

Audit Monitoring

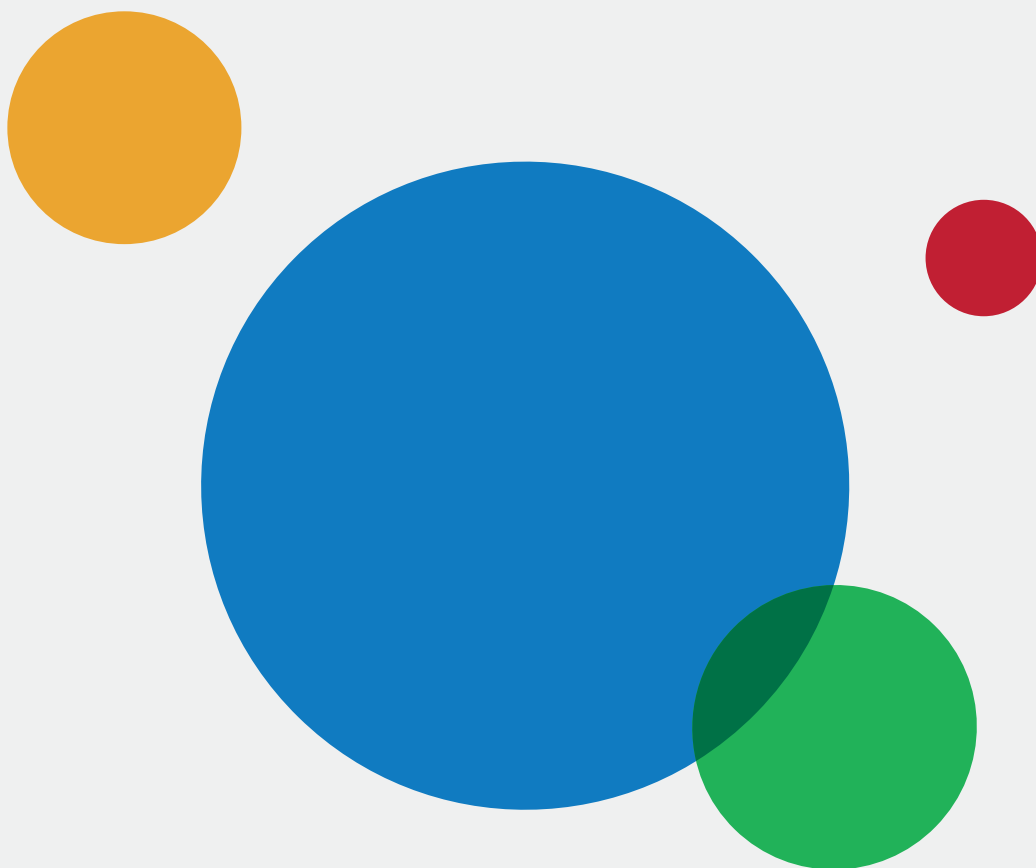
Annual Report

For the year ended 31 December 2020



Contents

Foreword from the ICAS Regulation Board	3
Introduction	4
What we do	5
2020 monitoring outcomes	8
Key themes and findings	13
What else do I need to know	18
ICAS support and other useful links	20



Foreword from the ICAS Regulation Board

The Regulation Board ('the Board') is the executive board established by Council for setting policy and procedure relating to the regulatory functions of ICAS, including audit regulation.

In the context of audit regulation, the following Regulatory Committees discharge important regulatory functions:

- The Authorisation Committee makes all regulatory decisions in relation to audit firms and Responsible Individuals.
- The Investigation Committee considers all complaints relating to the conduct of statutory audit work, or the conduct of individuals authorised as Responsible Individuals.

The Board are pleased to present this annual report on the ICAS Audit Monitoring activities for the year to 31 December 2021. In doing so, it remains concerned that some firms are not meeting the expected standards. Whilst the Board appreciates that the recent period has been one of significant challenge, some firms must take action to improve audit quality and compliance.

Firms that have demonstrated a good level of compliance in the face of these challenges are to be commended, and the Monitoring team have fed back these positive messages through the visit process.

Through this report the Board urges that the important messages are considered by all audit firms and responsible individuals in the conduct of audit work going forward.

Philip John Rycroft CB
Chair

Introduction

We are pleased to present our annual report for 2020. As in previous years, this report aims to provide transparency over our work and includes:

- An overview of the activities of ICAS Audit Monitoring during 2020; and
- Key messages and detailed findings arising from monitoring reviews.

It is recognised how challenging 2020 has been for practitioners, and indeed continues to be in 2021, dealing with the impact of the pandemic and its restrictions, both personally and professionally. CAs in practice have been at the forefront of supporting small business navigate the plethora of government pandemic support schemes for the employed and self-employed.

