April 2025

2024 Audit Monitoring visit findings

Executive summary

This report outlines the findings from the 2024 audit monitoring visits conducted by ICAS. It highlights trends in audit quality, compliance with auditing standards, and common areas for improvement.

Visits: 25 monitoring visits were conducted in 2024, the same number as in the previous year.

Outcomes: While there was a slight increase in the number of visits with only minor findings, there was also a rise in visits presenting the most serious issues. Generally, visits required to meet the 6-year cycle showed better outcomes compared to those on a shortened cycle, indicating firms with poorer outcomes in the last visit had not sufficiently improved.

Audit File Quality: There was a slight decline in overall audit quality, with 52% of files being considered compliant (requiring no more than 'limited improvement'), down from 60% in 2023. The number of files that were considered non-complaint rose from 40% to 48%, reflecting 13% of files 'requiring significant improvement' and 35% 'requiring improvement'.

Common ISA Breaches: The most common ISA breaches involved documentation (ISA 230), risk assessment (ISA 315), fraud considerations (ISA 240), evidence (ISA 500), sampling (ISA 530) and going concern (ISA 570). These are the same areas flagged in the 2023 annual monitoring report and should be key areas of focus for firms going forward.

Wider regulatory Compliance: Common breaches of audit regulations were noted in acceptance and reappointment procedures (AR 3.03), statutory requirements (AR 3.08), and compliance with ISQM1 (AR 3.10), ethical compliance (AR 3.02); Audit compliance reviews (AR 3.20). Again, these are the same most common areas as flagged in the 2023 monitoring report.

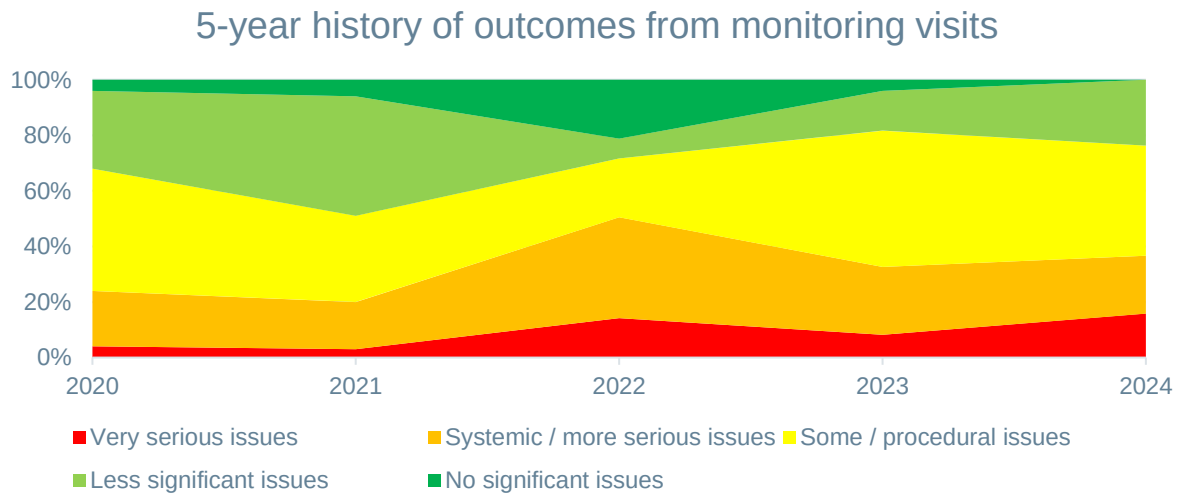
Recommendations for Improvement: The report seeks to highlight the importance of addressing identified common weaknesses, enhancing documentation practices, and ensuring compliance with all relevant standards to improve overall audit quality and regulatory compliance. Examples of good practice are included throughout to give some helpful tips for compiling compliant files.

2024 Audit Monitoring visit findings

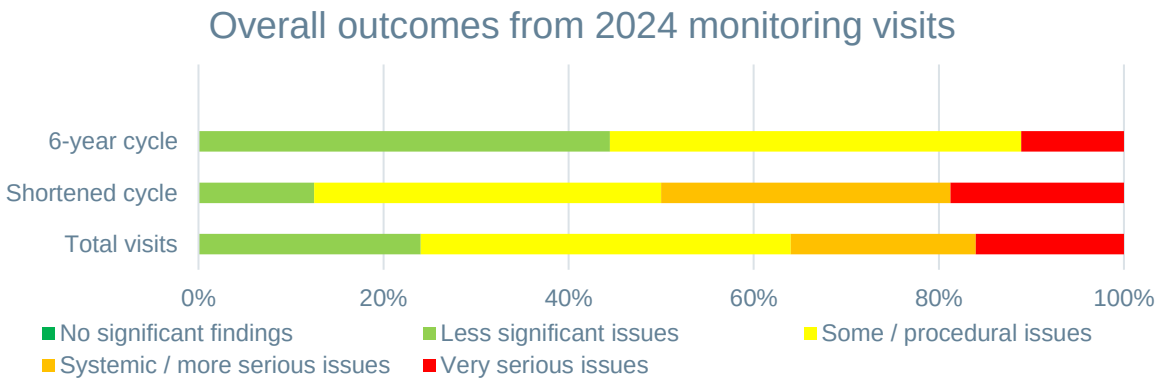
This report presents the key findings from our 2024 audit monitoring visits. There were 25 visits completed in 2024, which was the same as the prior year. 16 visits were to firms on a shortened cycle (typically due to the findings from their previous visit, but also due to other risk factors assessed by the monitoring team), with the remaining 9 firm visits being required under the statutory 6-year cycle.

Visit outcomes

It can be difficult to ascertain trends in, and underlying reasons for, changes in the outcomes of monitoring visits given the relatively small population reviewed each year and different firms being visited across a cycle. While there was an increase in visits presenting only minor findings issues in 2024, there was also a small increase in visits presenting the most serious issues. The Red visits in the chart below reflect those where there have been significant audit quality issues; where there have been ethical and/or integrity concerns; and those with eligibility issues. Such visits are always considered by the ICAS Authorisation Committee and will typically result in stringent regulatory action.

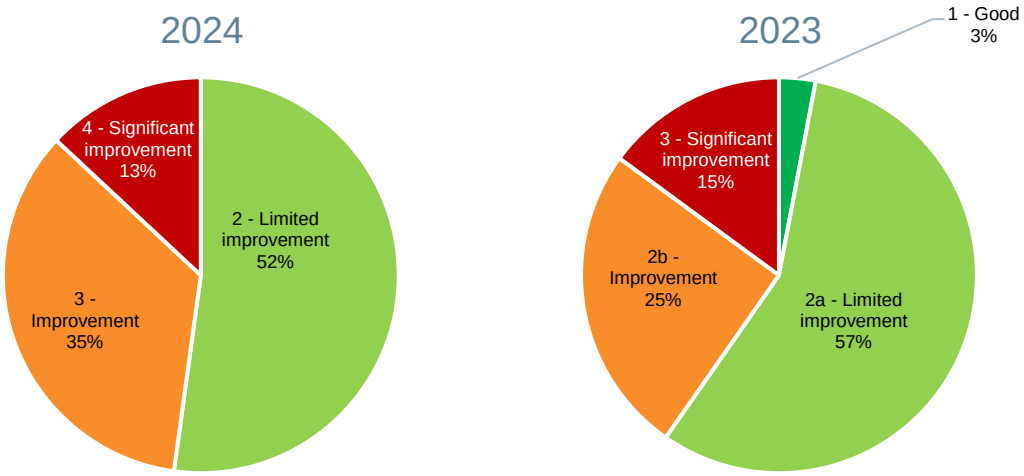


The statistics show that visits conducted on the 6-year cycle tend to present better outcomes. 6-year cycle visits are restricted to firms that have demonstrated good levels of audit quality and a clear commitment to compliance in the past, and where the ongoing risk assessment process conducted by the monitoring team has not raised areas of increased risk/concern since the last visit. Shortened cycle visits tend to present worse visit outcomes. This seems to indicate that previous quality or compliance issues are not being remediated sufficiently between visits, and firms should be aware that poor outcomes in the visit process are likely to lead to monitoring visits taking place sooner and more often, until compliance is brought up to the required levels.

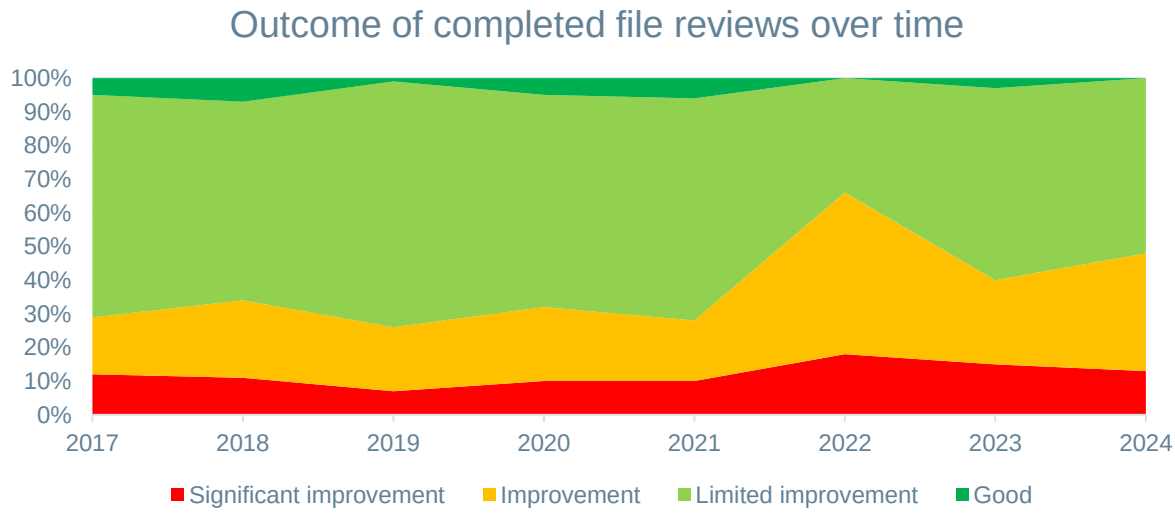


Audit file quality

As noted above, it can be difficult to ascertain trends in, and underlying reasons for, changes in audit file quality from year to year. Overall there was a slight decrease in audit quality from 2023. While 52% of files reviewed in the year required limited improvement, this reflected a small decrease from the 60% of files that fell in to that category, or better, in 2023. On the other side, there was a small reduction in files requiring significant improvement, from 15% to 13%, which was more than offset by an increase in files requiring improvement, which rose from 25% to 35% in 2024.



