Audit News – Autumn 2021

All Responsible Individuals in your firm should receive a copy of Audit News by email. If this is not the case, please contact us, however, note that the most common issues are when:

- ICAS do not hold an up-to-date email address for the individual; or
- The individual has indicated elsewhere (such as on their own annual return) that they do not wish to receive email communications from ICAS; or
- Emails get caught in an anti-spam filter.

Note that the best way to ensure you receive all communications from ICAS is to give permission to the email that these communications come from (the vast majority come from update@update.icas.com). You can do this by:

- Adding us as a contact on Outlook and marking us as a safe sender.
- On Gmail, marking messages as 'Not Spam' when finding them as well as adding us as a contact.
- On Apple Mail, search for any messages in Junk, go to 'more' and mark as 'not junk'

Audit Monitoring update

2021 Audit Monitoring visits

As a result of the COVID-19 pandemic, and related restrictions, ICAS has continued to conduct monitoring activities on a remote basis. From 1 October 2021, we will return to our pre-COVID-19 review practices, including onsite visits. If you already have a remote visit arranged after this date, your reviewer will be in touch to rearrange this to an onsite visit.

If an onsite visit is not possible because of a change in government guidance or if you have not yet returned to your office, your reviewer will discuss whether we can carry out a remote visit instead.

Please note that we are conscious of the difficulties that everyone is facing within the profession at the moment, however, are also required to ensure that our regulatory responsibilities are undertaken.

Mandatory audit quality course: Keeping Audit on the Right Track

This course aims to educate Audit Compliance Principals (ACPs) and Responsible Individuals (RIs) in developing a strong compliance function and preventing some of the recurring issues identified on audit monitoring visits. The COVID-19 pandemic, and related restrictions, has resulted in the planned 2021 face to face courses being cancelled. Please note that in 2020, the Committee approved the following changes to the course, and to mandatory attendance going forward:

- A video recording of the course is available on the ICAS website, which is free for members to access any time they wish and is split into seven modules which can be viewed together or individually. The course material can be accessed (by logging into icas.com) at https://www.icas.com/regulation/regulatory-monitoring/keeping-audit-on-the-right-track

  Should members prefer to attend a face-to-face course, we plan to recommence these in 2022 (subject to government guidance) with courses presented each year in Edinburgh, Glasgow, and Aberdeen. The cost of attendance will be in line with previous years, and further information will be provided in a forthcoming edition of Audit News.

- **Firms are reminded that the mandatory aspect of this course has been updated. All ACPs and RIs are now required to view all modules of the online course, or attend a face-to-face course, once every 2 years (commencing from 1 September 2020). In addition, all new RIs or newly active RIs must view all modules of the online course or attend a face-to-face course within 12 months of becoming active**.

- **The Committee considers that the availability of the course online will ensure that this mandatory aspect will be more easily adhered to, and that this will maintain the focus on audit quality**. **Going forward, firms will be required to confirm adherence to the mandatory requirements via the Firm's Annual Return.**

IAASB Consultation - A new standard for the audit of less complex entities

Based on the feedback from a discussion paper and outreach, the International Auditing and Assurance Standards Board (IAASB) has proposed a new stand-alone standard for audits of less complex entities.

The draft standard is designed specifically for audits of less complex entities and is based on the underlying concepts from the International Standards on Auditing (ISAs). In the opinion of the IAASB, the standard will reduce the risk of jurisdictional divergence by driving consistency and comparability globally.

This landmark new draft standard represents a new era for the IAASB, and stakeholder feedback is now needed. The public consultation on this draft new standard is open until 31st January 2022. Full details can be found at https://www.iaasb.org/focus-areas/new-standard-less-complex-entities

Financial Reporting Council (FRC) update

Illustrative Auditors Reports – Updated Bulletin

The FRC has issued an updated Bulletin of Illustrative Auditor's Reports which includes updated references to legislative changes post-EU exit transition period.

The bulletin is for private sector financial statements for periods commencing after 1 February 2020 with filing after 31 December 2020.

A link to the Bulletin can be found here.

FRC Revises UK Quality Management Standards

The Financial Reporting Council (FRC) has issued revised quality management standards for an audit firm's responsibilities to design, implement and operate a system of quality management:

- International Standard on Quality Management (UK) 1 (ISQM(UK)1) *Quality Management for Firms That Perform Audits or Reviews of Financial Statements, Or Other Assurance or Related Services Engagements*
- International Standard on Quality Management (UK) 2 (ISQM(UK)2) *Engagement Quality Reviews*
- International Standard on Auditing (UK) 220 (Revised July 2021) *Quality Control for an Audit of Financial Statements*

The new ISQM(UK)1 replaces ISQC(UK)1, while ISQM(UK) 2 is a new standard setting out the appointment and eligibility requirements, and responsibilities of the engagement quality reviewer in relation to the performance and documentation of an engagement quality review

The new standards introduce a quality management approach that is focused on proactively identifying and responding to risks to quality. This new approach will require firms to customise the design, implementation and operation of its system of quality management based on the nature and circumstances of the firm.

