

1 ICAEW audit monitoring 2021/22 (Lecture A819 – 10.22 minutes)

In the year ended 31 March 2022, ICAEW's QAD conducted 555 audit monitoring reviews. Most of these monitoring visits were onsite following the disruption caused by the Covid-19 pandemic. Going forward, some audit file reviews at the largest firms are likely to retain a combination of onsite and remote aspects.

1.1 Summary of findings

76% of audits reviewed were either good or generally acceptable and the improvement seen in 2020/21 has been maintained. Audits requiring significant improvement are down to 4% compared to 7% in 2020/21 and 8% in 2019.

80% (2020/21: 76%) of visits were closed without follow-up action. 14% of visits (2020/21: 17%) required some follow-up action to satisfy QAD that the necessary improvements would be made and 6% (2020/21: 8%) were referred to the ARC for more significant action.

Follow-up action taken by ARC included:

- A requirement to submit audit file reviews carried out by specialist third parties of either future audits pre-issuance (hot file reviews) or post-issuance (cold file reviews).
- A requirement to provide further explanations or documentation demonstrating changes to procedures or planned training to address matters raised during the visit.
- A requirement from the firm to be subject to another QAD monitoring visit to check the firm's progress.
- Referral of particularly serious matters for investigation by ICAEW's Professional Conduct Department leading to possible sanctions on the firm or individuals involved.
- Regulatory (financial) penalties.

1.2 Areas for improvement

Areas for improvement fall into a number of categories. The ICAEW's monitoring report cites the following areas for improvement:

Lack of audit planning and risk assessment

This leads to limited knowledge about the client and its activities, processes and controls. Consequently, firms do not adequately address the risk of fraud arising from management override of controls and audit procedures are poorly designed and sometimes inappropriate given the activities of the audit client. Even where audit procedures are considered adequate, they will sometimes lack consideration of risk and may result in over-auditing of some areas.

Audit evidence

Issues discovered by QAD include:

- Cases where QAD is presented with an accounts preparation file, with virtually no evidence of any audit work being completed
- Lack of consideration of asset valuations and existence
- Insufficient procedures over income and expenditure
- Lack of consideration of the use of service organisations by the audit client

Going concern issues have also risen in the ranks of importance since the Covid-19 pandemic, accentuated by recent changes to ISA (UK) 570 *Going Concern*. These changes require a positive statement on the appropriateness of the going concern basis in every auditor's report.

ICAEW have stated that they see firms which have carried out insufficient work to evaluate and challenge material uncertainties over audited entities' forecasts and assumptions underlying going concern.

Compliance with the FRC Ethical Standard

The ICAEW monitoring report acknowledges that significant ethical issues are rare but, where they do occur, they are of critical importance in the assessment of audit quality because they can bring into question the fundamental independence of the audit firm and those working on the audit engagement.

During 2021/22, QAD identified one case where the responsible individual (RI) and two fellow principles in a firm had entered into a business relationship with the director of an audit client, and two cases where the RI or another covered person was trustee of a trust with a material interest in the shares of the audit client.

Audit firms are reminded that breaches of the FRC Ethical Standard require biannual reporting to ICAEW (or where the firm is a PIE audit firm, the FRC).

Whole-firm procedures

As audit firms grow, they will become increasingly dependent on strong whole-firm procedures to monitor and control the quality of audit work across multiple audit teams and locations. Even smaller firms will need some key policies and procedures to ensure their audit practice is up to date.

CPD is an important factor where audit is concerned (particularly as auditing standards change on a frequent basis). The ICAEW monitoring report states that QAD have seen firms where there was little or no CPD undertaken by the RI over a number of years and/or no monitoring of CPD completed by sub-contractors and staff involved in audit work. These gaps were evident from the poor-quality audit work seen by QAD.

Cold file reviews are deemed to be an essential check on audit quality that enables a firm to identify and resolve emerging issues. Firms without anyone who can conduct a cold file review independently of the audit engagement team must have an external cold file review at least once every three years. QAD have seen firms that have not arranged a cold file review (either internally or externally) for three to four years which has led to the firm carrying out poor quality audit work.

Eligibility and control of audit firms

The management and control of an audit firm is important to safeguard the tone and message from leadership and to ensure that decisions are made that are in the public interest.

QAD monitoring visits that have led to a report to the ARC for consideration of further action include those where QAD have identified eligibility issues (although in some cases there may be little immediate concern about audit quality on engagements QAD have reviewed).

Cases include firm restructuring such that ownership is no longer with audit qualified individuals or other registered auditors, and appointment of directors/principals without properly notifying ICAEW.

1.3 Good practice

The ICAEW audit monitoring report for 2021/22 highlights four key areas that are considered to be good practice as follows:

- **Audit risk assessment** – depth of understanding of the business, structure and control of an audited entity enabling the firm to clearly identify areas of risk to plan effective audit procedures.
- **Challenge of management** – robust challenge of an audited entity's management to explain and justify key judgements underlying the information in their financial statements, whether this is in assessment of going concern, provisions or valuations of assets.
- **Documentation** – working papers that provide a clear narrative of the audit work completed and conclusions drawn, often with comprehensive cross-referencing across the audit file.
- **High quality reporting** – management of the audited entity and those charged with governance, explaining the work done and conclusions on the audit, and highlighting the principal risks and uncertainties with judgements made by management and the auditor's conclusions.