



Regulatory and Internal Audit Developments

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July 2014



Regulatory Developments

The governance agenda for 2014 – Audit market reform in the UK

The Competition Commission inquiry

Significant implications for audit committees



The Competition & Markets Authority announced a delay to its consultation on the draft Orders to allow time to consider the implications of the new EU regulations.

Remedies not taken forward

- Mandatory rotation
- Further restrictions on non-audit services
- Joint or shared audits
- Shareholder group or FRC responsibility for auditor reappointment
- Independently resourced Risk and Audit Committees

Audit tendering

The Competition Commission's transitional arrangements

"FTSE 350 companies should put the external audit contract out to tender at least every ten years."

If last put out to tender before 1 January 2005 (or have never done so):

- Must go out to tender within two years of the end of the current engagement partner rotation period

If there has been a tender since 1 January 2005 then:

- May choose not to hold a tender process at the end of the current engagement partner rotation period, but must do so by the end of the final year of the following five-year period

- Companies must explain when they intend to put the audit to tender in the audit committee report and why tendering at that time is in the interests of shareholders
- Audit committees must certify that they have complied with the Order
- Expected to come into effect in October 2014

Audit market reform

The position in Europe is now clear: Mandatory rotation
EU regulation



Under the proposals:

- All EU public interest entities will be required to **rotate** their auditors every ten years.
- If Member States choose to allow it, this period can be extended to 20 years if a tender is undertaken at the ten year point, or 24 years for a joint audit.

Transitional arrangements

Length of tenure as at date of entry into force	Must rotate
20 years or more	Within 6 years*
11-20 years	Within 9 years*
< 11 years	At the end of maximum duration permitted

* Of date of entry into force

Audit market reform

Further restrictions on non-audit services



The Regulation includes a list of prohibited non-audit services.

Plus there is a 70% cap on permissible non-audit services based on the average fees paid in the last three consecutive financial years for the statutory audit of the Group and its subsidiaries.

These requirements come into force in 2016 so there is time to plan, but need to note:

- Restrictions on services related to financial information technology systems applies during the year **prior** to the period covered by the financial statements.
- BIS will clarify the rules regarding permitted services for implementation in the UK in due course – there are likely to be differences between Member States.

Prohibited non-audit services

Under the current EU proposals, the following non-audit services will be prohibited:

- Provision of tax services relating to:
 - * preparation of tax forms
 - payroll tax
 - customs duties
 - * identification of public subsidies and tax incentives unless support from the statutory auditor or audit firm in respect of such services is required by law
 - * support regarding tax inspections by tax authorities unless support from the statutory auditor or audit firm in respect of such inspections is required by law
 - * calculation of direct and indirect tax and deferred tax
 - * provision of tax advice
- Services that involve playing any part in the management or decision-making process of the audited entity
- Bookkeeping and preparing accounting records and financial statements
- Payroll services
- Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or financial information technology systems
- * Valuation services, including valuations performed in connection with actuarial services or litigation support services

* Member States may allow these services, providing: they have no direct, or have an immaterial effect, on the audited financial statements; the effect on the audited financial statements is documented and explained in the report to the audit committee; and the principles of independence are complied with

Prohibited non-audit services cont'd

- Legal services, with respect to:
 - the provision of general counsel
 - negotiating on behalf of the audit client or
 - acting in an advocacy role in the resolution of litigation
- Services related to the audit client's internal audit function
- Services linked to the financing, capital structure and allocation, and investment strategy of the audit client, except providing assurance services in relation to the financial statements, including the provision of comfort letters in connection with prospectuses issued by the audit client (see next page)
- Promoting, dealing in, or underwriting shares in the audited entity
- Human resources services with respect to:
 - management in a position to exert significant influence over the preparation of the accounting records or financial statements which are the subject of the statutory audit, where such services involve:
 - searching for or seeking out candidates for such positions or
 - undertaking reference checks of candidates for such positions
 - structuring the organisation design
 - cost control
- Member States may prohibit additional services which could represent a threat to independence

Audit tendering

FRC offers advice on conducting effective audit tenders

The key steps identified to conduct an effective tender are....

Be clear about what you want to achieve and talk to major shareholders early

Develop clear criteria that are right for the business – reputation alone is not sufficient

Audit Committee leadership is essential

Put audit quality, not price, at the top of the list.

The role of the lead audit partner is key

Don't rule out incumbents without good reason

Work with potential auditors to ensure they are free to compete under independence rules

Allow sufficient time for an orderly handover – plan the transition

Internal Audit Developments – co-sourcing

Deloitte Internal Audit

Making it one of your most valuable resources



An effective internal audit activity is a valuable resource for management, the board or its equivalent and the audit committee due to its understanding of the organization and its culture, operations, and risk profile.