The standards are effective for audits of financial statements for periods beginning on or after 15 December 2022. Early adoption of the revised standards is strongly encouraged. Further and more detailed guidance will be issued on icas.com however in the interim, Audit Compliance Principals (ACPs) are strongly advised to review the new requirements and consider the impact on their own firms.

In June 2021, the International Auditing and Assurance Standards Board (IAASB) released two guides to help stakeholders implement its suite of quality management standards. The guides will help stakeholders understand the standards and properly implement the requirements in the manner intended:

- First-time Implementation Guide for International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*
- First-time Implementation Guide for ISQM 2, *Engagement Quality Reviews*

The IAASB will also issue an implementation guide for International Standard on Auditing 220 (Revised), *Quality Management for an Audit of Financial Statements*, in Q3 if 2021

FRC on track to become a new, more resilient regulator

The Financial Reporting Council (FRC) has published its Annual Report and Accounts which looks at the progress made over 2020/21 and the next steps in delivering a programme of transformation towards the new robust and independent regulator, The Audit, Reporting and Governance Authority (ARGA).

Significant development has been reported in the following areas:

- The FRC have established an integrated transformation programme to address the 155 recommendations of the three independent reviews from Sir John Kingman, Sir Donald Brydon and the Competition and Markets Authority.

- The FRC has strengthened its supervision of audit firms to promote better audit quality and provided support to the UK's largest audit firms as they took the first steps towards operational separation of their audit businesses. It has also set up a competition policy team and created a new stakeholder engagement and corporate affairs function.

- The FRC continues to focus on reflecting stakeholder views and concerns in its work. It is doing this through a more extensive and holistic stakeholder engagement programme.

This more extensive programme is intended to improve transparency, outreach and intelligence gathering to help the FRC deliver its strategic objectives.

A copy of the FRC's Annual Report and Accounts can be found here.

FRC Annual Audit Quality Inspection results

The Financial Reporting Council (FRC) has published its annual inspection and supervision results for 2020/21 covering the seven largest audit firms

The 2020/21 results show that 29% of audits reviewed required improvement or significant improvement, quality across firms was mixed; and a number of improvement measures implemented.

A link to all seven reports can be found here.

FRC announces proposals to strengthen significantly the UK's Audit Firm Governance Code

The Financial Reporting Council (FRC) has announced a consultation on proposals to update and strengthen significantly the Audit Firm Governance Code in support of the FRC's objectives to promote high-quality audit and audit market resilience. The Code applies to the Big Four and to other firms auditing FTSE 350 companies. Going forward it will also apply to firms that audit significant numbers of other types of public interest entities.

The consultation is open until 18th November 2021, and the proposals look to:

- Strengthen the Audit Firm Governance Code in key areas of accountability and firm resilience.
- Enhance and clarify the role played by partnership boards in holding management to account.
- Separate the roles of board chair and senior partner/chief executive.
- Introduce criteria for board composition and reinforce the position of independent non-executives within audit firms.
- Emphasise the importance of long-term sustainability, people, culture, and employee engagement, in line with the UK Corporate Governance Code.

New FRC guidance - Addressing exceptions in the use of audit data analytics

The FRC has issued guidance for auditors on addressing potential exceptions when using audit data analytics (ADA).

In the guidance, the FRC have laid out general principles for dealing with outliers when using ADA to respond to identified risks in an audit, a potential approach auditors could take and included an illustrative example based on a real-world scenario. The FRC have also included examples of best practice, and potential pitfalls to avoid assisting auditors in undertaking this process effectively.

The guidance includes a non-exhaustive list of considerations that auditors may wish to take account of before making use of ADA in the evidence collection stage of the audit. Note that the focus of the guidance is on using ADA to respond to risks, as part of substantive testing and evidence collection, rather than assessing the risk of material misstatement at the planning stage of an audit.

A copy of the guidance can be found here.

Reporting Ethical Breaches – a reminder

Firms are reminded that ICAS registered audit firms that do not audit PIEs must report breaches of the FRC's Ethical Standard to ICAS on a biannual basis. Firms need to be aware of this requirement and consider how to ensure any breaches are properly and promptly reported.