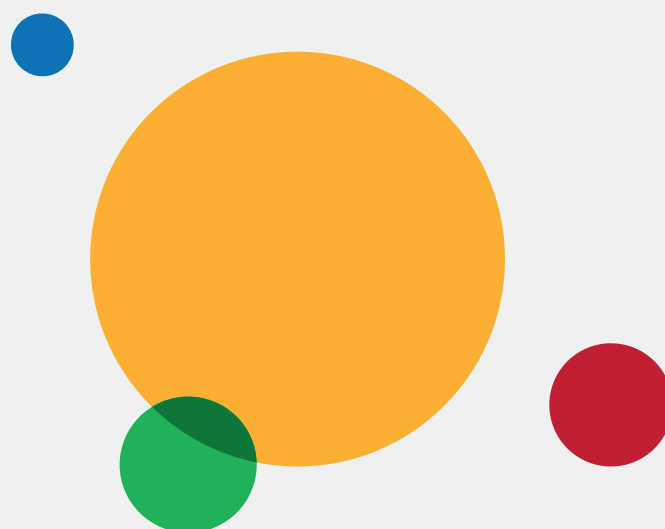
We acknowledge with gratitude the willingness of our practice community to engage with ICAS in relation to Audit Monitoring, readily adapting to a new approach to remote reviews and meetings held via video conference and telephone.

Whilst the environment in 2020 naturally impacted on the way in which our work was conducted, and the number of reviews were reduced against initial expectation, we are proud of the way in which monitoring and regulatory activities continued during the period.

Whilst we have identified a number of areas where audit firms have improved against previous findings, for consecutive years the majority of firms were subject to follow-up action following a monitoring review.

We hope that audit firms will find this report useful in considering how effectively the firm is complying with regulatory requirements. We encourage all Responsible Individuals to share the report with your audit colleagues, and also to utilise the key messages when conducting the Audit Compliance Review process.

If you have any comments or questions, please contact us at auditandpracticemonitoring@icas.com



What we do

The Regulation Board and ICAS Committees

The Regulation Board ('the Board') is the executive board established by Council for setting policy and procedures relating to the regulatory functions of ICAS.

The Authorisation Committee, which makes all regulatory decisions in relation to ICAS firms, reports regularly to this Board, as does the Investigation Committee.

Background: Improvement Regulation

We aim to deliver improvement regulation (sometimes referred to as developmental regulation), which means that our monitoring activities are designed to both:

- support the work of ICAS registered firms; and
- uphold standards and provide re-assurance to the public.

Our primary role is to effectively monitor our supervised population and to work with, and to support, firms to ensure compliance with requirements. The regulatory landscape is becoming increasingly challenging, meaning we require to act as a robust regulator.

What we review

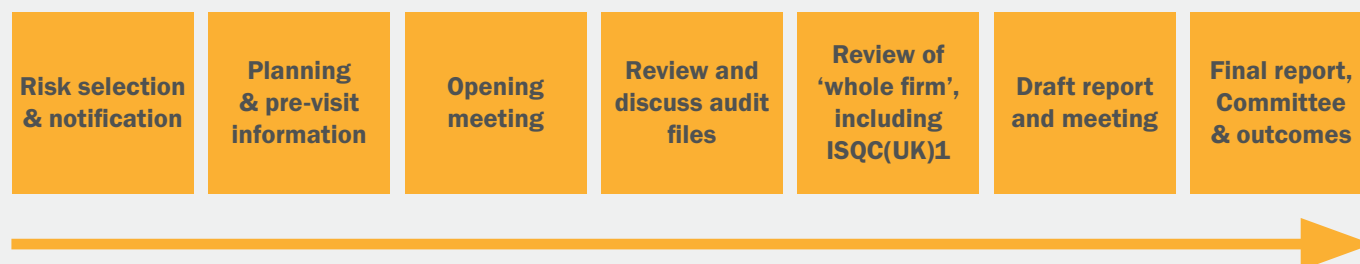
Audit Monitoring conducts the monitoring of all ICAS audit registered firms.

Visits are selected on a risk basis and all firms are visited at least once every six years. Risk indicators include: ongoing audit market analysis and intelligence; the type and size of the audit portfolio; changes within the practice; and the previous visit history. This risk-based approach determines the time and frequency of visits. Firms with previous visit issues will have their time until the next visit shortened.

The onset of the Covid-19 pandemic meant that no on-site reviews have been undertaken since mid-March 2020. The majority of our firms have been able to accommodate a remote review during this period. These reviews have mirrored the approach that would have been taken had the review been undertaken on-site, with the impact on the logistical aspects of the process and the timing of engagement with firms.