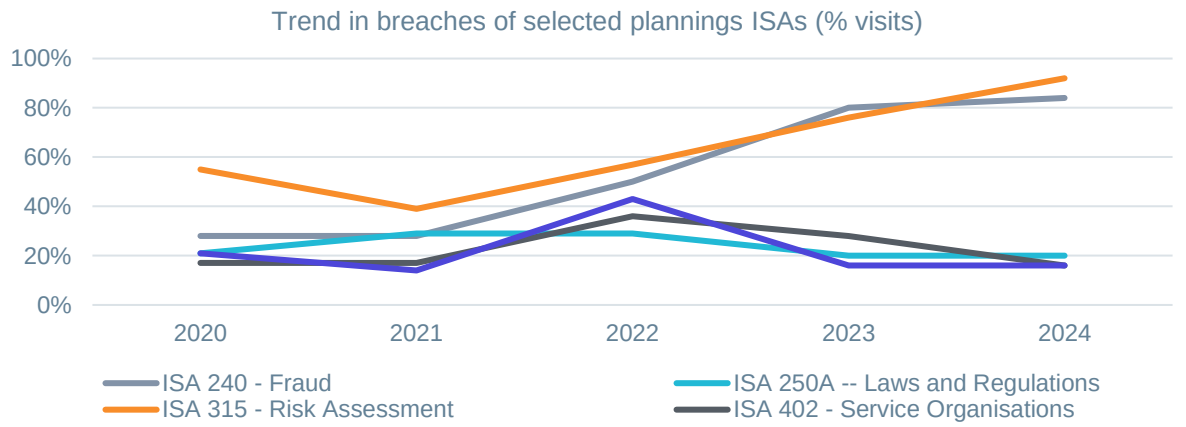
2022 was an unusual year for the monitoring team, with significant changes in the team meaning that fewer visits were conducted and the spread of firms visits was somewhat atypical, which muddies the water when trying to draw general trends out. However, the chart below indicates a slight move over time from files requiring only ‘limited improvement’ to those requiring ‘improvement’.

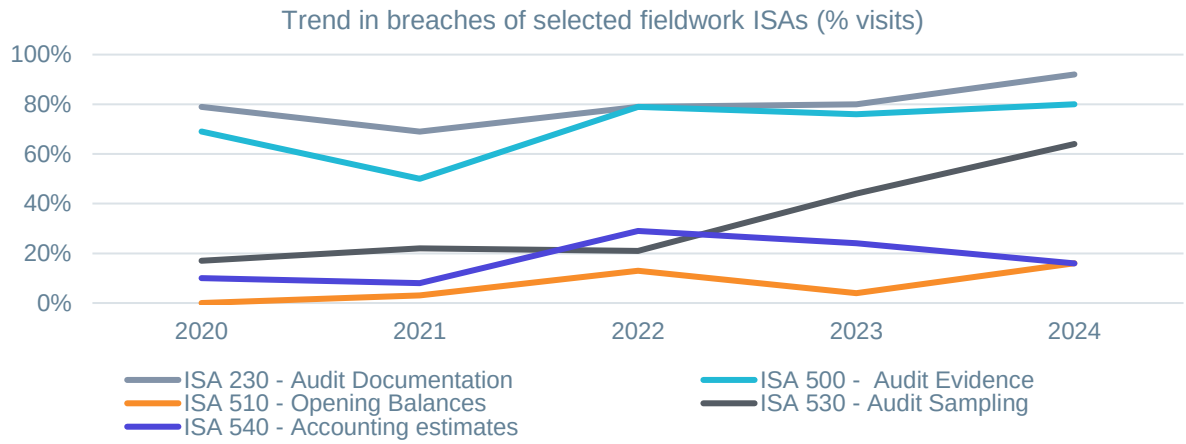


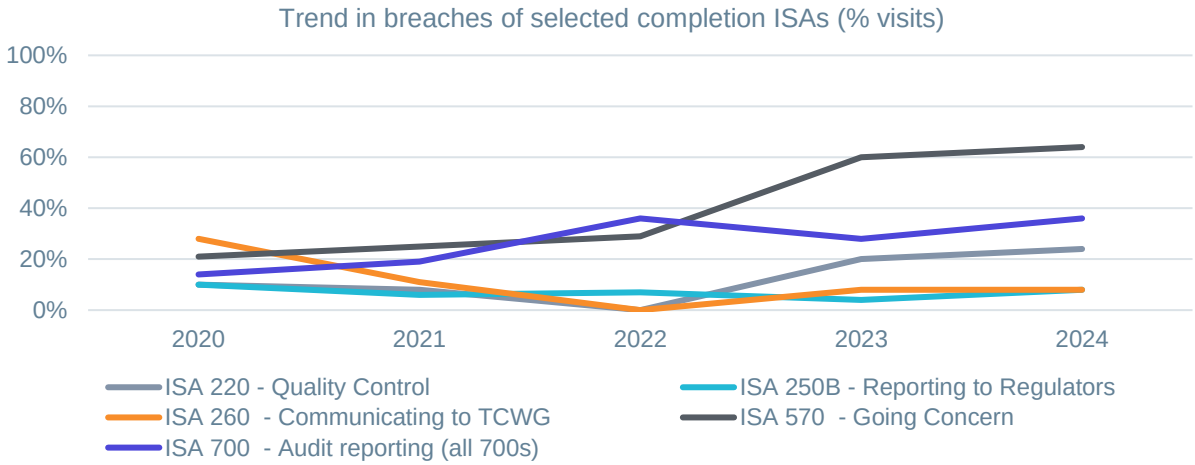
The 25 visits completed in 2025 reflected roughly a quarter of ICAS audit registered firms. There has been a general downward trend in the number of audit firms registered with ICAS in recent years, and at the time of writing there were 93 ICAS audit firms. This trend has been seen across the RSBs, and seems to be indicative of the smallest firms moving out of audit over time, a recent history of aggregation and acquisition in the sector, and audit work being consolidated in to the medium and larger firms. The move towards responsible individuals (RIs) specialising in audit work (rather than audit being a small part of a general practitioners portfolio), and the economies of scale that may come from consolidating work in larger firms, has the potential to bring quality benefits. However, such improvements do not yet appear to be manifesting in the file and visit outcomes.

General trends in ISA compliance over 5 years

As with overall file and visit outcomes, it can be challenging to draw clear conclusions when looking at movements at the granular level of compliance with specific ISAs. This is particularly the case where individual standards are revised over time, frequently bringing additional requirements, and typically resulting in an increase in related monitoring findings for a period thereafter. That said, the charts below provide useful information on common areas of weakness on audit files, and in particular those ISAs that firms appear to be having most difficulty in meeting. Further detail on the common findings flagged in these charts is provided in the next section.







Common breaches of the ISAs

ISA 230 – Documentation (breached in 92% of visits, up from 80% in 2023)

Weaknesses in audit documentation remain the most common findings on the audit files we review. The requirement to document significant matters during an audit permeates the entire audit file, and auditors should be mindful that one of the fundamental objectives of an audit file is to demonstrate (document) that the audit was planned and performed in accordance with the ISAs and applicable requirements.

There are a variety of underlying reasons for breaches in this area, ranging from situations where audit work has been undertaken, or supporting evidence obtained, which is not then included in the audit file; to more general weaknesses in the recording of the nature and extent of audit work. Often, excessive levels of client documentation can end up being used as a crutch to support poorly documented testing. In other cases, while the 'tick-and-bash' testing can be easy to record, auditors often fail to keep sufficient record of significant audit judgements and the rationale that supports them.

What does good look like?

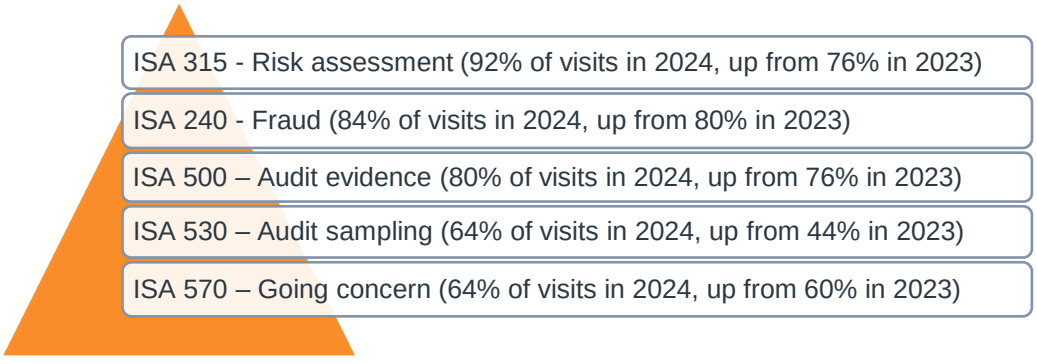
A good file does not need to document every team or client discussion verbatim, and does not need to hold every backup invoice, or other source documents seen during the audit. The best audit files clearly and consistently set out:

- the nature, timing and extent of the audit procedures performed;
- the results of the audit procedures performed, and the audit evidence obtained; and
- significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions

Common breaches

Other than the general weaknesses in audit documentation noted above, the most common ISA breaches identified in our monitoring work remained the same in 2024. While the same five most common issues were identified in 2023, in every case prevalence has increased, with the biggest increases noted over compliance with the sampling requirements, and in risk assessment process (perhaps unsurprising given the higher proportion of files reviewed this year under ISA 315 (Revised)).

Top 5 – most common ISA breaches identified on monitoring visits



Compliance Issues Case Study – Audit quality being adversely affected by out-of-date procedures

'Firm A' employed over 50 members of staff, of which around 20 worked in audit. Around 150 audit clients were split across three RIs, with mixed portfolios ranging across sectors and specialisms. Throughout the visit process, the firm presented a clear commitment to audit quality and there were no concerns regarding the firm's capability to conduct good quality audit work.

While general underlying file compliance was considered to be reasonable, and many areas of good work identified, common procedural issues were identified which affected all files subject to detailed review. While these procedural matters were not considered to have a significantly detrimental impact in and of themselves, when combined with a small number of file specific findings they were the key driver in two of the three files reviewed being considered of a 3 grade ('requiring improvement'), which prompted follow-up action by the Authorisation Committee.

The procedural issues noted related to: Fraud considerations; Risk Assessment; and Audit Sampling, and principally stemmed from the audit procedures on some files being out of date in the context where the firm was moving to new audit procedures on a phased approach. The firm responded positively to the monitoring process and the root cause analysis and action plan the firm was required to submit to the Authorisation Committee identified that the roll-out of new procedures was expected to address key weaknesses, and that training sessions had been planned for 2025 to support full remediation of the visit findings.

The firm will need to provide evidence that the remedial actions have been completed before the 2024 visit process can be closed. In practice, the monitoring team thought it likely that such submissions would not have been required if up-to-date procedures had been applied.