The revised FRC Ethical Standard 2019 applies for accounting periods commencing on or after 15 March 2020. One of the revisions at paragraph 1.21 requires audit firms to report breaches of the Ethical Standard **on a biannual basis** to either:

- The FRC (for Public Interest Entity (PIE) audit firms); or
- ICAS as Recognised Supervisory Body (for non-PIE audit firms).

ICAS registered firms (that do not audit PIEs) should make notifications on a biannual basis by email to regulatoryauthorisations@icas.com

Note that an inadvertent breach of the Ethical Standard does not necessarily call into question the firm's ability to give an audit opinion. In order to ensure that the requirements of the Standard are adhered to, firms are advised to:

a. Establish policies and procedures that require all partners and staff (and other covered persons) to report any breach in a timely manner to the engagement partner or to the Ethics Partner.

b. Ensure that any matter which has given rise to a breach is addressed as soon as possible.

c. Ensure that appropriate safeguards are applied and that these are in line with the requirements of the Ethical Standard.

d. Fully document all actions taken by the firm.

The relevant paragraph, 1.21 of the Standard is as follows:

"Whenever a possible or actual breach of this Ethical Standard, or of policies and procedures established pursuant to the overarching principles and supporting ethical provisions and requirements established in it, is identified, the engagement partner, in the first instance, and the Ethics Partner, where appropriate, shall assess the implications of the breach, determine whether there are safeguards that can be put in place or other actions that can be taken to address any potential adverse consequences and considers whether there is a need to resign or withdraw from the engagement. The firm shall report all breaches to the Competent Authority on a biannual basis and to those charged with governance of an entity relevant to an engagement, where a breach relates to a specific engagement or engagements in a timely manner."

A copy of the FRC Ethical Standard 2019 can be downloaded from https://www.frc.org.uk/auditors/audit-assurance/standards-and-guidance/current-ethical-standards

Streamlined Energy and Carbon Reporting

Streamlined Energy and Carbon Reporting (SECR) requirements have been in place for periods commencing 1 April 2019. We have had a number of queries on monitoring visits around disclosure and the auditor's responsibilities in this regard.

The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 (the 2018 Regulations) implemented the government's policy on Streamlined Energy and Carbon Reporting (SECR).

The Regulations require certain UK companies and LLPs to report their UK energy use and associated greenhouse gas emissions as a minimum relating to gas, electricity and transport fuel, as well as an intensity ratio and information relating to energy efficiency action, through their annual reports.

These requirements are for reporting periods starting on or after 1 April 2019, and impact:

- All UK incorporated companies listed on the main market of the London Stock Exchange or in an EEA state or whose shares are dealing on the New York Stock Exchange or NASDAQ
- Unquoted large companies incorporated in the UK, which are required to prepare a Directors' Report under Part 15 of the Companies Act 2006**
- Large Limited Liability Partnerships (large is defined as per the existing framework for annual accounts and reports, based on sections 465 and 466 of the Companies Act)

*** Large companies, as defined in sections 465 and 466 of the Companies Act 2006, are companies that meet two or more of the following criteria:*

- *turnover (or gross income) of £36 million or more,*
- *balance sheet assets of £18 million or more,*
- *250 employees or more.*

For companies, the associated disclosures must be included in the directors' report. For LLPs, the associated disclosures must be included in a new Carbon and Energy report which will form part of the annual report.

Summary of required disclosures

Quoted companies	Large unquoted companies and LLPs
Annual GHG emissions from activities for which the company is responsible including combustion of fuel and operation of any facility, and the annual emissions from the purchase of electricity, heat, steam or cooling by the company for its own use. This includes KWH used and emissions of carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulphur hexafluoride (SF_6).	UK energy use (as a minimum gas, electricity and transport, including UK offshore area) This includes gas and fuel used (fuel only for transport); and electricity for own use (including transport).
Underlying global energy use and emissions (with UK proportion disclosed)	Associated greenhouse gas emissions (i.e., emissions associated with UK energy use above)

Previous year’s figures for energy use and GHG emissions	Previous year’s figures for energy use and GHG emissions
At least one intensity ratio - an intensity ratio divides the total emissions by a normalising factor, in order to give comparable data e.g., emissions per £m revenue: emissions per full-time employee etc)	At least one intensity ratio
A summary of the main energy efficiency action taken	A summary of the main energy efficiency action taken
The methodology used for calculations	The methodology used for calculations

Guidance states that 'organisations must use verifiable data where reasonably practicable' and, while this will likely include meter reading data and invoices or annual statements from suppliers, it may also include estimates, extrapolation of data and benchmarking.

