

March 2024



# Audit News- Spring 2024



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

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

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

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

## New Look Audit News

We have launched a new look digital Audit News but are also retaining the PDF versions in our Audit News library, which is located [here](#), to enable firms to share copies within audit teams.

## ICAS Audit Monitoring launches the first two videos in its revised mandatory audit course

Our mandatory audit course is currently being redeveloped to bring it up to date for ISQM (UK) 1 requirements. We will be releasing new video modules throughout 2024 and will alert firms to new videos via Audit News

The first two videos in the revised mandatory audit course series 'Keeping Audit on the Right Track' have been launched. They focus on Root Cause Analysis and Action Plans given these are new requirements in ISQM (UK)1 and areas that firms are finding challenging.

These are a topical if audit firms have finished their first year's monitoring of their System of Quality Management. Part one explains what they are and how to conduct them. Part two provides monitoring feedback and gives some real firm examples to share what 'good looks like'. This is important viewing for all Audit Compliance Principals and RIs as part of the mandatory course requirements. We will be adding more videos into the mandatory course series during 2024.

### RCA and action plans: Part one

This *video* provides an introduction to the remediation requirements of ISQM(UK)1, including the requirements to conduct root cause analysis and action plans.

In this video presented by Lesley Byne, Director of Regulatory Monitoring, we cover:

- What Root Cause Analysis (RCA) is and when to conduct it
- Who should lead an RCA
- How to conduct an RCA
- An introduction to the '5 Whys' approach
- An example RCA template
- A worked example
- What an action plan is and how to conduct one
- An example Action Plan template

- A worked example

## RCA and action plans: Part two

This *video* 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.

In this video presented by Lesley Byne, Director of Regulatory Monitoring, we cover:

- Monitoring findings
- The most common causes found by firms
- Example root causes
- Common RCA failings
- What good looks like: Three real life examples of good RCAs and the key take-aways
- What the Authorisation Committee expects

*Author: Lesley Byrne, Director of Regulatory Monitoring*

## Common Findings from the 2023 ICAS Audit Monitoring results

The ICAS Audit Monitoring Team highlights the *common findings identified in the 2023 monitoring visits*.

2023 was another transitional year for ICAS Audit Monitoring, with a number of changes in the review team taking place through the year, and ongoing development of new monitoring methodologies and documentation.

The bulk of the visits in 2023 were required under the statutory six-year cycle. The remaining visits were conducted on a shortened cycle, informed by the monitoring team’s ongoing risk assessment process. The schedule remained somewhat atypical, but there remain key themes and common findings that all audit registered firms should consider and learn from.

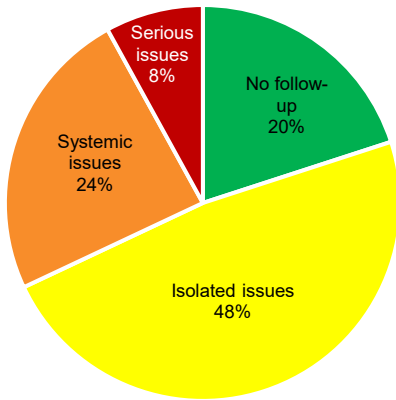
### Visit outcomes

The percentage of visits that presented serious and systemic issues has fallen compared to the previous year. 8% of visits in 2023 presented serious issues (14% in 2022) and 24% of visits presented systemic issues (36% in 2022), which is a positive trend. However, a smaller percentage of visits required no follow-up action in 2023, with only 20% of visits being closed without further submissions or other follow-up actions being required by the Committee (29% in 2022). What is left is an increase in visits presenting isolated issues, which has risen to 48% in 2023 (21% in 2022).

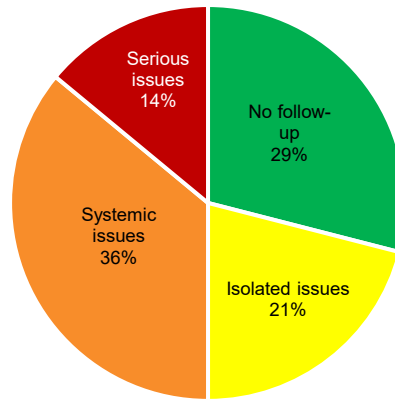
Visits falling in to the ‘serious’ and ‘systemic’ categories are always reported to the full Authorisation Committee (‘the Committee’), as they are considered to present the most significant findings. In the most serious cases, the Committee has considered whether further regulatory action is required, and that has included stringent follow-up actions and, where appropriate, regulatory penalties.