ISA 315 – Risk assessment (breached in 92% of visits, up from 76% in 2023)

Weaknesses in required risk assessment procedures continues to be a regular finding in monitoring visits, and reviewers found a lack of compliance with ISA 315 in almost every visit undertaken in 2024. In large part, this resulted from challenges in implementing the revised (and expanded) requirements of the 2020 standard. However, there were also a substantial number of visits where the risk assessment work undertaken would have been non-compliant with the previous version of the ISA, and some cases where audit procedures had not been updated to reflect the new requirements.

Getting the risk assessment process right is fundamental to achieving a good quality audit. In order to do that, the auditor needs to understand the entity's own risks assessment processes and the related control environment. Reviewers appreciate that, particularly in smaller less complex clients, the audited entity may not always have robust documentation of their control framework. In such cases, early engagement and clear communication from the auditor can be the key to making sure the client understands what is required, and can support the audit team in developing, and documenting, the required understanding.

It's also important that the risk assessment process is properly refreshed in every audit. Risk assessment work should be designed to ensure it doesn't just corroborate previous year's findings (eg key financial systems should not be assumed to be low risk just because that was the assessment last year). An auditor can only assess whether risks of material misstatement exist in a system if they have gone through due process to understand the system, controls and risks arising in it.

"If the audit file does not demonstrate a clear understanding of the entity's control environment, there is a real danger that the risk assessment process is fundamentally flawed, and that the appropriate response to audit risks has not been formulated. Poor quality planning work at the risk assessment stage has the clear potential to result in insufficient or inappropriate audit work being conducted at the fieldwork stage, and auditor's should ensure that sufficient time and resource is set aside to allow a comprehensive planning process to take place." (2023 common findings report)

The main reason for breaches of ISA 315 remained the lack of adequate audit work to understand and document the internal control environment. While some issues were clearly related to expanded requirements in the revised ISA, underlying weakness in basic systems and control work are similar to previous findings. In 2024 reviewers noted:

- Insufficient record of a general understanding the entity and its environment;
- A lack of documentation on the entity's risk assessment process, including an assessment of the significance and likelihood of relevant risks, and the exposure to IT risks;
- Systems work not being recorded over all relevant transaction streams (eg no system notes being held over a key financial system), or where controls had not been identified over all significant audit risks (which will always need to include controls over journals).
- Auditors had not determined whether the controls identified in risk assessment work had been implemented (eg through 'walkthrough' testing).

What does good look like?

Good files use up-to-date audit procedures that prompt the right risk assessment questions. They clearly set out, in a proportionate manner to the complexity of the entity, an understanding of:

- The general background of the entity and its environment, including relevant inherent risk factors arising from the sector in which it operates.
- The entity's control environment, including the relationship between management and those charged with governance, and the entity's risk assessment processes, including the significance and likelihood of risks arising.
- The information systems relevant to the preparation of the financial statements, including an understanding of the IT environment and any risks arising (eg through bespoke, old or out of date / unsupported systems, and how different systems interface).
- An understanding of the control environment over key financial systems.

Good files, have a clear thread from the risk assessment processes, to the identified risks of material misstatement (at the financial statement and assertion level), through to the significant audit risks raised. They also demonstrate an iterative risk assessment process where the auditor has not been biased towards corroborating existing (or previous) assessments of risk.

ISA 240 – Fraud (breached in 84% of visits, up from 80% in 2023)

Non-compliance with this standard can be split in to issues identified at the planning and fieldwork stages, and the underlying findings here are remarkably consistent with previous years.

Audit planning

Much like the risk assessment work noted above, adequate consideration of fraud is an essential requirement at the planning stage, and is fundamental to achieving a good quality audit. Key weaknesses in planning process were noted over:

1. Insufficient consideration of management's assessment of fraud risk, typically because the audit files does not clearly demonstrate with the ISAs requirements to understand:
    a) Management's assessment of the risk of material misstatement due to fraud;
    b) Management's process for identifying and responding to the risks of fraud;
    c) Management's related communication, if any, to those charged with governance; and
    d) Management's related communication, if any, to employees.

    As noted in our 2023 findings report, smaller less complex clients may well require support in order to give the auditor the information required here. Much like the risk assessment piece above, early engagement and clear communication with such clients will probably be key in order to tease out how and where they consider fraud might take place. While these detailed considerations are often overlooked, they are nonetheless a key part of understanding the client and the risk of fraud, and gaps at this stage could mean the risk assessment process is fundamentally flawed and that the appropriate audit testing is not designed.

2. Insufficient evidence of a team briefing, or weaknesses in the record of the team briefing meaning that the file does not demonstrate the required discussion on how and where the entity's financial statements (including the disclosures) may be susceptible to material misstatement due to fraud, including how fraud might occur. It's also common for meeting notes to indicate insufficient professional scepticism, often making clear assumptions over the honesty and integrity of management and those charged with governance as a means of rebutting or reducing audit risk.

3. Insufficient consideration of the presumed significant risks relating to fraud in revenue recognition and from management override. Reviewers still find files that lack explicit commentary on these two presumed significant audit risks, or attempt to rebut the risk of fraud in revenue recognition without clear/sufficient rationale being recorded for that judgement.

What does good look like?

Good files tend to have succinct meeting notes demonstrating the planning process has included:

- A meeting with the client (including 'those charged with governance' if they are different to 'management') which has included sufficient discussion on fraud. The notes go beyond confirming whether any frauds have been identified/suspected, and record: management's actual assessment of fraud risk; their process for identifying and responding to those risks; and relevant communications they make on the subject.
- A team briefing which has been led by the RI with specific comment on how and where the financial statements might be susceptible to material misstatement due to fraud, how fraud might occur, and setting out the appropriate level of professional scepticism with regards the honesty and integrity of management and those charged with governance.

Good files also clearly record the special consideration afforded to significant audit risks, setting out the relevant assertions, related controls, and what audit testing will be conducted. In practice, these files don't suggest significant audit risks are 'low' risk, and don't rely on any assumed honesty and/or integrity of the client or a lack of findings in previous audits when considering fraud risks.

Audit fieldwork:

Management Override is the only significant audit risk that must be recognised, and responded to, on every audit. As a result, non-compliance with the related requirements set out in ISA 240 is a basic failing, yet still commonly comes up on our visits. In the main, weaknesses in related audit fieldwork tend to be related to a lack of suitable testing being conducted over manual and automated journals and other adjustments, which is a core requirement of the ISA. 2024 weaknesses included:

- A lack of dedicated audit testing over journals and other adjustments, with the auditor taking too much reliance from other standard audit work over transactions and balances.
- Insufficient work being conducted to ensure the population being considered for journals testing was complete.
- Summary commentary being recorded that all journals have been reviewed, without sufficient audit documentation setting out the nature and extent of the procedures adopted.
- A sampling approach being adopted over journals, with arbitrary sample sizes selected through professional judgement and items selected for testing through haphazard sampling. For the avoidance of doubt, this approach cannot provide sufficient appropriate audit evidence in response to the significant audit risk of management override.
- A filtering process being adopted, using excel, to strip out journals that were not considered to present risk, leaving a large number of risk journals that were not subsequently subject to sufficient detailed testing. For example, an auditor concluding upon 100's of journal lines relating to accruals in aggregate by cross referring to balance sheet testing of accruals which did not include those specific entries.

What does good look like?

Good files clearly demonstrate that appropriate time and resources have been directed towards journals testing, and that dedicated inquiries have taken place with the client with regards the processing of journals, other adjustments, and more generally over areas of significant accounting estimates and areas where bias might arise.

On the cleanest files, work over journals and other adjustments tends to be allocated to senior experienced auditors who understand how management override might present itself. Working papers document the process through which a complete population of manual and automated journals and other adjustments (including post-closing entries) has been obtained, and how it has been interrogated in order to identify specific journals and adjustment that require testing. Commonly a filtering process is used to ensure appropriate consideration of the ISA identified characteristics of potentially fraudulent journals, and others, such as entries:

a) made to unrelated, unusual, or seldom-used accounts;
b) made by individuals who typically do not make journal entries;
c) recorded at the end of the period or as post-closing entries that have little or no explanation or description;
d) made either before or during the preparation of the financial statements that do not have account numbers;
e) containing round numbers or consistent ending numbers; and
f) presenting any other standard or specific risk factors identified by the auditor.

Dedicated testing is conducted over the identified journals and adjustments and clearly recorded in a standard test schedule.

In some cases, and tending towards larger firms, data analytics are used in the work in response to management override. While this may not be essential on most of the audits that ICAS reviews, it is becoming increasingly difficult for an auditor to demonstrate sufficient consideration of journals and other adjustments without the use of software, such as excel, to record the process.

ISA (UK) 500 – Audit evidence (breached in 80% of visits, up from 76% in 2023)

ISA 500 – *Audit Evidence* – is one of the shorted standards, with only six requirements, but the collection of sufficient appropriate audit evidence is the cornerstone objective of the audit process. Given the fundamental role evidence plays in the audit process, any breaches in this area can have a significant impact on the grading of a file and the practical outcomes from a monitoring visit.

Audit evidence weaknesses and their impact on file grading

While reviewers are careful to consider every case on its individual merits, a significant gap in audit evidence is the most common reason for a file to receive a poor grade (eg needing ‘improvement’ or ‘significant improvement’), and for follow-up actions to be considered required by the Authorisation Committee.

The standard recognises that audit evidence is cumulative in nature, and talks about two aspects of evidence: sufficiency and appropriateness. These two facets are interrelated, and an auditor only gets ‘enough’ evidence if both of these requirements are met. Sufficiency relates to the quantity of evidence (eg if sample testing has been conducted, have enough items been tested); while appropriateness relates to the quality of evidence (eg is the evidence relevant and reliable). Reviewers have continued to see weaknesses in both of these aspects of evidence regularly through 2024, and auditors should ensure both aspects are considered when designing audit testing.

Good Practice Case Study – Comprehensive work undertaken to obtain sufficient appropriate evidence

'Firm B' had two RIs, and a employed a small audit team working across around 20 audits. Audit planning work on one of the files reviewed clearly recorded the risk assessment at the assertion level across all of the financial statement transactions and balances. Appropriate audit work had been planned over the significant audit risks from Management Override and Revenue Recognition, and tailored suites of audit tests had been planned on every section of the file.

At fieldwork, lead schedules covered every figure in the financial statements and clearly identified where testing had been conducted (or where testing was not considered to be required – eg due to the figure being trivial). The standard sample assessment approach had been applied in all cases, with forms retained on file in support of the sample size assessed. The test schedules clearly set out the method for selecting the sample items, and the results from testing were recorded succinctly in standard test schedules. The file clearly and concisely demonstrated that sufficient appropriate audit evidence had been obtained over all material transactions, balances, and disclosures. As a result, no ISA 500 breaches were identified I the visit report.

