessment of risk for accounting estimates.	• Increased incidence of accounting estimates and fair value measurements under FRS 102. • Lack of management experience in making new estimates required under FRS 102. • Assessment of prior period estimate outcomes may be inhibited.	• Ensure consideration of the impact that FRS 102 has on understanding and update documentation as required. Relevant issues include: – awareness of requirements of FRS 102 relative to accounting estimates relevant to the entity; – enquiries of management about the impact of FRS 102; and – the method/model used in calculation of amounts and underlying assumptions.
Evaluate the degree of estimation uncertainty associated with the accounting estimate.	• Some new accounting estimates may implicitly have a high degree of estimation uncertainty attached.	• Consider whether a lack of track record or management experience increases risk. • Where estimation uncertainty gives rise to significant risk, evaluate alternative assumptions or outcomes, reasonableness of significant assumptions and, where appropriate, develop a range with which to evaluate the estimate.
Determine whether requirements of the financial reporting framework are appropriately applied and whether changes in estimates or methods would be appropriate.	• Potential motivation to restate comparative accounting estimates on the basis that the initial estimates were in error. • Enhanced disclosure requirements related to judgements and key assumptions concerning the future and other sources of estimation uncertainty. • A number of other issues may also arise resulting in changes to treatment and options unavailable prior to FRS 102, for example: – application of options to use fair value as deemed cost; – recognition and measurement of intangible assets on business combinations; – recognition of deferred tax in an increased range of circumstances; – valuation of investments; and – accounting for basic financial instruments that represent financing transactions.	• Ensure estimates prohibited from restatement are only amended where there is objective evidence of error. • Evaluation of additional financial statement disclosure in year of transition and on an ongoing basis. • Review judgements and decisions for indicators of management bias. • Consideration of audit approach for previously unaudited information included within the financial statements. • Consideration of approach to intangible valuation in response to the subjectivity of valuation and techniques used. Assessment of the basis for determining useful economic life. • Consider availability and reliability of information required to assess appropriateness of estimates. • Consider whether the audit team has the requisite skill set to assess the accounting estimate and fair value application and whether the auditor's expert is required (see ISA 620). • Ensure that recognition and measurement of financial instruments is appropriate and in line with requirements of sections 11 and 12 of FRS 102. • See also ISA 500 relating to using the work of management's experts and ISA 505 on external confirmations. • Clear documentation of all of the above.
ISA 550 *Related parties*		
Evaluate whether related party relationships and transactions are appropriately accounted for and disclosed.	• FRS 102 includes a similar definition of related parties, though disclosures differ in some areas, for example: – aggregation of related party transactions; and – disclosure of key management personnel remuneration.	• Consider the appropriateness of aggregation of transactions and whether separate disclosure is necessary for an understanding of the effects on the financial statements. • Assess the completeness of remuneration disclosures in light of the overlap with company law requirements. • Clear documentation of the above and conclusions.

Subject dealt with	FRS 102 implementation issues	Application/action required
ISA 570 *Going concern*		
Consider whether events or conditions may cast significant doubt over the ability to continue as a going concern and evaluate management's assessment.	• FRS 102-related adjustments may have an effect on the underlying information used to form a conclusion on going concern. • Increases in the type and extent of liabilities recognised, changes in net assets and amounts reported through profit or loss may impact on items including: – loan covenant calculations – distributable reserves – reported profits and – bonus arrangements.	• Communication to affected entities of specific terms in need of amendment prior to implementation. • Consider whether clauses exist that allow the use of GAAP that was being applied when the agreement was signed to assess compliance with financial covenants. • Consider whether it is necessary to renegotiate the terms that are effective and applicable. • Where a breach of terms is apparent, consider the implications on presentation and disclosure in financial statements. • Ensure forecasts used in assessment of going concern are prepared on an FRS 102 basis. • Documentation of the above.
ISA 580 *Written representations*		
Written representations about responsibilities for preparation of financial statements.	• Clarification of responsibilities relating to the implementation of FRS 102 may be sought.	• Consider the need to obtain representations on the potential impact of implementation of FRS 102 in the periods prior to implementation. • Use of a representation letter to clarify responsibilities regarding the first application of FRS 102 in the year of transition. See also ISA 210, paragraph 6 for reference to representations sought.
ISA 600 *Special considerations – audits of group financial statements (including the work of component auditors)*		
Communicate the scope and timing of work with component auditors and obtain sufficient, appropriate evidence regarding financial information of components and consolidation, to express an opinion on group accounts.	• Potential for staggered first-time adoption of FRS 102 across entities within the same group and impact on consolidation. • Inconsistent application of treatment options across group companies. • Classifications and measurement in individual entity financial statements may be inconsistent with that required in group accounts.	• Confirmation of the basis of preparation of component financial statements prior to planning the approach to engagement and communication of key changes, as appropriate. • Consider the extent to which instructions to component auditors are required regarding the need to perform additional procedures and to provide information relevant to transition. • Consider the extent to which changes impact on the evaluation of component auditors and sufficiency of their work. • Consider the need to perform additional procedures on the work of component auditors related to transition or consolidation adjustments. • Documentation of conclusions related to the above.
ISA 610 *Using the work of internal auditors*		
Determine the nature and extent of work of the internal audit function that can be used.	• The internal audit function may have performed work on processes for preparation of FRS 102 accounts and related adjustments.	• Assess the work of internal audit to identify whether FRS 102-specific work can be used and to what extent for the purposes of the audit. • Draw appropriate conclusions from this assessment and from the internal audit work as applicable, and document accordingly.

Subject dealt with	FRS 102 implementation issues	Application/action required
ISA 700 *The independent auditor's report on financial statements*, **ISA 705** *Modifications to the opinion in the independent auditor's report* **and ISA 706** *Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report*		
An unqualified opinion on the financial statements shall be expressed only when the auditor concludes that they have been prepared in accordance with the identified financial reporting framework.	• Clarity over the financial reporting framework, in particular where there is early adoption of FRS 102.	• To make clear which accounting standards have been used (in particular where adopting FRS 102 prior to the mandatory implementation date) the introductory paragraph of the auditor's report may read: 'The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"'.
	• Differences in terminology between company law, auditing standards and FRS 102.	• FRS 102's use of the term 'presented fairly' should be read as having the same meaning as 'true and fair view'.
	• Departures identified from FRS 102 in the preparation and presentation of financial statements.	• Consider implications of departures on the audit report, for example: – where a material departure results in a disagreement regarding application of accounting policy selection or application or disclosure, consider whether this is so misleading that an adverse, rather than qualified, opinion is required; and – assessment of the approach to transition to FRS 102 may lead to the conclusion that a limitation of scope has been imposed where the entity has failed to record information with the necessary level of detail or accuracy to obtain sufficient audit evidence.

Appendix 2: Support from the ICAEW Financial Reporting Faculty on FRS 102 implementation

The Financial Reporting Faculty is providing a range of resources to help its members manage the changes that lie ahead, including:

- factsheets
- frequently asked questions
- webinars
- UK standards tracker
- UK GAAP conference and roadshows
- additional electronic resources and
- special editions of the faculty's journal *By All Accounts*.

You can find more information about this support in the leaflet *The New UK GAAP: Preparing for Change* and at icaew.com/newukgaap

Appendix 3: Glossary of terms and abbreviations used

Accounting Regulations	The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008
Management	This term is used to include those charged with governance over an entity where the context requires it
ES	APB Ethical Standard
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standard
ISA	International Standard on Auditing (UK and Ireland)
ISQC 1	International Standard on Quality Control (UK and Ireland) 1
UK GAAP	UK Generally Accepted Accounting Practice

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