What we do

How we review



How we review

As part of our monitoring process, we require some firms to provide a root cause analysis of findings identified during a review. The detail and length of such an analysis will vary depending on the nature of findings, however our firms have commented that they find this process a useful exercise and it serves to focus on what actions are required going forward. The analysis that has been undertaken demonstrates consistency with the challenges and themes expressed throughout this report.

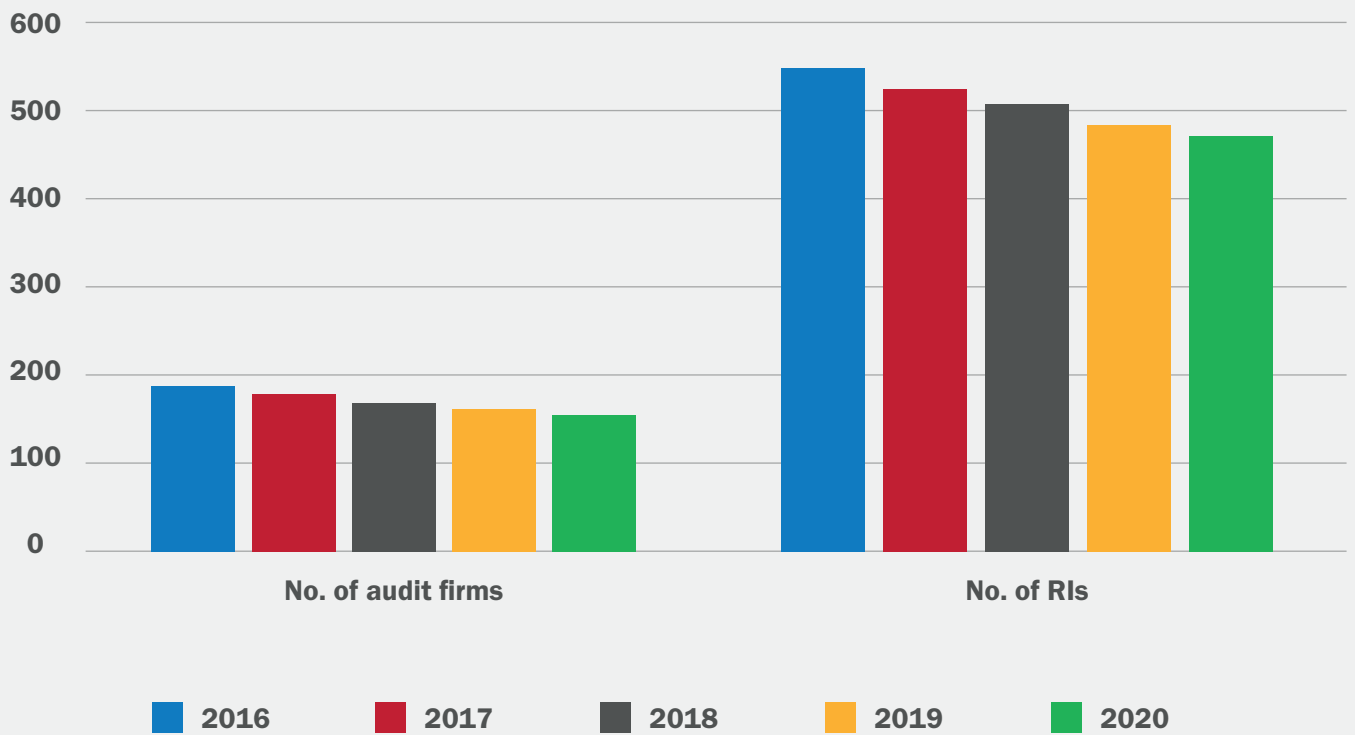
The size of firms registered with ICAS to conduct audit work varies and the monitoring visit approach is tailored to reflect the nature and client base of each firm.

For more information about Audit Monitoring, and the role of the Authorisation Committee, please search for “audit monitoring” at [icas.com](https://www.icas.com).

Who we review

The number of ICAS audit registered firms and approved Responsible Individuals (RIs), has reduced slightly year-on-year, partly due to the increased regulatory environment. As at 31 December 2020 there were 158 firms registered with ICAS for audit; and 476 related RIs.