While a few relatively minor areas of non-compliance were identified in relation to planning and completion ISAs, the high-quality audit work at the fieldwork stage supported the file being considered a 2 Grade, requiring only minor improvements, and no follow-up actions were needed.

In addition to ensuring both sufficiency and appropriateness of evidence is considered when designing and conducting audit testing, auditors should also be mindful that the standards require substantive procedures for every material class of transactions, account balance, and disclosure irrespective of assessed audit risk. While more work would be expected over high risk areas, low risk areas cannot be omitted from substantive testing, yet reviewers do still come across such gaps in testing fairly regularly. Common failings relating to audit evidence have remained relatively consistent for a number of years now, and in 2024 have included:

- Material transactions, balances, or disclosures being missed out of substantive testing.
- Testing being conducted over the incorrect assertion, leading to inappropriate audit evidence being obtained in response to the audit risk assessment. A common example being revenue work intended to test completeness starting from the ledger and instead testing occurrence.
- Non-compliant audit sampling, leading to insufficient evidence being obtained (see below for more detail). Sampling issues have included samples being split across two different assertions leading to insufficient evidence being obtained as per the bullet point above.
- Areas of significant estimates and judgements continue to be a challenge for auditors too. One of the most common areas of concern is in the audit of construction contracts, where consistent findings have arisen for the last few years. Auditor's should take care to ensure the requirements of ISA 540 are taken in to account when conducting work on estimates, including those where revenue is recognised on construction contracts. Common issues included:
    - Insufficient (documented) understanding of the estimation process. While the likes of contract estimates are often identified as a significant audit risks, related controls are not always documented as required by ISA 315 (see above).
    - The outcome of previous estimates (eg those made in the prior year), not being reviewed as part of the risk assessment process as required by the standard.
    - Inappropriate audit evidence being obtained over the estimate (eg where there is a reliance on an internal management expert who has produced the estimation).
    - Insufficient evidence being obtained over some relevant assertions, such as testing addressing the existence or a contract balance but not the specific valuation adopted at the balance sheet date.

What does good look like?

Good audit files have a clear link between the planning process and the resulting audit testing. The audit test programmes have been tailored to the specific entity and are reflective of the assessed risks at the assertion level on each section of the file. All material transaction streams, balances, and disclosures have dedicated testing conducted over the identified risk assertions and appropriate consideration has been given to the completeness of figures that fall below the material level where understatement is an identified audit risk.

Lead schedules reconcile to the accounts, and set out the populations for each test, linking the sample size assessment process back to the underlying records. Test schedules record the objective for each test, explain how the samples were selected, and record enough detail on the testing conducted that an experienced auditor could reperform the work. Substantive testing focusses on the assessed risk assertion(s), and where errors are identified these are considered and where appropriate projected across the population when concluding on the testing.

ISA (UK) 530 – Audit sampling (breached in 64% of visits, up from 44% in 2023)

Typically, auditors employ a sampling approach when designing at least some of their substantive tests. Sampling is a well-established way to obtain audit evidence over many areas, and monitoring reviewers rarely find a sampling approach to be unsuitable (though auditors should be mindful that there are situations where sampling may be inappropriate, inefficient or ineffective). There has been a general trend in recent years for more sampling issues to be identified in visits, which in part may be due to evolving expectations with regards the level of documentation needed to adequately justify the sampling approach adopted. Common findings in 2024 have included:

- Inconsistent approaches to sampling being adopted across a file, or across the files reviewed in the visit, where assessed samples are insufficiently justified / supported.
- The continuing use of ‘standard’ sample sizes (eg testing 5 items pre and post-year end in cut off testing), which are not justified on file, and which do not appear to take in to account differing risk assessment across key financial statement lines.
- Professional judgement being relied upon for the sample size assessment without any rationale or recorded reasoning behind the sample size adopted, including cases where there were illogical/inconsistent assessments applied (eg high risk areas having lower sample sizes than low risk areas).
- Sample sizes being assessed that do not clearly reflect the application of risk (eg a significant audit risk being tested as if ‘low’ risk, or sample assessments for low and high risk areas using the same risk factors).
- Differences between financial statement values and the resulting sample size assessment which have increased the risk that assessed sample sizes are insufficient, and which have not been investigated or explained.
- Inappropriate sample selection techniques such as restricting selections to the highest value items, or only parts of the population.
- Splitting assessed sample sizes across two different assertions resulting in insufficient evidence being obtained over the risk assertion, the remainder of testing being inappropriate for the assessed risk.
- The application of capping / flooring on assessed sample sizes, which has significantly reduced the number of items to be tested and which has not had substantial support and rationale documented.
- While less common than previous years, some sample sizes were reduced inappropriately due to reliance on analytical procedures that are not substantive in nature (in accordance with the four-step process required under ISA 520); and / or reliance being placed on controls being effective without dedicated compliance testing taking place to support that approach.

What does good look like?

The audit file clearly sets out the sample size assessment methodology being applied, which takes in to account assessed materiality and different levels of audit risk. The methodology is consistently applied across the file and does not include any amendments to the assessed sample sizes without substantial supporting rationale which has been approved by the RI. Sample sizes are not subject to capping (or flooring), and in all cases the lead schedules have been clearly reconciled to the population values used in the sample size assessment process.

Sample selection methodology is clearly recorded in each audit test schedule, and all items in each population for sample testing have had a chance of selection. It is clear from the file that where haphazard sample selection has taken place that it has not been biased towards certain items (eg only the highest value items).

ISA (UK) 570 – Going concern (breached in 64% of visits, up from 60% in 2023)

Insufficient audit work being conducted over going concern continues to be prevalent, with more than half of visits identifying weaknesses in this area. ISA 570 was last revised in 2019, being effective for audits of periods commencing after 15 December 2019, so should be well understood and embedded at this stage. None-the-less common findings remain.

The positive assurance statement required in the auditor's opinion means that the ISA requires auditors to obtain sufficient appropriate audit evidence regarding:

- whether a material uncertainty related to going concern exists; and
- the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

Good Practice Case Study appropriate scrutiny of going concern

An audit client entering administration within 12 months of a clean audit report is a clear risk flag that would inform file selection during a monitoring visit. During a visit to Firm C one such case was identified, and the monitoring team reviewed the file in detail to consider whether the appropriate audit work had been conducted.

At the planning stage of the audit, the auditor had requested, and obtained, financial forecasts covering the next financial year and beyond as well as having dedicated discussions during the planning meeting on the clients projected trading performance. The file clearly recorded the auditors understanding of the entity and its environment, and how the client went about preparing its financial projections. While one component of the group was identified as loss making, there was a reasonable amount of consideration and judgement held on file supporting the view that a material uncertainty relating to going concern did not exist at that time. Audit risk in this area was increased to medium and detailed testing planned in response to the potential issues identified.

During audit fieldwork, the auditor obtained financial projections for the group and individual companies, covering a period of 20 months from the balance sheet date (which was expected to cover the required 12-months form the audit report date). Further discussions took place with management to confirm how the projections had been prepared, and to understand the key assumptions therein. Detailed testing then took place, agreeing the projections to known information where possible (eg the rolling cash balance to post-year end bank statements), and the audit schedules recorded clear scrutiny of the key assumptions used by management (including sensitivity analysis) and the auditors conclusion over the reliability of the underlying date used. Confirmations were also obtained directly from the entity's bank regarding the renewal of an overdraft facility and the auditor had access to key contract agreements relating to future revenue.

The work over going concern was subject to a substantial amount of documentation, with work initially being conducted by experienced auditors, and subsequently being reviewed by the manager and the RI. The file clearly demonstrated the nature and extend of work undertaken, and the key professional judgements throughout. Work was subject to updating and final review at the completion stage of the audit, and it ultimately it was considered that sufficient-appropriate audit evidence had been obtained in support of the auditors clean conclusion over going concern.

While it can be tempting to review cases like this with the benefit of hindsight, particularly where it is known that the entity entered in to administration after the audit report sate, reviewers are careful to only take in to account information that was available up to the audit report date. Ultimately the auditors opinion will always be open to a degree of subjectivity, and there is no crystal ball available, but in this case the file demonstrated that the requirements of ISA 570 had been met. Working papers clearly supported the opinion formed and recorded the substantial amount of audit evidence obtained, and key professional judgements applied, in arriving at that outcome.

Unfortunately, reviewers continue to see cases where insufficient work has been planned, or conducted on a timely basis, in order to support the auditor's opinion. Work over going concern should not be left until late in the audit, and as previously discussed, early engagement with the client may well be necessary in order to obtain all the information the auditor needs come completion. If management has not yet recorded an assessment of going concern, the ISA requires the auditor to request they do so. Common weaknesses in going concern considerations have included:

- Insufficient attention paid to going concern at audit planning stage, including cases where there has been insufficient enquiry/record of how the entity makes its own assessment and where clear going concern risks (such as recurring losses, or negative balance sheet positions) have not been considered / concluded upon.
- Insufficient audit work being conducted over the clients projections, with a lack of dedicated testing being conducted over the key assumptions therein or the reliability of the data being presented by the client.
- Work over going concern only covering the period until the next balance sheet date, rather than the full 12-month period from the audit report date as required.
- Modifications to the going concern opinion not following the expected format, or meeting the requirements of the standard(s).

Auditors should also be aware that audit report commentary on material uncertainties relating to going concern should cross refer to existing disclosures in the accounts on the matter, and comment in the audit report does not negate the need for the client to make the required disclosures. There may be challenges to consider where an audit client is a small entity that has some disclosure exemptions under FRS102, and care should be taken to ensure the requirements of the ISA are carefully considered in such cases.

What does good look like?

Audit planning records consideration of potential risks relating to going concern from early on. Going concern is discussed in the client meeting, and clear expectations are set by the auditor as to what audit evidence they expect to need in order to sign off. Potential indicators of risk (eg recurring losses, negative current / overall balance sheet positions, issues with projected cash flows) are considered at planning, and where appropriate a significant audit risk is raised over going concern.

Audit fieldwork includes a detailed review of the client's projections and cashflows. Audit work is conducted to evaluate the reliability of the underlying data used in management's projections, and the assumptions on which management's assessment is based. The working papers document the consideration applied, and link into other work conducted on file that is relevant (eg cashflow projections linked to post year end bank figures to confirm accuracy). Where required audit evidence is obtained over key projected changes (eg new contracts; rate changes etc.)

Audit work is considered again at the completion stage, and where required revisited/revised to take into account any new information, and covers a period of at least 12 months from the audit report.

Other notable breaches of the ISAs

ISA 220 – Quality control (breached in 24% of visits, up from 20% in 2023)

One concerning trend has been the increase in breaches relating to insufficient quality control. Issues in this area have increased from zero in 2021 and 2022, to 24% of visits in 2024. In the main, issues in this area have fallen in to two areas: insufficient RI review taking place(particularly where audit quality on a file has been found to be poor); and insufficient record being maintained of the RIs review (at times due to technical issues or the poor use of an electronic system). While the ISA does not require the RI to sign off on every working paper, the file should demonstrate that the RI has conducted sufficient review of the audit documentation, and discussion with the engagement team, to be satisfied that sufficient appropriate audit evidence has been obtained in support of their reported opinion.