We bring the required skills, experience and capacity to the table in co-sourcing with or outsourcing your internal audit function. We draw on our firm wide specialist skills to bring a comprehensive solution to our clients. In addition to providing independent assurance on critical business processes, we strive to be strategic business advisors by focusing on continuous business improvement and assist you to achieve your business objectives.

Full outsourcing includes the performance of all internal audit activities (including risk assessment, audit planning, performance, communication/ reporting, etc.) on a recurring basis. Whereas, Co sourcing is the performance of ongoing support of the client's total internal audit efforts.

Our approach includes

- Identification and monitoring of financial and operational risks;
- Conducting financial and operational audits;
- Assessing the adequacy, efficiency and effectiveness of internal controls; and
- Recommendations on best practices towards process improvements and corporate governance practices.

Internal Audit Related Services



Our offering with a difference:

- Provides an integrated approach aligned to Standards for the Professional Practice of Internal Auditing.
- Includes IT audit capabilities, as well as SAP, that incorporates the requirements as set out by the Standards for the Professional Practice of Internal Auditing.
- Includes Deloitte Analytics, a big step towards continuous auditing as our analytics could be used on a continuous basis.
- Provides an approach that strives to assist clients in obtaining world class Internal Audit functions.



The table below illustrates benefits organisations need to consider when deciding on where the internal audit function should be housed.

Benefits

Company hires a limited core internal team of management and/or staff and uses an outside professional provider to supplement the team and/or to provide strategic direction to the internal audit service.

- Enables a balance of internal knowledge with external leading edge experience;
- Enables team resource flexibility as required (level, skill set, fit with company);
- Leverages subject matter specialisation when required;
- Enables team load levelling and flexible staffing to balance out demand without full-time commitment of resources;
- External providers usually maintain integrated technologies and toolsets that can be shared internally;
- Provides access to professional knowledge bases and benchmarks;
- Can be viewed as “one team” that is committed to internal goals;
- Can enable management development and rotation of internal resources with the external provider providing continuity; and
- May provide an optimal pricing structure with limited commitment.

Company uses an external professional provider for all internal audit activities.

- Leverages external resources for the management and execution of the internal audit function;
- Does not require commitment to internal recruiting, retention and development of resources;
- The external provider can provide a complete, turnkey approach to internal audit (e.g. methodology, tools);
- The entity pays for core audit time only with limited administration or overhead costs;
- Enables team resource variability as required (level, skill set, experience, fit with company, location);
- Can be a lower-cost option, but need to weigh cost and benefits, given challenges;
- Enables global resourcing when required for language, location, cultural understanding; and,
- Reduces the travel expense where the service provider has local representation amongst auditees.

Cosourcing arrangement cycle

CONTINUE EXISTING INTERNAL AUDIT ACTIVITIES

1

- Complete 2013 plan (2 engagements) and refine follow up activities

Deliverables:

- Engagement reports
- Presentation to the Audit Committee on Q3/4, as required

ANALYZE RISK MAP AND DEVELOP INTERNAL AUDIT PLAN

2

With management:

- Analyze risk map and audit universe, previous reports and management action plans and open items. Consider external factors
- Prioritize risks to determine the relative risk rankings
- Apply risk assessments to internal audit universe and prioritize auditable activities
- Develop risk-based internal audit plan

Deliverables:

- Preliminary risk-based internal audit plan

CO-DEVELOP EXPECTATIONS AND APPROVE PLAN

3

- Meet with senior management and Audit Committee to refine expectations, define communication and reporting
- Consider the expectations from the Audit Committee and the senior management for internal audit opinions and other conclusions
- Schedule internal audits and plan resources
- Present internal audit plan to executive management and the Audit Committee

Deliverables:

- Determined frequency and content of reporting
- Risk-based internal audit plan

Stage 1

Stage 2

6

DELIVER RESULTS AND INSIGHTS

- Present internal audit report
- Follow up and track internal audit recommendations/ management action plans
- Periodically report to executive management (and the Audit Committee, as required) on results of internal audits, emerging risk issues, etc.
- Continuously monitor performance and enhance internal audit plan

Deliverables:

- Internal audit report
- Issues and observations tracking (follow up)
- Audit Committee reporting, as required

5

EXECUTE INTERNAL AUDIT PLAN

- Perform walk-throughs, detailed testing and analysis
- Assess business risks and evaluate controls
- Identify internal audit issues and process and control enhancement
- Review results with management (throughout the internal audit)
- Hold formal exit meeting at conclusion of fieldwork
- Draft internal audit report

Deliverables:

- Internal audit work papers
- Business risk assessments
- Issues and recommendations

4

DESIGN ENGAGEMENT WORKPLAN

- Identify internal audit project scope
- Conduct planning meetings with management
- Coordinate core project team and subject matter specialists
- Develop internal audit work program
- Complete planning details

Deliverables:

- Internal audit work program

Planning Methodology

Risk Assessment Methodology

Execution Strategy



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