Where audit file quality has seen a general trend of improvement (as seen in the charts below), the reduction in visits without follow-up action has been impacted by a number of firms having ‘whole firm’ findings, or due to isolated issues affecting only some audit files, affecting the visit outcome.

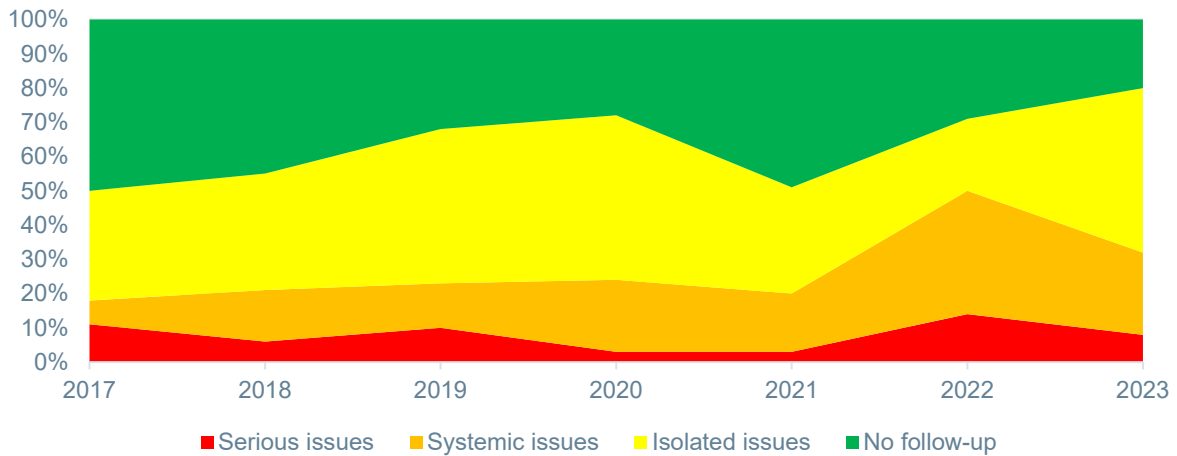
### Visit outcomes 2023



### Visit outcomes 2022



### Visit outcomes - historical trend



### Audit file quality 2023

Generally, there was a slight improvement in the level of audit quality seen on the files compared to 2022. The majority of files reviewed in the year (60%) were of a good standard or only required limited improvement, which is a significant improvement on the levels of compliance noted in the previous year, when only 33% of files fell into that category.

A small number of 1 Grade files were reviewed in 2023, which reflected particularly good levels of compliance. These files presented no areas of concern regarding the sufficiency and quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed. Further, there were only limited weaknesses in the documentation of audit work.

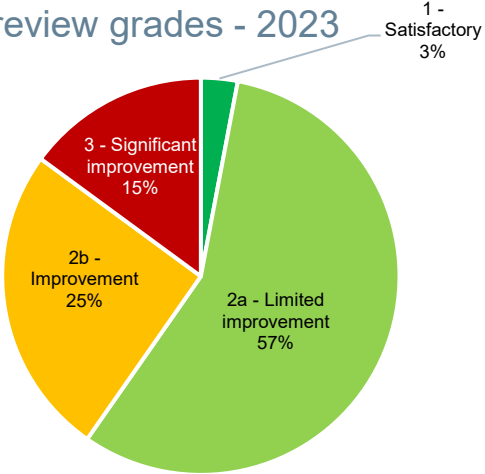
The team also reviewed more files of a 2A standard in 2023, with 57% of the files reviewed reflecting only limited concerns regarding the sufficiency or quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed, and where weaknesses in documentation were restricted to a relatively small number of areas. This is a substantial improvement from 2022 when only 33% of the files reviewed were of a 2A standard.