Insufficient evidence of RI control

Examples of issues identified in this area have included:

- Insufficient consideration of identified concerns relating to the integrity of the client at the acceptance stage;
- Hard copy files not holding sufficient record of the RI's review of significant audit risks, and other areas of the file considered necessary for review;
- An RI not evidencing the review of the audit file before the date of the audit report; and
- While there was a record of schedules being signed as reviewed by the RI, the overall quality of the file, and experience of the reviewer during visit discussions, raises concern over the level of RI supervision and an over-reliance on an employee conducting the audit work.

Electronic systems not being used properly

Examples of issues identified in this area have included

- Audit files being held in a mix of hard copy and electronic files, increasing the risk that schedules remained editable after the file closedown date, impinging the integrity of the file.
- Evidence of RI review being limited to overall sign-off of an electronic file, without clearly illustrating the level of review expected.
- Electronic files not demonstrating sufficient RI control and supervision where a number of completion schedules were recorded as RI reviewed after the audit report date (and outwith the 60-day period allowed for file administration).
- Hyperlinks to supporting documentation no longer worked as those records had been retained on the firm's network rather than on the audit file itself.

What does good look like?

High quality files demonstrate robust direction, supervision and control of the audit by the RI. In practice, the file will hold a clear record of work by less experienced team members being reviewed by more experienced team members across, with a general trend of more complex areas being conducted by more experienced auditors, escalation of issues and findings, and a segregation of review duties wherever possible. While the RI may not review every audit working paper, there is a clear record of their timely review of:

- Acceptance / continuance of the engagement, including independence considerations and appropriate safeguarding of any ethical threats arising;
- Audit planning, which is approved in advance of fieldwork commencing;

- Critical areas of audit judgment and any areas relating to difficult or contentious matters encountered during the audit (as escalated through the file review process);
- The approach to, and resulting work and conclusions over, significant audit risks; and
- Other areas of the audit that the RI considers important.

The file is closed down on a timely basis, and clearly demonstrates that all audit work, has been completed before the audit report has been signed.

Electronic audit files make use of the inbuilt functionality to record the various levels of review process including overall sign off of audit planning, key fieldwork schedules (including those over all significant audit risks) and completion by the RI prior to the audit report date. Only minor administrative additions to the file (eg filing of the signed accounts and letter of representation) are made thereafter and the file is locked and archived within 60 days.

Compliance Issues Case study – Poor use of systems adversely affecting visit outcomes

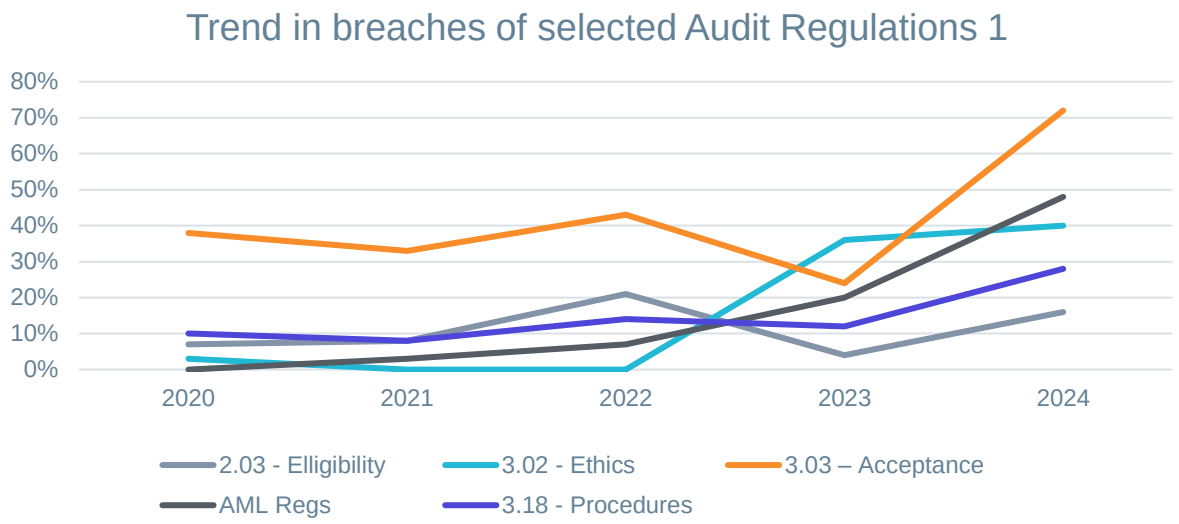
Firm D had around 100 audit clients, and used a recognised electronic audit system from one of the main providers. The firm presented a clear commitment to audit quality in all visit discussions, and there were no concerns regarding the firm's commitment or capability to conduct compliant audits. While a small number of file specific issues were noted, as is often the case with any monitoring process, these were considered to reflect systemic weakness in the audit approach. However, a significant issue was identified during the visit which was the main driver in follow-up actions being required by the Authorisation Committee.

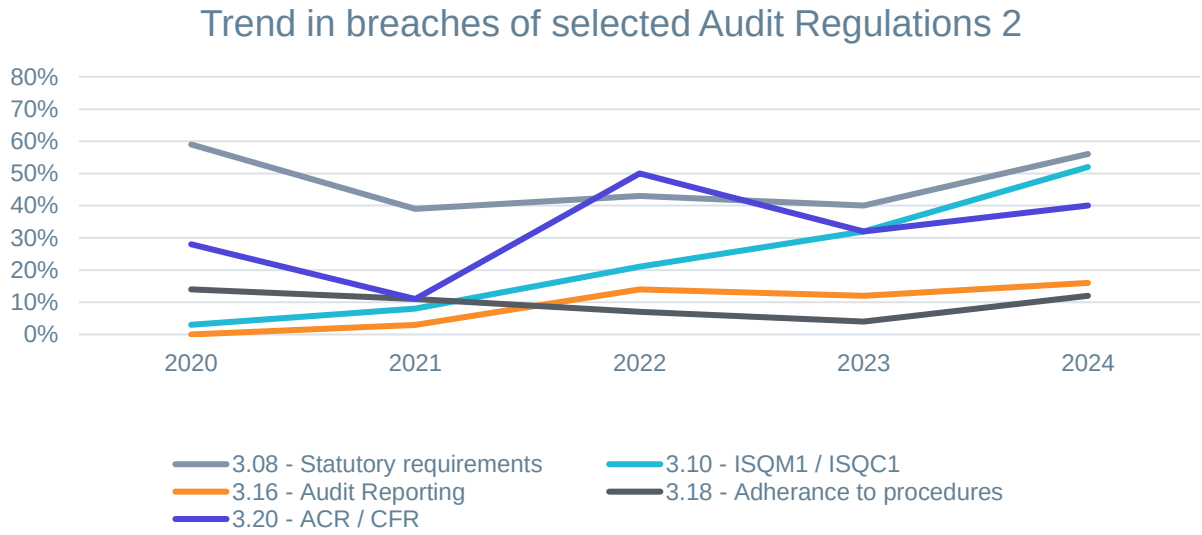
The firm had not been using the 'review' functionality built in to the audit system as designed, and as a result there was a lack of clear evidence of timely file sign off. While there was considered to be sufficient evidence obtained during the visit, and the related discussions, of timely RI control and supervision in practice, this was not sufficiently recorded on the files and in some cases files were not sufficiently closed down within the 60-day period set out in ISQM1.

As a result of the issues identified, the firm was required to conduct a root cause analysis which was submitted to the Authorisation Committee and the 2024 visit process will not be closed down until the firm has demonstrated that key remedial actions have been completed.

General trends in Audit Regulation compliance

As mentioned previously, it can be challenging to draw clear conclusions when looking at movements at the granular level of compliance with specific Audit Regulations. However, the charts below provide some useful information on common areas of weakness identified in monitoring visits, and those regulations that present most challenges to firms.



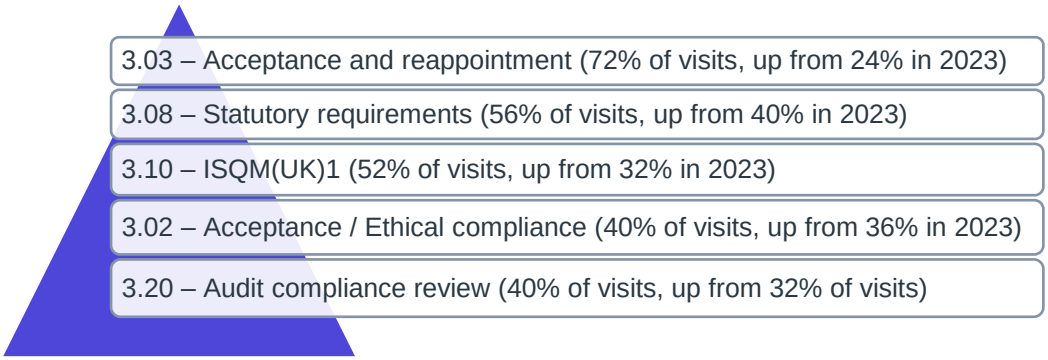


Further detail on the common findings relating to ethics, acceptance, AML compliance, statutory requirements (typically relating to accounts disclosures), ISQM1, and the Audit Compliance Review (ACR) process are provided in the next section. There is also commentary provided below on compliance with the eligibility requirements and the maintenance of audit procedures, both of which have seen increased levels of non-compliance in 2024.

Common breaches of the Audit Regulations

Any monitoring visit that identifies a breach of an ISA, will also reflect a breach of Audit Regulation 3.10 *"A Registered Auditor must comply with the auditing standards and the quality management standards"*. As a result, a breach of this regulation was identified in every monitoring visit undertaken in 2024. Following that, as was noted in the ISA section above, the same five most common issues were identified as in 2023, and again in every case prevalence has increased. The most common breaches of the Audit Regulations related to:

Top 5 – most common Audit Regulation breaches identified on monitoring visits



1. Audit Regulation 3.03 – Acceptance and reappointment (breached in 72% of visits, up from 24% in 2023)

In 2024, there was a significant increase in the number of visits where a breach of acceptance and reappointment procedures was identified. This stems from two underlying areas: compliance with anti-money laundering procedures; and the documentation of some ethical considerations.