Firms and RIs registered with ICAS



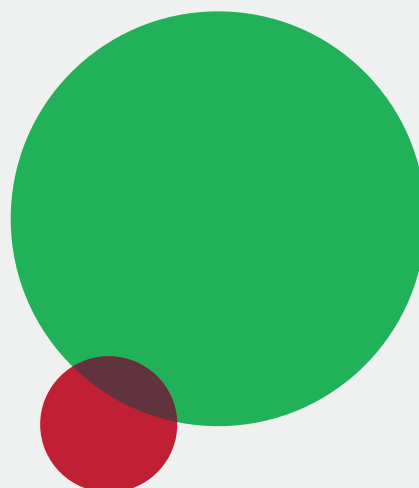
2020 monitoring outcomes

Overview

As has been highlighted throughout this report so far, 2020 was an exceptionally demanding year for our firms. This has compounded the challenges already impacting the profession in recent years, including the implementation of the EU Regulation and Directive; the implementation of the Money Laundering Regulations 2017; the introduction of the General Data Protection Regulation (GDPR); and the changes to UK GAAP.

Whilst the knock-on impact of these changes has been to increase the workload of firms, it can often be the case that firms have been met with staff shortages. This can result in some firms being unable to devote sufficient resource to audit work, which can contribute to the downward trend in compliance. Firms must ensure that adequate and skilled resources are devoted to all work, and in particular audit.

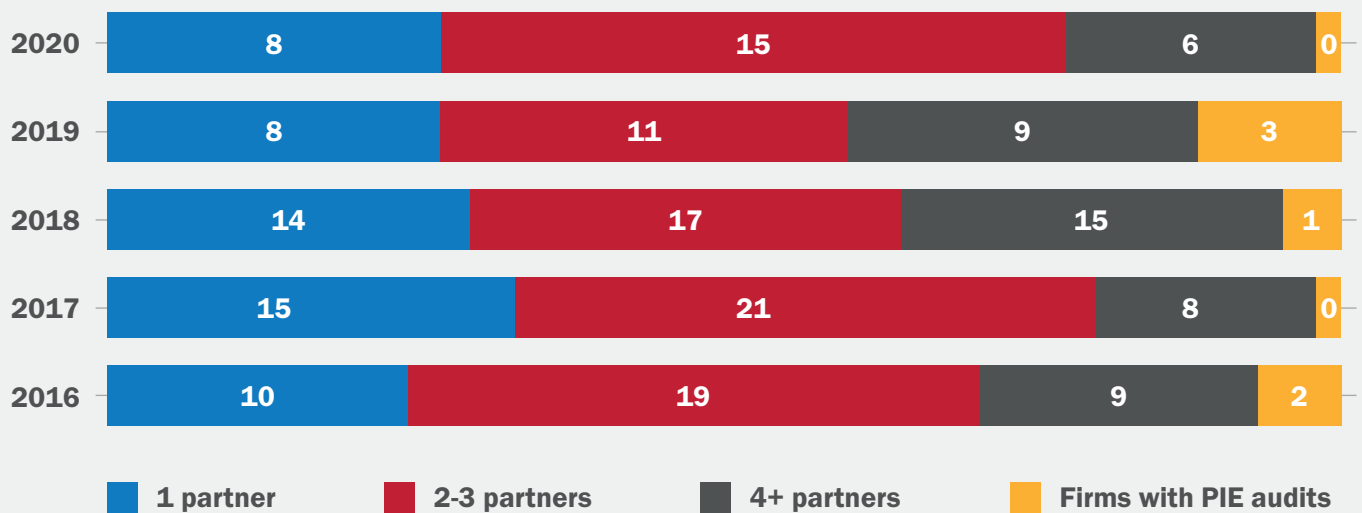
ICAS has a focus on 'improvement regulation', in that we want to work with and support firms to make improvements, but this approach is becoming challenging in the current environment, and poor audit quality will not be tolerated. Where firms are subject to conditions or restrictions, improvements need to be made, otherwise more stringent enforcement measures may be applied, such as withdrawal of audit registration, regulatory penalties with publicity, or disciplinary measures. We hope that this is not needed and that firms will make the necessary improvements with support.



Monitoring reviews and outcomes

During 2020, 29 firms (2019: 31) received an Audit Monitoring review. The profile of the firms reviewed has been broadly similar year on year:

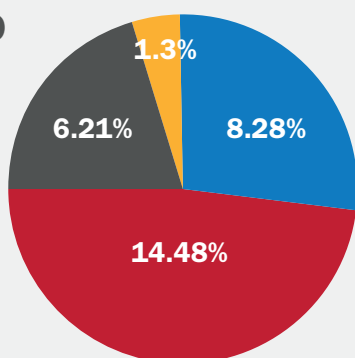
Profile of firms reviewed



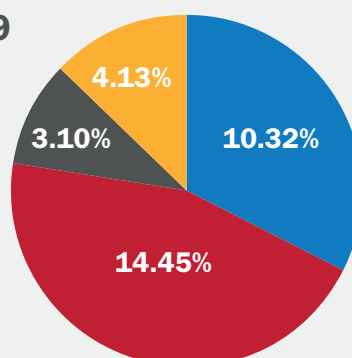
2020 monitoring outcomes

The outcome of the reviews carried out in 2020, and compared to prior years, is summarised below:

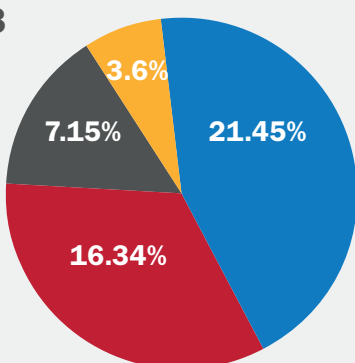
2020



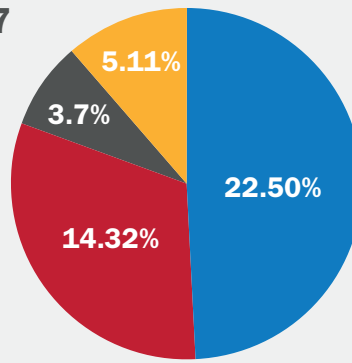
2019



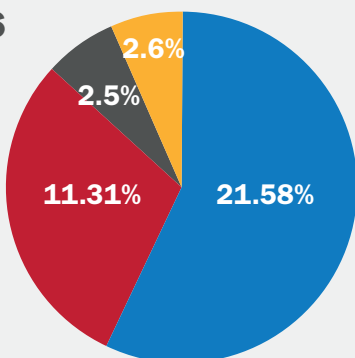
2018



2017



2016



■ No follow up
■ Isolated issues
■ Systemic issues
■ Serious issues

Whilst it can be difficult to make comparisons year-on-year, given that different firms are visited each year, and the regulatory landscape has been changing significantly, the following is noted:

- 76% of firms reviewed (77% in 2019) had no systemic/serious audit quality issues.
- The largest movement in recent years has been in the number of firms with isolated issues, and the corresponding reduction in firms with no follow-up action required. In such cases, the isolated issues relate to the work on either one specific engagement; type of engagement; or a specific individual, and whilst the rest of the visit would not require any follow-up action, and there are no systemic issues within the firm, it has been considered that follow-up action on the isolated issues provides comfort that improvements are made.

All firms with isolated, systemic and serious issues are considered by the Authorisation Committee and will require the firm to submit evidence of follow-up action. All other monitoring reports are reviewed on a sample basis by the Committee. The main issues, which often lead to firms requiring follow-up action, are explained in the “Key Themes” section of this report.

For information, recent regulatory penalties issued by the Authorisation Committee are published on the ICAS website at: <https://www.icas.com/regulation/regulatory-monitoring/regulatory-penalties>

Follow-up checks

The firms requiring a greater level of action to enhance quality are those falling into the ‘systemic’ and ‘serious’ groups (24% of visits during 2020; and 23% in 2019).

Such firms would be required to provide a greater level of evidence to demonstrate improvement, and this ranges from submitting external hot file reviews, cold file reviews and CPD records, through to the more serious cases, where more robust enforcement may be required, such as withdrawal of RI status or audit registration, regulatory penalties, publicity and referral for disciplinary action.

The ICAS ‘improvement regulation’ approach means that as well as the range of follow up measures above, ICAS provides a range of support (see the “ICAS Support” section of this report) including the mandatory audit course and Audit News.

Firms are also encouraged to engage with external compliance reviewers, to make the necessary improvements.

2020 monitoring outcomes

Audit file standards

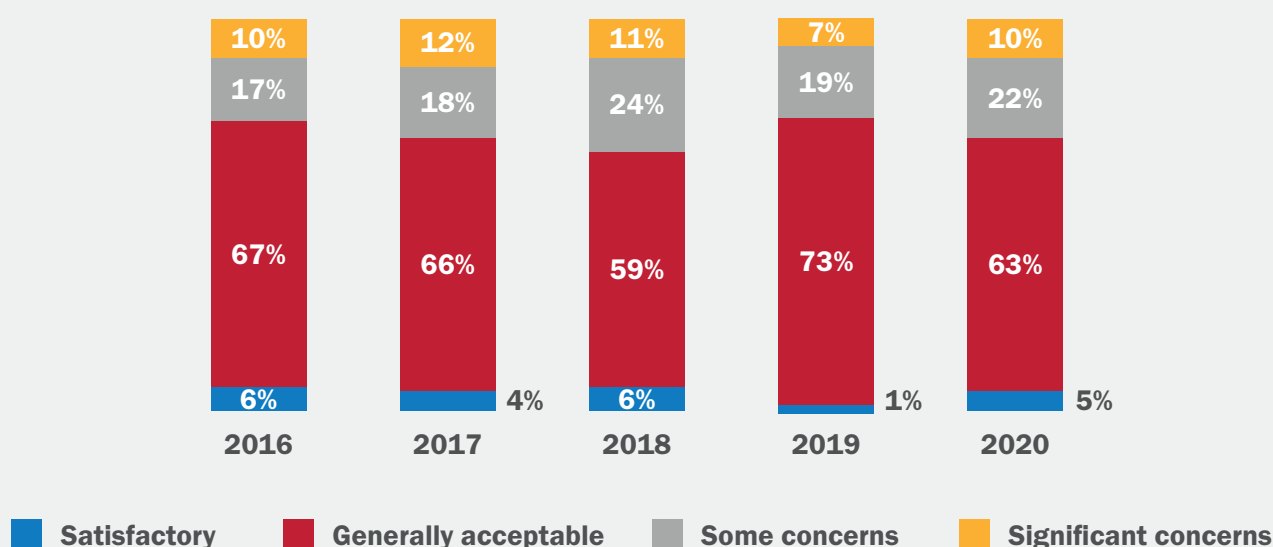
In 2020, 78 audit files were reviewed in full, and 26 reviewed on a restricted basis. This is compared to the number of full reviews in previous years: 89 (2019); 123 (2018); 101 (2017); and 113 (2016).

