
small company reporting

Vol. 21.4 Winter 2012/13

A quarterly bulletin dealing with Accounting and

ISSN 0 968 8897

Auditing matters affecting the smaller company

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first new rules for UK GAAP

At the end of November the Financial Reporting Council issued two FRSs which set out the basic framework for UK GAAP and which introduce exemptions for subsidiary and parent companies using EU-adopted IFRS. Early in 2013 it is the FRC expects to issue FRS 102, which will replace all current UK standards, with requirements based on the IFRS for SMEs adapted to take account of the provisions of the Companies Act 2006. All of these FRSs were developed by the ASB, but finally endorsed by its Accounting Council and issued by the FRC. The new rules apply for periods commencing on or after 1 January 2015, but may be applied early.

FRS100 *Application of Financial Reporting Requirements* sets out the basic framework governing true and fair accounts and requires entities to use the FRSSSE, FRS 102, FRS 101 or EU-adopted IFRS. A note will be required in the accounts stating which framework has been applied. Most the existing SORPs will be revised to cover the new arrangements and will be applied under rules in the new FRSs. Transition to the new arrangements will be dealt with in accordance with the rules set out in the relevant standard. All of the existing SSAPs, FRSs and UITF statements will be withdrawn, as will the Statement of Principles, its public benefit equivalent and the reporting statement on retirement benefits. FRS 101 *Reduced Disclosure Framework* applies to group companies applying EU-adopted IFRS, so is unlikely to be of any significance to users of **small company reporting**. It provides exemptions in the individual accounts from the extensive disclosures otherwise required.

After the changeover, all UK rules will follow the structure of IFRS, apart from those in the FRSSSE. This has been revised to require amortisation of goodwill and intangibles over no more than 5 years, when a reliable estimate of useful life cannot be made, and to require impairment reviews for all fixed assets, when there is an indication of impairment. In due course it is likely that FRSSSE will be revised to refer to FRS 102 and to reflect EU rules. In the meanwhile reference is to be made to FRS 102, instead of SSAPs, FRSs and UITF statements, which are withdrawn from 1.1.15, as a means of establishing current best practice.

How are all of these changes going to affect **small company reporting**? However, the old standards will remain in force until 2015, so we plan to retain the current checklists, specimen accounts and accounting standards summary until the end of 2016. We have included a summary of FRS 100 and 101 in the Accounting Standards Summary and expect to add a brief synopsis of FRS 102 in the next update and to include a succession of articles in the Bulletin explaining the new standard.

Over the next year or two we will revise the text of **small company reporting** to reflect the content of FRS 102. This will include:

- adding a full summary of the text (this spring or summer)
- revising the checklists in Part 2 and Part 3 (later this year and next)
- replacing the second example in Part 4 – specimen accounts (later)

When finished, as now, there will be three checklists covering the FRSSSE, main disclosures for companies applying FRS 102 and supplementary disclosures for less common items. There will be specimen accounts based on the FRSSSE and FRS 102 and a full summary of each standard, as well as the Companies Act guide and Pitfalls Checklist. For a while, probably until the end of 2016, it will be necessary to hold both new and old material from Parts 2,3,4 and 6. Once all of the changes are made, few companies will notice much difference in their accounts. For those using the FRSSSE new rules on goodwill, impairment and related parties will apply. However, FRS 102 will retain the Companies Act formats and many practices from the old standards.

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revisions to isas on auditor communications and audit reports

In later September the FRC made changes to the ISA 260 *Communication with those charged with governance*, which has triggered minor changes to several ISAs dealing with audit reports. Most of the amendments apply for periods commencing on or after 1 October 2012 but, apart from those covering application of the UK Corporate Governance Code may not be applied earlier. The changes give effect to the proposals of the FRC in *Effective Company Stewardship Next Steps*, published in September 2011 and support changes to the UK Corporate Governance Code and Guidance for Audit Committees, published a year later.

ISA 260 – communication with those charged with governance

The revised version of ISA 260 includes a requirement for the audit to communicate certain information to the board or audit committee, where the entity reports on how they have applied the Governance Code. Clearly this does not affect small companies, however, it may affect some small voluntary bodies such as charities so may be worth a brief look.