In line with best practice, including recommendations from the FRC, reports for larger and more complex entities may include more detailed narrative including:

- The process for identifying & managing climate related risk.
- A description of the risks and opportunities identified in the short, medium and longer term.
- The impact on strategy and financial planning; and
- How resilient the strategy is to climate change?

Considerations for auditors

As with any part of the Directors’ report, auditors must consider whether disclosures:

- are consistent with the financial statements
- have been prepared in accordance with applicable legal requirements
- contain any material misstatements based on their knowledge obtained in the audit.

Under ISA (UK) 720, there is a requirement for the auditor to consider whether the other information presented in the financial statements is materially inconsistent or appears to be materially misstated. This, together with the requirement for the auditor to obtain an understanding of the legal and regulatory requirements applicable to the statutory other Information, and how the entity is complying with those legal and regulatory requirements (ISAs (UK) 250A and 315) make it likely that the work to be performed by the auditor will amount to more than a ‘read through’

ICAS AM would advise auditors to ensure that, where SECR disclosures are required, that the matter is discussed fully with management at the planning stage to understand how the report has been prepared and the extent of verifiable data used. This will allow the auditor to consider the impact on the audit approach and the extent of further work required.

Group reporting

If you are reporting at group level, when making energy and carbon disclosures, the entity must take account of the information of any subsidiaries included in the consolidation which are quoted companies, unquoted companies or LLPs. The entity does, however, have the option to exclude any information relating to a subsidiary where that subsidiary would not have to report in its own accounts.

At subsidiary level, the entity might not be obliged to include energy and carbon information if:

- They are a "subsidiary undertaking" at the end of the relevant financial year.
- They are included in the group Report (whether a group Directors' Report or a group Energy and Carbon Report) of a "parent undertaking".
- That group Report is prepared for a financial year of the parent that ends at the same time as, or before the end of, the subsidiary's financial year; and
- The group Report complies with the relevant obligations on the parent to report energy and carbon information for themselves and their subsidiaries.

Considerations for auditors
ICAS AM considers that it would be appropriate for parent company auditors to check that reporting is at a group level and includes those subsidiaries who would have to report in their own accounts.

At a subsidiary level, specifically where the audit firm does not audit the parent company, the auditor should confirm the validity of any exemptions taken for subsidiaries who would otherwise have to report in their own accounts.

Low energy users

Note that where an organisation is a low energy user it is not required to make the detailed disclosures of energy and carbon information. This should be disclosed in the relevant report i.e., that its energy and carbon information is not disclosed for that reason.

The following qualify as low energy users:

- **Quoted companies** – those entities preparing a Directors' Report which have consumed 40,000KWh or less during the period in respect of which the report is prepared. If the quoted company is preparing a group Directors' Report, the assessment is of the energy consumption of the parent and its subsidiaries which are included in the consolidation and are quoted companies, unquoted companies or LLPs.
- **Unquoted companies or LLPs** – those preparing a Directors' Report or Energy and Carbon Report which have consumed 40,000KWh or less in the UK, including offshore area, during the period in respect of which the report is prepared. If the entity is preparing a group report, the assessment is of the energy consumption of that parent and its subsidiaries.

Considerations for auditors
Auditors should consider, when the exemption is taken, whether the appropriate disclosure has been made. As part of general audit work, there should be consideration of whether the entity is likely to be below the thresholds defined in the legislation (based on the nature of the entity; its size and trade) and perform further enquiries of management and audit procedures if considered appropriate.

The audit of cash at bank

ICAS AM have raised a number of points on recent monitoring visits around the audit of cash at bank.

Specific issues have arisen where the auditor has not obtained a bank confirmation letter, and this has led to a number of queries from firms.

Background

On 14 July 2017, the FRC announced that it would be replacing Practice Note 16 (PN16) with additional application material in ISA (UK) 330 – The Auditor's Responses to Assessed Risks; and ISA (UK) 505 – External Confirmations. The proposed changes applied to the audit of financial periods beginning on or after 15 December 2017.

The reason for the removal was that, in the opinion of the FRC, the requirement for a bank confirmation report continued to be a matter of professional judgment for the auditor and, therefore, the revision did not change the existing requirements on auditors, but rather was intended to reduce the amount of guidance in issue, and to better integrate that guidance with auditing standards.

However, some key questions were raised on removal of the Practice Note. Under PN16:

"*Given the importance of cash to an entity's business and its susceptibility to fraudulent misuse the auditor will usually conclude that, in the absence of a bank report regarding account balances, facilities and securities, it will not normally be practical to obtain sufficient appropriate audit evidence from other sources*".