All Recognised Supervisory Bodies in the UK use a common method of assessing audit quality on individual files reviewed. This method assigns the following grades to

an audit file, and these are communicated to each firm at the completion of each review process:

- 1: Satisfactory.
- 2A: Generally acceptable but a small number of improvements required.
- 2B: Some improvement required.
- 3: Significant improvements required.

File review grades



The above outcomes show consistent findings to the overall visit outcomes, and further demonstrate that audit quality is not showing the necessary signs of improvement year on year.

Key themes and findings

In the following section we will highlight some key themes and common areas that are discussed with firms during monitoring activities. We would strongly recommend that firms use this information when undertaking work and conducting compliance and engagement reviews.

When firms and the monitoring team consider the root cause of matters identified, there are messages that are consistent year on year. The following are the most common underlying causes, and some of the more prevalent are considered within this section of the report:

- A lack of Responsible Individual involvement and supervision;
- Issue with regards programmes and systems, being either a lack of effective adherence to these, or over reliance;
- A lack of, or ineffective, Audit Compliance Review;
- Eligibility concerns; and/or
- Issues with regards the competence of an audit team or Responsible Individual.

Further to this, we would highlight that findings often occur in areas of the audit that are perhaps viewed as straight forward or of low complexity. The findings year on year can arise in similar areas, and it is our view is that it is time for audit teams to 'get back to basics'.

Key themes and findings

Professional scepticism and judgement

As ever, the need for professional scepticism and judgement is of importance. There should always be evidence of robust challenge of management, and what is categorised as scepticism can often be viewed as ‘good auditing’, and is something that should be inherent in everything an auditor does.

It is also time for there to be an increased focus within audit teams on the considerations and judgements made, and in the way in which the audit is planned and conducted. The use of formalised audit procedures, and the advent of data analytics and other related tools, is evidence of the desire within the profession to enhance audit quality. We are keen, however, to highlight that an auditor's professional judgement should be at the forefront of all audits, and that what can sometimes be missing from engagement files is the evidence that the audit team has taken time to reflect on what the procedures and tools are providing, and their consideration of the reasonableness of this.

For example, where procedures are driving a sample size that, on reflection, appears to be low, it is key for the audit team to consider whether the risk assessment and input

has been appropriate, rather than merely accepting the sample that is presented. We have seen some instances where an audit team taking a short time to increase professional judgement at the correct stage has addressed a potentially low sample size, or incorrect audit approach. This could again be categorised as reinforcing the need to ‘get back to basics’.

Eligibility

As is regularly covered in our publication ‘Audit News’ firms can, on occasion, fail to identify that their firm no longer meets the eligibility requirements of the Audit Regulations. This can occur where there are changes in a partnership, or a group restructure. Such issues are viewed seriously by the Authorisation Committee and, as such, we would remind each firm to ensure the following:

- That the majority of the voting rights in your audit firm are held by persons holding an ‘appropriate qualification’ (or are ‘Registered Auditors’). There have been cases where firms have set up a parent company which hold the majority of the voting rights in the audit firm, but the firm hasn’t realised that the parent would require to be audit registered.

- That if any principals in the firm are not members of ICAS, that the principal has been granted Affiliate status by ICAS.
- That all audit engagement leads, including non ICAS members, have applied to ICAS to become Responsible Individuals in your firm. Holding the audit qualification (such as the ICAEW audit qualification or the ACCA PC/AQ status) isn't enough and all audit engagement principals must be approved by the RSB which regulates your firm.
- That you have applied for RI status for any RIs moving from another firm. RI status is not portable and does not move from firm to firm.