Where applicable, if not already covered by existing requirements of ISA 260, the standard requires an auditor to communicate the auditor's views:

- about business risks relevant to financial reporting objectives, the application of materiality and the implications of their judgments in relation to these for the overall audit strategy, the audit plan and the evaluation of misstatements identified;
- on the significant accounting policies (both individually and in aggregate);
- on management's valuations of the entity's material assets and liabilities and the related disclosures provided by management;
- without expressing an opinion on the effectiveness of the entity's system of internal control as a whole, and based

solely on the audit procedures performed in the audit of the financial statements, about:

- the effectiveness of the entity's system of internal control relevant to risks that may affect financial reporting; and
- other risks arising from the entity's business model and the effectiveness of related internal controls to the extent, if any, the auditor has obtained an understanding of these matters; and
- on any other matters identified in the course of the audit that the auditor believes will be relevant to the board or the audit committee in the context of fulfilling their responsibilities referred to above.

The ISA requires the auditor to include with this communication sufficient explanation to enable the audit committee to understand that the auditor's views relating to internal control are only expressed within the context of an examination for expressing an opinion on the financial statements.

ISA 700 – audit reports

The Governance Code includes a requirement for boards of listed entities and other complying entities to include a statement that the annual report is fair, balanced and understandable. In the light of this, the APB has determined that auditors should state in the scope paragraph of their report that the purpose of reading the financial statements and non-financial information in the annual report, is not only in order to be able to detect material inconsistencies but also "to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit". An example of the new scope paragraph is shown below. The changes made to ISA 705 and 706 concern upgrading some references to headings to reflect current practice and examples and to distinguish guidance relating only to reports in Ireland.

Scope of the audit

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether *the* accounting policies are appropriate to the group's and company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of the significant accounting estimates made by the director; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the [describe the annual report] to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

ISA 720 – other information

Under the current version of ISA 720 auditors are required to read other information in the annual report in order to identify material inconsistencies with the financial statements. In the revised version this is also done to identify information that is apparently materially incorrect based on, or inconsistent with, the knowledge acquired in the course of performing the audit. A new paragraph 14.1 requires the auditor to discuss any such information with management.

Although applicable only to periods commencing on or after 1 October 2012, it is something which almost all auditors will have been doing anyway. Alternations to audit programmes are unlikely to cause any practical changes.

notebook

accounting standards

frs update

As noted on page 1 the FRC published two new FRS at the end of November, both applicable for period beginning on or after 1.1.2015.

FRS 100 - Application of Financial Reporting Requirements. Will require entities preparing financial statements in accordance with legislation, regulations or accounting standards applicable to use of FRS 102, EU adopted IFRS or, for individual financial statements of qualifying entities, FRS 101.

FRS 101 – Reduced Disclosure Framework. Sets out disclosure exemptions for the individual financial statements of subsidiaries, including intermediate parents, and ultimate parents that otherwise apply the recognition, measurement and disclosure requirements of EU-adopted IFRS.

foreword to accounting standards

In November the FRC issued a revised version of the *Foreword to Accounting Standards*. This explains the authority, scope and application of accounting standards, now issued by the FRC, and the relationship to international standards issued by the IASB. Standards issued by the FRC, which currently include SSAPs, FRS, the FRSE, UITF Abstracts and FRC Abstracts are accounting standards for the purposes of the Companies Act 2006 and Regulations made there under. These require large company accounts to state whether they have been prepared in accordance with applicable accounting standards and to give particulars of any material departures and the reasons for it. The foreword contains no major changes from the ASB version, issued in 1993, beyond those arising from the new structure for issuing standards, outlined in the summer edition.

auditing

isa update

In late September the FRC published revised versions of ISAs 260, 700, 705 706 and 720A. The changes affect the wording of audit reports and communication with audit committees. Most of the amendments apply for periods commencing on or after 1 October 2012, but may be applied to earlier periods. However, changes to ISA 700 covering application of the UK Corporate Governance Code may not be applied early. The changes are outlined in the article on page 2.

auditors responsibilities - other information in the report

Just before Christmas the FRC published a consultation paper on the latest IAASB proposals for revising IAS 720 *The Auditor's Responsibilities Relating to Other Information in Documents Containing or Accompanying Audited Financial Statements and the Auditor's Report Thereon*. Under the proposals an auditor would be required to "read and consider the other information for consistency with the auditor's understanding of the entity and the environment acquired during the course of the audit. Whilst this would not have a great impact on auditors reports on private companies, those on the audits of listed entities would be considerable.