Anti-money laundering procedures (breached in 48% of visits, up from 20% in 2023)
AML monitoring has evolved in recent years and in August 2023 ICAS introduced a new risk-based monitoring regime, which is explained in detail in the most recent *Anti-Money Laundering Supervision Report*. Enhancements in the AML monitoring regime have had some knock on impact on the work conducted in the audit monitoring visits in relation to AML, which is restricted to considering the AML procedures conducted on the audit files selected for review. This has led to an increasing number of issues due to insufficient or inappropriate AML procedures being applied. 2024 findings included:

- A lack of basic 'Know Your Client' information and / or verification of identity taking place for business owners.
- Multiple cases where verification of identify had not taken place for relevant trustees of a charity audit client.
- Identified risk factors identified in the AML risk assessment not being sufficiently considered and concluded upon.
- Instances where the auditor had recorded ownership structure of an audit client, demonstrating foreign ownership, but had not conducted sufficient work to identify and verify the ultimate beneficial owner(s).

As part of its commitment to be an effective supervisory body for AML, ICAS will take Regulatory Action where there is sufficient evidence of a failure by its supervised entities and individuals to adequately meet their AML obligations and requirements. Auditors should ensure that appropriate AML considerations are recorded for all audit clients, and where ownership sits with foreign entities the firm must ensure a clear understanding, and where relevant verification of identity, is recorded over the ownership structure including any the ultimate beneficial owners. More detail on ICAS's wider AML findings, and a range of helpful guidance, advise and case studies can be found in the most recent *Anti-Money Laundering Supervision Report 2024/25*[1], including the one below.

[1] *https://www.icas.com/news-insights-events/news/regulation/icas-publishes-its-annual-aml-report*

Good Practice Case Study – AML compliance when dealing with a complex group

This case study was first reported in the ICAS Anti-Money Laundering Supervision Report 2024/25, but is included here too as useful reference given there are regular weaknesses in this area.

- A monitoring review to a sole practitioner tax specialist with only a small portfolio of very specialist niche clients.
- One of the clients selected for review during the monitoring visit was a client with a complex group structure owned via a trust established in an offshore jurisdiction.
- The client has international interests in an industry considered high-risk by FATF / the National Risk Assessment.

A detailed KYC/CDD memo was noted on file, including evidence of the following considerations: •

- The full group structure was recorded on file.
- The CDD recorded and verified all beneficiaries and trustees.
- Extracts from the FATF website were retained on file and used to determine whether there had been any change in the compliance with Regulations for the geographies where clients were based.
- The OFSI consolidated sanctions list was retained and file and used to determine if there were any positive search results for clients including their related organisations. No positive results were noted from these searches.
- The Transparency International Corruption Perception Index was retained on file and used to identify any changes to the index for clients' geographies and the ranking of those geographies. No material changes were noted.
- The CDD also recorded the outcome of internet and other relevant CDD searches.
- There was a detailed explanation of source of wealth noted.
- CDD was monitored at each interaction with the client, with the memo updated and dated.

Conclusion – while this case-study shows all aspects of CDD – not just client identification and verification – it shows that the firm obtained a good understanding of the organisation structure and conducted identification and verification checks accordingly.

Documentation of ethical threats and safeguards (breached in 44% of visits, up from 12% in 2023)

2024 saw an increase in documentation weaknesses relating to the threats arising from non-audit services and with the safeguards applied to them. This markup is used where reviewers are content that the non-audit services provided are in compliance with the FRC Ethical Standard, and where safeguarding has taken place in practice, but where the audit file did not record matters sufficiently.

Auditors should ensure that audit acceptance procedures clearly set out:

- The non-audit services being delivered to the client (including common services like account preparation work and corporate tax computations).
- The specific ethical threats arising from non-audit services, including as a minimum the relevant threats identified under the FRC Ethical Standard (likely to include the Management threat, and the Self-Review threat as a minimum, but potentially others too)
- The specific safeguards applied to each identified Ethical threat.

2. Audit Regulation 3.08 – Statutory requirements (breached in 56% of visits, up from 40% in 2023)

Before starting any audit file review, monitoring reviewers consider the quality of the financial statements that were audited. While it is recognised that the financial statements and related disclosures are the responsibility of management, there is a clear expectation that the auditor should challenge any inaccurate or insufficient disclosures when conducting their work.

Reviewers regularly find minor areas where further expansion and tailoring in accounting disclosures would be of benefit to the users of the accounts, including over areas such as: expansion being required in the business review within the strategic report, including better use of financial KPIs; a lack of commentary on principal risks affecting the entity in the front end of the accounts; more clearly tailored accounting policies needed for revenue (including that relating to construction contracts where relevant); reference to residual values and impairment review being omitted from fixed asset policies; and inappropriate 'boiler plate' accounting policies for financial instruments, including references to instruments that the entity does not hold. However, in some cases more significant weaknesses are identified in the Financial Statements and disclosures which result in a breach of Audit Regulation 3.08.

Significant disclosure issues identified in 2024 (general findings)

The Strategic Report and Directors' Report in two cases omitted the required "Section 172" statement.

On one visit, the figures included within financial statement notes did not reconcile to the primary financial statements

Inappropriate accounting policies for revenue which led to material revenue being recognised in advance on one file, and a lack of contract accounting on another file.

On two sets of accounts there were considered to be significant omissions in the disclosures regarding a material uncertainty relating to going concern.

One entity recognised an investment asset on balance sheet which was not line with the expected FRS102 treatment of the legacy transaction with an Employee Benefit Trust

In a couple of cases, related party transactions identified during the audit were not disclosed

In one case, consolidated group accounts had not been filed at Company's House, with unaudited single entity accounts being filed for the parent.

One company had made insufficient disclosures relating to significant events after the end of the reporting period.

Significant disclosure issues identified in 2024 (specialist entities)

Significant disclosure omissions in Charity Trustees' Reports, where general expansion was required to meet the requirements for 'larger' charities set out in the SORP.

Signed charitable group accounts not presenting a separate Charity SoFA (ie in addition to the Consolidated SOFA).

A departure from the SORP, was not sufficiently explained / disclosed

Filings on the Mutuals Public Register were not up to date for a Registered Society

3. Audit Regulation 3.10 - Compliance with ISQM1 (breached in 52% of visits, up from 32% in 2023)

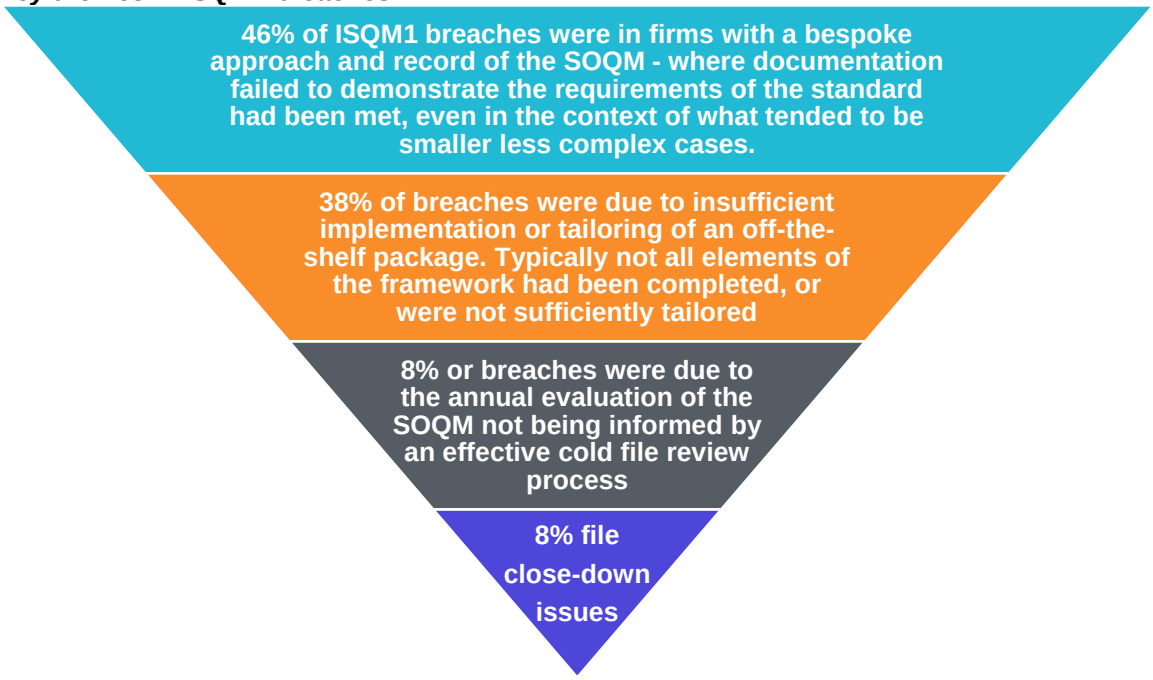
International Standard on Quality Management 1 (ISQM1) requires all audit firms to implement and document a system of quality management (SOQM) proportionate to the scale and complexity of the firm's activities. A core part of the implementation process is to conduct a risk assessment process to establish quality objectives, identify and assess quality risks and design and implement responses to address the quality risks. The SOQM needs to addresses the following eight components:

- The risk assessment process.
- Governance and leadership.
- Relevant ethical requirements.
- Acceptance and continuance of client relationships.
- Engagement performance.
- Resources.
- Information and communication.
- The monitoring and remediation process.

ISQM1 became effective from15 December 2022, so all audit firms have had ample opportunity to design, implement and record their SOQM. Around the time of implementation, *practical insights and tips on ISQM1*[2] were published on ICAS.com alongside some guidance videos, and while firm's should now have recorded the SOQM these resources can still be useful when considering ongoing improvements.

As we identified in the 2023 monitoring report, as time moves on, breaches in relation of ISQM1 arrangements will be considered progressively more significant, and while no regulatory penalties were raised in 2023 or 2024 as a result of failings in SOQM arrangements, that may not always be the case. All monitoring visits consider firms' ISQM1 arrangements in the context of the firm's particular circumstances, but at this stage there is no room for doubt that all firms should have a clearly recorded compliant SOQM in place. In practice however, that was not the case in 2024 with more than half of visits identifying significant weaknesses in the approach to ISQM1.

Key themes in ISQM1 breaches



As indicated above, where firms had chosen to develop a bespoke approach and record of the SOQM, there were often challenges in making sure the documentation demonstrated sufficient compliance with ISQM1. In the vast majority of cases where a bespoke approach was adopted there was a resulting breach of the standard. That said, there were a very small number of cases where the firm started from a 'blank page' and managed to record a compliant framework, but it was clear that a substantial amount of time and effort is needed for such an approach to cover all the required bases.

[2] *https://www.icas.com/news-insights-events/news/audit-assurance/practical-insights-and-tips-on-isqm-uk-1*

Back in 2022, *ICAS issued videos and implementation guidance*[3] to assist members in the design and implement a System of Quality Management in accordance with ISQM1. While all firms should have already documented their SOQM, the guidance remains a useful reference point for firms when reviewing their approach and planning incremental improvements.