Following the explicit requirements of the PN wording, a bank confirmation letter was historically obtained by audit firms as a matter of course, regardless of the assessment of risk.

With this wording removed, and the revised guidance within ISAs (UK) 330 and 505 not closely replicating the wording of the withdrawn PN16, or the prescriptive nature of the extract quoted above, the emphasis was very much placed on auditor judgement.

Issues with bank confirmation letters

We have regularly received feedback from our audit firms for a number of years that obtaining an accurate bank confirmation letter can be very frustrating and time consuming. Common issues include:

- The inability to obtain an accurate confirmation which can delay the signing of an audit report, or simply the confirmation is not received until after the date of signing.
- Errors or inaccuracies in bank confirmations which have been received; and
- Concerns over completeness – i.e., how can a bank confirmation test completeness when the bank asks the auditor to supply the account numbers first?

These are all valid concerns. They do not, however, remove the existing requirement under the ISAs to obtain sufficient and appropriate audit evidence, and from a regulatory perspective the bank letter can still be an important source of evidence.

Gathering evidence

There have been a number of issues on recent audit monitoring visits where a bank confirmation letter has not been obtained and the reviewer has asked the auditor to confirm how sufficient evidence was obtained, in particular over the assertions of existence and accuracy.

Naturally this has led to a number of further queries from firms during the review process, in particular given the removal of PN16 seemed like an opportunity for auditors to rid themselves of the bank confirmation letter for good.

On recent monitoring visits, where we have raised a breach for lack of evidence obtained over bank and cash, this has been where the firm not only hasn't obtained a bank confirmation despite being part of the planned audit approach but has also not designed and performed alternative audit procedures with reliance placed solely on a copy of the year-end bank statement.

While other bank testing issues do arise – for example: no additional testing on bank reconciliations; no window dressing tests; and no review for large and unusual items – the key omission is usually the bank letter and, where this is deliberately not requested, is very rarely supported by a detailed assessment of low risk or a suitable alternative audit approach.

The risk assessment process

What is clear is that where auditors have elected not to obtain a bank confirmation letter, the risk assessment process is rarely documented sufficiently to justify low risk. The risk assessment of cash at bank is often overlooked given the presumed comfort of the bank confirmation letter and is therefore often not given sufficient attention by the audit team. This is becoming more of an issue as firms look to dispense with the annual confirmation requirement.

Auditors should be clear that attributing low risk to a bank balance requires a number of additional considerations, which might include:

- whether there has been previous fraud or error.
- the size and nature of the balance in relation to the financial statements.
- whether it is the first year of audit; and
- the expectations of a group auditor.

Even if the auditor is able to demonstrate low risk, they will then have to demonstrate how appropriate evidence can be obtained over all relevant audit assertions which would otherwise be covered by the confirmation letter. In the opinion of ICAS AM, viewing bank statements or bank details online is alone not enough; additional work will extend beyond routine bank testing (e.g., cut-off, window dressing etc); and firms will have to consider whether obtaining sufficient appropriate audit evidence over all relevant assertions may require elements of controls testing or data analytics. This may include, but is not limited to, further procedures such as:

- Ensuring that walkthrough tests – the assessment of key systems and controls in the current year under ISA (UK) 315 – appropriately cover the entity’s system for recording transactions and relevant controls.
- Observing a member of the entity’s finance team log on to the electronic bank system, vouching the bank accounts listed, the balance at the year-end for each account and ensuring that this is sufficiently documented on the file.
- Targeted controls testing over bank reconciliations; access rights; BACs controls etc

Other considerations

There are also considerations for other disclosures in the financial statements - the bank confirmation letter, for example, is a valuable source of evidence for confirming the nature of any securities and obligations; bank loan balances; and title to property. It is worth noting that this point is further reflected in ISA (UK) 330:

“In the UK, depending on the auditor’s risk assessment, the auditor considers whether confirmation is needed in relation to additional information such as trade finance transactions and balances or information about guarantees and other third-party securities, in addition to the confirmation of balances and other banking arrangements usually provided in such a request”.

It is important to note that the FRC has ruled out further guidance in this area and, while this does not rule out further guidance which might be issued by ICAS or another professional body, the requirement for bank confirmation letters under the ISAs (UK) is firmly a matter of professional judgement.

Conclusion

Firms who no longer consider it appropriate to obtain bank confirmation letters are advised to review their approach to testing cash at bank to ensure a proper risk assessment has been performed and documented, and that sufficient evidence has been obtained to justify the audit conclusions in this area.