Audit Compliance Review (ACR)

An effective ACR acts as an internal 'health-check' ensuring that the firm is meeting the requirements of the ISAs and Audit Regulations. While there are two distinct parts, the whole firm review and process of cold file review, the latter is the area that more commonly impacts on audit quality.

Each audit firm is required to complete at least one cold file review on an annual basis (but the actual number will depend on the size of the firm), to assess audit quality

and the level of compliance with ISAs. In 2020 the issues primarily related to either a lack of a cold file review process, or a lack of improvement against the findings of previous reviews.

An effective cold file review process should be challenging and thorough, and although many firms use a checklist, it should not be a 'tick-box exercise'. As such, we recommend that all audit firms:

- Ensure the cold file reviewer is suitably experienced to conduct a thorough review, and consider using an external reviewer if there is insufficient internal resource;
- Ensure all RIs are covered on a cyclical basis;
- The review should assess the quality of the work performed, rather than merely checking that programmes are completed;
- Specialist audit clients should be included in the review each year; and
- Action points should be collated and circulated to ensure points are addressed in a timely manner.

Key themes and findings

Evidence breaches and documentation issues

Documentation issues arise where firms have not recorded audit work in sufficient detail to allow the reviewer to understand at a later date the extent, nature and timing of the work which had been performed, and the conclusion reached by the auditor.

This can include lack of documentation in key areas of judgement or inadequate or poorly documented working papers. This would also include where working papers have not been attached to the file, something particularly prevalent in electronic files, or where documentation in relation to material balances or specific judgements has been retained on a prior year file.

We have continued to identify an increase in documentation issues in 2020, and in some cases, the audit monitor was simply unable to conclude that sufficient evidence has been obtained over a particular balance or transaction. Where there has been an accumulation of documentation issues on an audit file we will often conclude that the file requires some improvement which may lead to follow-up action.

ISA (UK) 240 Fraud

The most significant issues relating to ISA (UK) 240 are:

- A failure to test journals as part of the work required to address the significant risk of management override.
- On a number of audits, there was no evidence that the firm had discussed fraud risk with the client or did not go into sufficient detail.
- Most firms are aware of the requirement to have a fraud briefing with the engagement team, but often this is not well recorded, or the RI has not been in attendance.

ISA (UK) 315 Identifying Risks

Most firms now document a good understanding of their client, along with detailed systems notes. Firms are, however, omitting to confirm their understanding of the systems (e.g. by walkthrough tests) which is a requirement of ISA (UK) 315.

ISA (UK) 570 Going concern

Going concern has consistently been an area of focus, and this has been compounded in some industries by the uncertainties around Brexit, and the impact of the pandemic.

During 2020 ICAS issued a guidance document around the impact of the pandemic, and the revisions to ISA 570. A link to this guidance is provided in the ICAS Support section of this report.

Following concerns around the quality and rigour of audit, ISA 570 on going concern was revised by the FRC in September 2019, and requires additional work on the part of the auditor, increases the level of

documentation required in support of the auditor's conclusion on going concern, and updates the wording of the audit report. It is vital that appropriate time and consideration is given to disclosures in the financial statements and in ensuring that audit files clearly set out the auditor's considerations, and the work undertaken.

It is extremely important, when considering going concern in the current environment, that firms (and indeed the audited entity) understand the different responsibilities of the auditor and the audit client in relation to the financial statements. This is of particular importance for firms who prepare financial statements on behalf of their audit clients.

Responsibilities of the audit client	Responsibilities of the auditor
• Management is required to demonstrate that the company will remain a going concern regardless of any uncertainty. • It is the directors' duty to make appropriate disclosures in this regard, including consideration in the directors' / strategic report and in the notes to the financial statements. • To disclose any material uncertainty about a company's ability to continue as a going concern in both the directors' report and in the notes to the financial statements. This would include any doubts in relation to financial support at the date of signing.	• It is the auditor's duty to consider whether they agree with management's assessment, and whether disclosures made by the directors in this regard are appropriate and sufficient, and the impact, if any on the audit report.

What else do I need to know

Audit Regulations

Following the end of the Brexit transition period at the end of 2020, the Audit Regulations required amendment to reflect the changes in the relationship between the UK and the EU from 1 January 2021.

The up to date Regulations can be found at: <https://www.icas.com/governance/charter/icas-rules-and-regulations>

ICAS status in the Republic of Ireland

In September 2021, ICAS announced that it had applied to IAASA to revoke its status as a Recognised Accountancy Body (RAB) and a Prescribed Accountancy Body (PAB) in the Republic of Ireland. IAASA announced it had received this application and that the revocation would occur in December 2021.