Annual evaluations

Effective monitoring and evaluation arrangements are a key component of a functioning System of Quality Management, and firms should now have conducted at two annual monitoring and evaluation cycles. The importance of an effective annual evaluation process was set out in an *Audit News article*[4] last year, and going forward, firms will be asked to report their conclusion on the annual evaluation of the System of Quality Management through the Firm's Annual Return process.

As noted in the Audit News article, the FRC has been very clear on the importance of ISQM1's implementation and compliance as part of all audit firms' registrations, and this will remain an area of focus during 2025. In terms of monitoring compliance, there is a clear expectation that any firms that do not conduct and evidence the required annual evaluation are breaching Audit Regulation 3.10. Where such a breach is identified, any failure to remediate the issue on an expedited basis will result in reporting to the ICAS Authorisation Committee, which could include the consideration of regulatory actions. Additionally, ICAS is required to notify the FRC directly of any firms failing to remediate such non-evaluation on an expedited basis. This reporting requirement is a significant step, and should leave all parties in no uncertain terms as to the importance of compliance in this area.

Root cause analysis

ISQM1 requires any deficiencies identified through (internal or external) monitoring processes to be subject to root cause analysis (RCA) in order to understand why the issue arose, and to enable the firm to:

- Evaluate the severity and pervasiveness of the identified deficiency; and
- Appropriately remediate the identified deficiency.

Not every issue/finding in a monitoring process will reflect a deficiency. However, the most significant findings, or widespread / systemic failings identified across files, would likely be considered to indicate deficiencies exist that require evaluation. Under the terms of the standard, a deficiency exists where:

1. A quality objective required to achieve the objective of the SOQM is not established;
2. A quality risk, or combination of quality risks, is not identified or properly assessed
3. A response, or combination of responses, is not properly designed, implemented or operating effectively; or
4. An other aspect of the SOQM is absent, or not properly designed, implemented or operating effectively.

There is no one-size-fits-all approach to an RCA process, and the work conducted will vary depending on the size, complexity and operating characteristics of the firm. Most off-the-shelf packages include resources that firms can used to conduct root cause analysis. *ICAS Practice Support has also developed an Excel based tool*[5] which can be used to record the process, which firm's may find useful. Used as suggested, it provides a structured approach to investigate the root cause of deficiencies identified, and to document the process undertaken. The tool is set up to be used with "The 5 Whys" methodology. "The 5 Whys" method allows uncovering the root cause of a problem by simply asking "Why" multiple times. This interrogative technique is one of the most effective tools for root cause analysis and is likely to be proportionate and easily implemented, particularly in smaller and medium sized firms.

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[3] *https://www.icas.com/news-insights-events/news/audit-assurance/practical-insights-and-tips-on-isqm-uk-1*
[4] *https://www.icas.com/news-insights-events/news/regulation/isqm-uk-1-annual-evaluations*
[5] *https://www.icas.com/members-membership/resources/toolkits/isqm-uk-1-root-cause-analysis-tool*

Additionally, Lesley Byrne (Director of Regulatory Monitoring) previously created *two videos, to help firms when conducting their RCS processes*[6]. Part One provides an introduction to the remediation requirements of ISQM1, including the requirements to conduct root cause analysis and action plans; and Part Two provides real life case studies on 'what good looks like' when conducting root cause analysis and action plans, our monitoring results and how to avoid pitfalls found during audit monitoring visits. The videos for part of the mandatory audit course "Keeping Audit on the Right Track", which is open to all audit professionals, and viewing is mandatory for all ACPs and RIs once every 2 years.

Remedial action plans

Once root causes have been identified, it is important that remedial actions are planned to address the identified deficiencies on a timely basis. It is this process of remediation that really drives required improvements across a firm. Action plans should be developed, and documented, that respond to the root causes of the deficiencies, and the plans should be kept under regular review. If done properly, the remedial action plan can act as the cornerstone for quality enhancements being rolled out. Conversely, if only lip service is paid to the RCA process and remedial action plans firms are destined to repeat the same failings, and if anything audit quality will deteriorate rather than improve as time moves on and requirements are revised and enhanced across the ISAs.

Good Practice Case Study – Effective root cause analysis and remedial action plans

'Firm E' was subject to a monitoring visit in late 2022 which found systemic / more serious issues and related non-compliance with Audit Regulations 3.08 (Statutory Requirements); 3.10 (Auditing Standards); 3.18 (Audit Procedures); and 3.20 (Audit Compliance Review). The file reviews identified a significant decrease in audit quality since the last visit with the majority of files reviewing 'significant improvements' which was particularly concerning. These poor grades were principally due to significant issues around the level of audit evidence obtained over key transactions and balances across the files for which the monitoring team considered there to be two key underlying factors:

1. The application of **out-of-date audit procedures**, particularly with regards the most recently revised ISAs (UK). Further, in some cases procedures designed for small & less complex entities had been applied to larger companies and specialist entities, without sufficient tailoring and enhancement for the risks those entities presented.
2. An **ineffective audit compliance review process.** Despite engaging a robust eternal cold file review process annually, the findings from those reviews were not being remediated on subsequent audit files.

The firm approached the visit process positively, with a clear commitment to compliance and a desire to improve. A comprehensive root cause analysis was undertaken, which identified the root causes the deficiencies identified by the visit process, and a remedial action plan put in place. While the updating of audit procedures was a relatively easy fix, there were also more challenging root causes that took a longer period to address, including those around:

- Staff resourcing issues during and after the COVID period;
- Resourcing at the partner level, with high workloads & insufficient support for the ACP;
- Challenges from rapidly moving to remote auditing & soft copy files;
- Insufficient audit training in place across the firm.

[6] *https://www.icas.com/regulation-technical-resources/regulation/monitoring/keeping-audit-on-the-right-track*

The Authorisation Committee proposed a suite of follow-up actions, which were accepted by the firm, designed to support the firm in bringing audit quality up to the required level. Over the course of two years, the firm provided the Committee with regular updates on progress against its remedial action plan, advising of changes in approach where required, which demonstrated the root causes of the quality issues were being addressed on a reasonable timeframe. Additionally, a substantial number of external cold file reviews were submitted over the course which demonstrated an incremental, but continual, improvement in file quality – as would be expected where root causes where being dealt with.

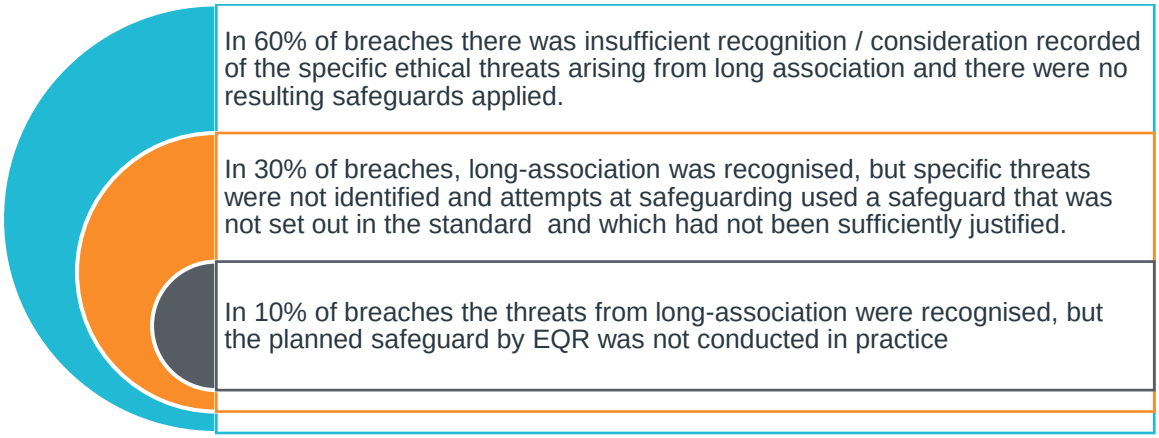
In early 2025, following significant effort by the firm and as a direct result of the application of the fundamental concepts embedded within ISQM1, the Committee was pleased to be able to confirm that the firm's 2022 visit process had been completed, with the follow-up actions undertaken leading to a clear and demonstrable improvement in audit quality and compliance.

4. Audit Regulation 3.02 – Acceptance / Ethical compliance (40% of visits, up from 36% in 2023)

It's vitally important that the users of the accounts can trust and have confidence that the audit opinion is objective. To that end, the Ethical Standard sets out the overarching principles of integrity, objectivity and independence, together with supporting ethical provisions which establish a framework of ethical outcomes that auditors need to meet.

Non-compliance with of the Ethical Standard has remained relatively consistent since 2023, and in particular firms continue to have some issues when responding to the threats arising from long association. Insufficient consideration of the threats, and resulting safeguarding, accounted for all of the breaches raised over regulation 3.02 in 2024.

Key themes in breaches of the Ethical Standard relating to Long-Association



The Ethical Standard identifes that self-interest, self-review and familiarity threats to the integrity or objectivity may arise once RIs and staff in senior positions have a long association or extensive involvement with an audit client. In practice, for the non-Public Interest Entities that fall under ICAS's monitoring remit, long-association exists once the RI has held the role for a continuous period of ten years. The Ethical Standard is not prescriptive in how the threats expected to arise from long-association (eg self-interest, self-review and familiarity) must be safeguarded. However it does note that appropriate safeguards may include:

- Appointing another Responsible Individual ('RI') to lead the audit (something that may not be possible in all firms);
- Involving an additional partner, who is not and has not recently been a member of the engagement team, to review the work done by the partners and the other senior members of the engagement team; or
- Arranging an Engagement Quality Review (EQR) of the engagement in question.

It is recognised that in some cases the presumed ethical threats may not arise in practice. For example, if management and those charged with governance have changed over the course of the 10+ year audit appointment the familiarity threat may be reduced; and where the time allocated to the engagement is not significant to the RIs annual workload / fees the threat from self-interest may be reduced. However, any such considerations would need to be clearly recorded at the acceptance stage, and while some threats may be mitigated others may exist which still need to be safeguarded.

All audits that present long association should have a clear and unambiguous record of the auditor's consideration of the self-interest, self-review and familiarity threats, as well as any other ethical threats that are considered to arise. Where applicable, the record should also set out any related consideration of the relevant risk factors flagged in the Ethical Standard (para 3.3):

- the role of the individual in the engagement team(s);
- the relationships established with management and those charged with governance;
- the proportion of time that the entity contributes to the individual's annual billable hours;
- the length of time that the individual has been associated with an entity;
- whether the individual is employed exclusively or principally on an engagement that extends for a significant period of time;
- whether the individual is remunerated on the basis of the performance of a part of the firm which is substantially dependent on fees from that entity.

While in some cases presumed ethical threats may not arise in practice, appropriate safeguards must be applied to any residual ethical threats that do exist, and it is anticipated that the potential safeguards set out in the standard would be the auditor's first port of call. Any safeguards other than those set out in the standard would need to be clearly justified on file, and given the significance of ethical compliance may well warrant consultation.