The FRC have produced an analysis of the effect of the proposed changes, which may be found at:

[http://www.frc.org.uk/getattachment/26508172-2b47-4e4b-81f6-532c89052d82/Analysis-of-the-main-potential-changes-in-auditing-standards-arising-from-the-Exposure-Draft-of-ISA-720-\(Revised\).aspx](http://www.frc.org.uk/getattachment/26508172-2b47-4e4b-81f6-532c89052d82/Analysis-of-the-main-potential-changes-in-auditing-standards-arising-from-the-Exposure-Draft-of-ISA-720-(Revised).aspx)

points arising

We act as auditors for a housing association registered as an industrial and provident society. There has been a breakdown of control during the period. We undertook additional work and are satisfied that the accounts show a true and fair view and comply in all other respects. However, we feel that we should qualify the audit report. Can you point us in the direction of a suitable example?

Strictly speaking this is not a qualification, but statement on which the auditor is expresses a negative opinion. You should base you report on example 28 in APB Bulletin 2010/2 but adapt it based on example 44. It is probably bet to include a basis paragraph after, the scope paragraph, although this it is not clear that this is required where the accounts are not qualified.

Basis for Matters on which we are required to report by exception

As explained in note xx to the financial statements, there was a break down in the system of control for part of the period.

After Opinion on financial statements:

Matters on which we are required to report by exception

In our opinion a satisfactory system of control over transactions has not been maintained.

We have nothing to report in respect of the following matters where the Industrial and Provident Society Act 1965 to 2002 require us to report to you if, in our opinion:

- the association has not kept proper accounting records
- the financial statements are not in agreement with the books of account; or
- we have not received all the information and explanations we need for our audit;

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update instructions

This update reflects changes arising from publication of revised ISAs including the additions to the audit report scope paragraph. This applies for period commencing on or after 1.10.12 but may be applied earlier. It also includes summaries of FRS 100 and 101. We have also revised the examples covering sample selection in the explanatory notes to cover application of performance materiality.

small company reporting

Introduction. *Replace pages 1,5-8,*

Part 1 – Small company checklist. Paras 1.3.10 *Replace page 6.*

Part 2 – Medium-sized and large companies. Paras 2.3.10 *Replace page 8*

Part 4 Specimen Accounts – APB addition to scope paragraph. *Replace pp 4/3 and 16. Delete p. 39*

Part 6 – Accounting Standards. Updated for FRS 100-101. *Replace 2/7/12,2/8,2/14*

scr procedures manual

Introductory notes / Update information *Replace pages 1,8-11*

Part 1 – Explanatory Notes. EN Paragraphs added 5.260.16, 5.700.16, 5.720.A6.1, 5.720.A14.1 Paragraphs revised 10.5.8, and audit evidence summary basic and advanced. *Replace pages 19/29, 19/100,20/1-20/2,32-34 and 36-37.*

Part 3 – Accounts Preparation. Minor corrections. *Replace page 7*

Part 5 – Audit. Revisions made to ACP 1.8, to remove a misprint in the misstatements summary, to highlight, in the audit planning memorandum, the need to discuss fraud arising from management override of controls and related party relationship and transactions and to reflect APB changes to the example audit report scope paragraph. *Replace AU.4, 15, 29 and 63.*

Part 7 – Pensions Schemes. Revisions made to ACP 2.7, CL 7.3.2.5 and audit report scope paragraph. *Replace PEN.53,83, 100.*

Part 9 – Clubs. Revisions made to ACP 2.7, CL 9.4.1/1.5 and audit report scope paragraph. *Replace CL.21,55,76.*

next edition

The next edition will be produced at the end of March and we expect to include a new section for the manual summarising FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. The bulletin will include the first of a series of articles reviewing the effect of implementing the new standard. Later in the year we intend to add a new checklist based on the FRS 102. In due course we will also revise the checklists in the SCR Procedures Manual to reflect changes to the rules governing the accounts of pensions schemes and clubs.