The decision was based on the diminishing number of ICAS firms that undertake audit work in the Republic of Ireland, and an increasing divergence in audit regulation between the UK and the Republic of Ireland.

ICAS has communicated directly with the members and firms impacted by this change, however if anyone has not received this communication and considers that they will be impacted, they are advised to contact ICAS at: regulatoryauthorisations@icas.com

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.

In 2020 the Authorisation Committee approved significant changes to the presentation of the course:

- A video recording of the course is now available on the ICAS website.
- The recording is presented in seven modules, which can be viewed individually or together.
- This material is free of charge for ICAS members to access any time they wish.
- It is anticipated that when Covid-19 restrictions are eased, a face-to-face course will be presented each year in Edinburgh, Glasgow and Aberdeen. There will be a cost to attend the face-to-face course.

With the material now easier to access, and free of charge, it is anticipated that the key messages will be delivered to a wider audience, including more junior members of staff, which is a population that is key to target to influence the future of auditing.

Further, the Authorisation Committee approved a change in the mandatory requirement:

- 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.
- 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.
- Each firm is required to confirm adherence to the mandatory requirements via the Firm's Annual Return, and this is followed up as part of the monitoring visit.

Reporting Breaches of the Ethical Standard

The FRC Ethical Standard 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
- The firms Recognised Supervisory Body (for non-PIE audit firms).

ICAS registered firms that do not audit a PIE entity should make notifications on a biannual basis by email to:

regulatoryauthorisations@icas.com



ICAS support and other useful links

Contact details

If you have any comments or questions regarding monitoring activities, please contact

auditandpracticemonitoring@icas.com

For queries in relation to audit, and other, licences and RI status: please contact regulatoryauthorisations@icas.com

Audit News

We publish Audit News on a quarterly basis, which covers current topics and issues noted at monitoring visits. It is also the way we notify firms of any changes to the Audit Regulations.

This is available on-line, but for each publication we produce a printer-friendly pdf. Audit News, including past publications, can be accessed by first logging into [icas.com](https://www.icas.com) then searching “Audit News”.

ICAS response to the COVID-19 pandemic

As part of the ICAS commitment to supporting the welfare of our members, students and staff, a hub was launched for information and resources relating to the impact of the Coronavirus pandemic: <https://www.icas.com/professional-resources/coronavirus>

Guidance publications

The following publications were issued in 2020:

- **Guidance on attendance at stocktakes during the coronavirus outbreak:** assists auditors in assessing whether, in light of their potential non-attendance at a stocktake, the use of alternative procedures would enable them to have sufficient and appropriate evidence. This can be found at: <https://www.icas.com/professional-resources/coronavirus/practice/accounts-audit-and-corporate-reporting/icas-issues-updated-guidance-for-auditors-on-attendance-at-stocktakes-during-the-coronavirus-outbreak>
- **Going Concern Considerations: Covid-19 and Beyond:** outlines the greater requirements of ISA 570 (UK) (Revised September 2019); and consideration of going concern in relation to Covid-19 challenges. This can be found at: <https://www.icas.com/professional-resources/coronavirus/latest-updates/icas-issues-guidance-on-going-concern-considerations-for-auditors>

Technical Support

The ICAS Technical Helpdesk provides advice and guidance on technical queries in relation to accounting, auditing, ethics, AML, tax and insolvency.

The technical helpdesk can be accessed online via [icas.com](https://www.icas.com) (search Technical Helpdesk).

ICAS General Practice Manual

ICAS provides a focussed, relevant and accessible resources for general practice in The General Practice Manual (GPM). This can be found at: <https://www.icas.com/professional-resources/practice/knowledge-centre/general-practice-manual>

The GPM is available directly through [icas.com](https://www.icas.com) and linked with members logins. The GPM is also accessible to anyone within an ICAS firm. GPM will remain a free resource to ICAS firms.

The ICAS Practice Support Service

This service provides support to all ICAS registered firms. It offers a variety of services on all aspects of practice, which can be tailored to meet the needs of your firm. For more information on any of these services, contact practicesupport@icas.com

Anti-Money Laundering Support and Advice

Advice re AML procedures and approach

If you have a question in relation to procedural matters in relation to Money Laundering compliance then contact our Practice team who will be happy to discuss your queries. They can be contacted at practicesupport@icas.com

Money laundering confidential helpline

If you have queries in relation to possible money laundering reporting issues then you can contact our helpline in confidence on 0131 347 0271.

Protect – Whistleblowing helpline

ICAS has joined forces with Protect to provide members with access to an independent, confidential helpline. This service offers free advice regarding whistleblowing and speaking up.

You can call the ICAS Protect Helpline on 0800 055 7215.



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