5. Audit Regulation 3.20 – Audit compliance review (breached in 40% of visits, up from 32% in 2023)

Historically there have been two main areas of reporting under Audit Regulation 3.20: weaknesses in a firm's cold file review process; and weaknesses in a firm's Audit Compliance Review process (ACR), also known as the 'whole firm review'. These areas are now intrinsically linked to a firms compliance with ISQM1 as they form a core part of the required monitoring and remediation processes, however separate reporting continues given the specific Audit Regulation in place.

Good Practice Case Study – Effective cold file review process

'Firm F' was a small partnership with one RI and around 10 audit clients, mostly charities. Small firms like this face real challenges in keeping up to date with changes in audit and it can be difficult to 'stand back' from the audit file and undertake an effective cold file review process when the audit team is very small and there are no other RIs to support the process or share the load.

The Audit Regulations allow the sole RI to conduct a cold file review of their own file, so long as an external review is engaged at least once every three years. However, the sole-RI preferred to engage an external cold file review, from an experience provider, every year to get a fresh perspective on the audit files. The external reviews were robust, and included clear reporting on the findings. A root cause analysis was conducted where the RI considered groups of findings indicated some areas for improvement, and a succinct action plan prepared. The firm used the reports as a training tool for the small audit team, and held a schedule of key finding on all subsequent audit files as a prompt to ensure the same issues did not recur.

While reviewers commonly find procedural weaknesses in smaller firms like this, the audit files were found to be of a relatively high standard and required only limited improvements. The firm's approach to engaging external cold file review processes, and responding to the findings therein on a timely basis, was considered to be a key underlying factor in the overall positive outcomes from the visit. The process had ensured that audit files incrementally improved year on year between monitoring visits, and that no significant gaps existed when ICAS came round to visit again.

Cold file review processes
The most common reason for a breach of this regulation was due to the weaknesses in the cold file review process, which affected 40% of the firms visited in 2024. These fell under three categories:

- In 12% of visits there had been a complete lack of a cold file review process in at least one of recent years. As flagged above, an effective cold file review process is an essential component of a firm's SOQM, and the lack of a cold file review would mean that any annual evaluation conducted in order to comply with ISQM1 would likely be considered ineffective.
- In 16% of visits, the scope of the internal process was found to be inadequate. This included cases where a sole RI firm had not engaged the required external review at least once in the last three years; and also where some RIs or client types had not been covered in recent years.
- In 16% of visits, the findings from the firms internal cold file review process were not considered to be consistent with the findings of the ICAS monitoring reviewer. This would be the case where a firms internal process had raised either no findings, or only minimal issues, but where the monitoring visit flagged significant or widespread compliance issues.

All audit firm's should ensure that at least one cold file review process is conducted annually, and firm's should be careful to ensure sufficient coverage across all RIs and client types in a reasonable cycle. While RIs should not typically conduct the cold file review of their own files, the regulations recognised that approach may be required in a sole RI practice. However, if that is the case the firm must engage an external review at least once in every three years.

Firms should endeavour to make their internal file review processes as robust as possible and they should be conducted by individuals with sufficient capability and experience. There have been some indications that firms that engage external compliance review services, even only on a periodic basis or in supplement to their own internal reviews, tend to have better levels of audit quality. Firms may want to consider the potential benefits from obtaining and responding to feedback from a reviewer with a different perspective, or one with wider exposure to different approaches and methodologies, in between ICAS monitoring visits.

Audit regulation compliance review
On 20% of the visits in 2024 it was identified that the firm had not conducted an effective compliance review against the audit regulations. That encompasses a small number of firms not conducting any ACR process; and the remainder conducting a process that was not considered effective in practice due to missing key areas of non-compliance identified by the monitoring reviewer. Again, an effective review of compliance with the Audit Regulations is an essential component of a firm's SOQM, the lack of an effective review could negate the outcome of any annual evaluation conducted in order to comply with ISQM1.

Other notable audit regulation breaches

Audit Regulation 3.18 - Audit Procedures (breached in 28% of visits, up from 12% in 2023)

Audit Regulation 3.18 requires every firm to maintain appropriate audit manuals, programmes, checklists, procedures, etc. Ensuring that the firms audit procedures are kept up to date is a key control supporting the production of compliant audit files, reflective of any revisions in the standards.

As would be expected, the application of out of date audit procedures greatly increases the risk that any revisions to the ISAs are not sufficiently taken into account. In 2024 there was an increased number of cases where out-of-date procedures had a detrimental impact on audits, and in particular in relation to compliance with the revised ISA 315 *Identifying and Assessing the Risks of Material Misstatement*. In total, 20% of the visits undertaken in 2024 found that the firm's general audit procedures were out of date; and in a further 8% of visits the firms' specialist audit procedures were out of date.

During 2024 reviewers heard that a number of firms had been having issues with the providers of their audit procedures, including a number of cases where there had been unexpected requirements to update software and/or hardware in order to have access to the most up-to-date procedures. As auditors become more reliant on software to conduct and records audits, it becomes more important than ever that systems are maintained and updated / upgraded timeously.

Audit Regulation 2.03 - Audit eligibility (breached in 16% of visits, up from 8% in 2023)

Breaches relating to eligibility have been increasing in recent years, and remain among the most significant issues identified on a visit. A breach of eligibility would always warrant consideration by the Authorisation Committee and will carry the potential for regulatory action to be taken, including the likes of regulatory penalty (with associated public notice), or worse, depending on the circumstances.

As flagged in 2023, issues with eligibility most often arise where there have been changes in the structure of a firm, or where principals have changed, without sufficient notification being made to ICAS and consideration of the potential impact of the changes with regards compliance with the Audit Regulations. Audit Regulation 2.11 requires audit registered firms to inform ICAS in writing, as soon as practicable, of any changes which might affect a firm's eligibility. Notification of such changes should be timely and not later than ten business days after the event.

Of the four visits where this standard was breached, three related to cases where firms were constituted as a limited company but had failed to make the required amendments to the Articles of Association in order to comply with regulation 2.03d. Limited company audit firms are reminded that the Articles of Association must include specific provisions regarding share transfers, including (but not limited to):

- requiring shareholders to notify any changes in the number of shares held;
- enable the directors to deprive any shareholder the right to vote if notifications aren't made; or if the firm's application for registration is rejected, or registration withdrawn due to ownership of any shareholding; and
- require the board of directors to approve any transfer of shares which would result in a shareholder having more than 3% of share capital.

If in doubt, a template for the amendments required can be found in the *Registered Auditor application form*[7].

In the remaining visit presenting a breach of this regulation, eligibility of the firm had been affected by changes in the firm's principals. As a result, the ratio of audit qualified partners to non-audit qualified principals became exactly 50:50 which meant that the firm did not demonstrate the required control by principals with the audit qualification. While the issue was temporary, and relatively short term, the firm had not applied to the Authorisation Committee for dispensation.

A summary of other potential risk factors relevant to eligibility is provided below for firms' reference, and all firms are reminded to keep ICAS Regulatory Authorisations aware of changes in the practice:

Eligibility risk factors

Principals in an audit firm who are not members of ICAS, ICAEW, ICAI, or ACCA will probably need to be an Audit Affiliate.

If there are changes in a firm's principals it will be important to ensure the requirements in the Regulations are checked, changes notified within 10 days, and any required affiliate applications made. In the past firms have been tripped up where internal promotions, or external appointments, of non-qualified individuals has resulted in eligibility issues that could have been easily addressed.

[7] *https://www.icas.com/regulation-technical-resources/documents/audit-registration*

Individuals with the audit qualification must hold sufficient rights to direct an audit firm's overall policy or alter its constitution (ie hold at least a majority control).

The monitoring team has come across issues where new appointments, or retirals of existing principals, has led to a firm ceasing to be eligible for audit registration as individuals with the audit qualification no longer hold sufficient control of the firm. Not all CAs have the Audit Qualification, so care should be taken to keep track of changes in Audit Qualified principals and voting rights.

Further, changes to the Audit Regulations in October 2024 affected the definitions for 'voting rights' and what constitutes a 'majority'. These changes could affect the eligibility of a significant number of audit firms. All firms should review the updates provided in Audit News[8] and Regulation News[9],and consider their own circumstances to ensure they remain

Audit Regulation 3.17 & 3.17a - Maintaining competence (breached in 16% of visits, which was the same as 16% in 2023)

These audit regulations relate to maintaining competence, and are reported against when the monitoring team finds weaknesses in a firm or RIs arrangements for training and continuing professional development (CPD). Breaches of these regulations are often closely linked to other significant, or widespread, issues with audit quality or compliance and readers are directed to the commentary provided in the *2023 monitoring report*[10] which remains relevant.

[8] *https://www.icas.com/news-insights-events/news/regulation/changes-to-the-audit-regulations-eligibility*
[9] https://www.icas.com/news-insights-events/news/regulation/1-april-2025-compliance-deadline-audit-firm-eligibility
[10] *https://www.icas.com/news-insights-events/news/regulation/common-findings-from-the-2023-icas-audit-monitoring-visits*

Conclusion

It is a little concerning that the issues identified in this report mirror those observed last year, and indeed are broadly similar to those identified in the preceding years too. However, it is recognised that to a greater or lesser extent many of the weaknesses identified here reflect areas that permeate throughout every file reviewed, and the substantive weaknesses can manifest at different stages of the audit depending on the particular challenges / issues faced in any given audit. In other cases, the issues reflect the inherent challenges firms face in applying new and revised standards, where 'business as usual' may need to be cast aside and precious time and resource spent on understanding and implementing new requirements, which may well not be welcomed by audit clients, at a time when firms are facing significant challenges in recruiting and retaining good auditors. We hope that presenting the findings as we have will help firms to proactively address these common areas of concern on future audit files.

At the same time, it is important to recognise and highlight the significant amount of good audit work that we have reviewed over the past year. In the vast majority of cases, firms have presented a clear commitment to compliance and a positive approach to the visit process. We know that an audit monitoring visit can be a stressful experience for auditors and firms, but it is encouraging to see firms recognise that high-quality regulation is essential if trust in the profession is to be protected and promoted. Ultimately our monitoring visits are regulatory processes, and it is important that they identify and respond to areas of non-compliance. But for every issue identified in this report, reviewers have seen many more examples of high quality, compliant audit work being conducted. While outputs necessarily focus on areas requiring improvement, throughout the visit discussions reviewers do their best to recognise and feedback on good work, share good practice, and provide practical examples that could help the audit process becoming more efficient and/or effective going forward. Looking ahead we will be trying to further develop and enhance the monitoring visit process to provide better feedback on these areas of good practice, and clear compliance, which we hope will enable us to share more good practice points in future reports.

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