The monitoring team understands the significant challenges that firms face in maintaining audit quality, at a time of increasing regulatory expectations, while at the same time ensuring audits are conducted

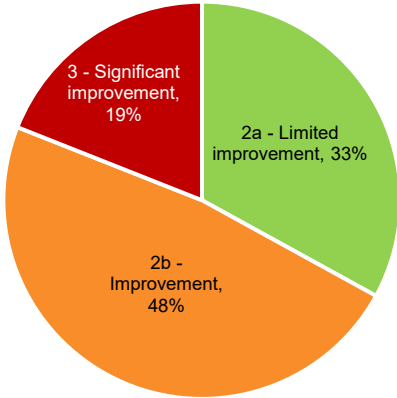
on a commercial basis. In that context the number of 1 and 2A Grade files is seen as a positive outcome and we hope that this continues into 2024.

The 2023 monitoring year saw fewer files of a 2B and 3 standard, though these still accounted for 40% of the files reviewed. These poorer files, by their nature, present more serious breaches of ISAs and Audit Regulations and also bring the clear potential for further regulatory action to be considered required by the Committee in order to bring standards up to the required level.

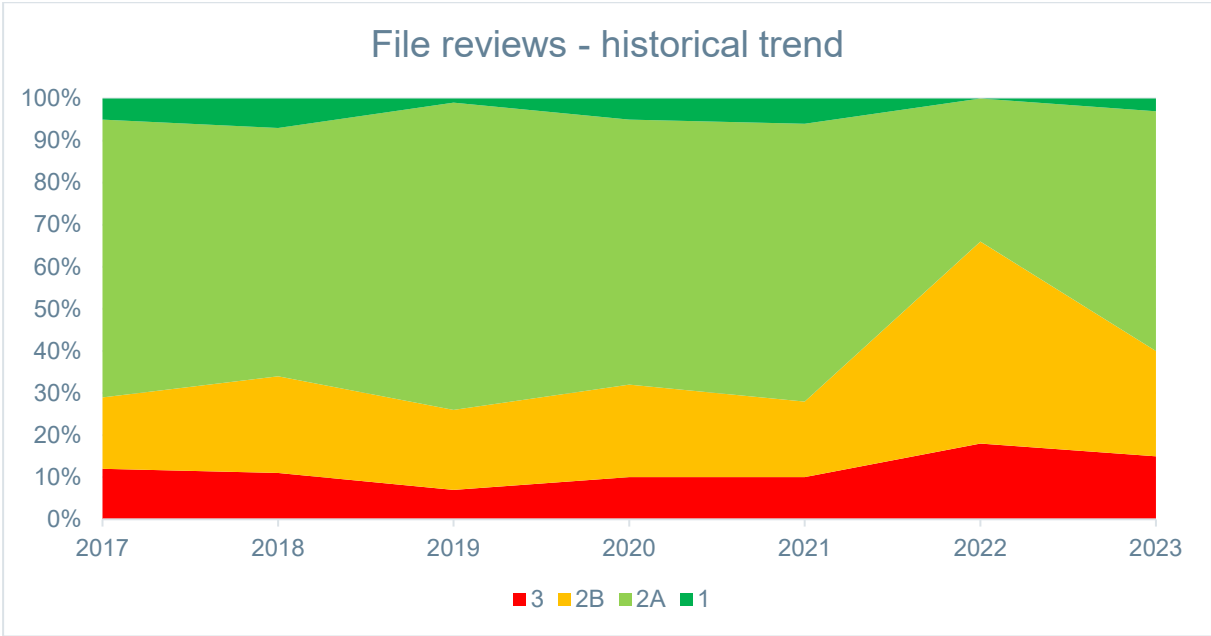
File review grades - 2023



File review grades - 2022



File reviews - historical trend



**Common ISA breaches**

Other than general weaknesses in audit documentation (relating to ISA 230), the most common ISA breaches identified in our monitoring work during 2023 related to:

- ISA 240 - Fraud (80% of visits)
- ISA 315 - Risk assessment (76% of visits)
- ISA 500 – Audit evidence (76% of visits)
- ISA 570 – Going concern (60% of visits)
- ISA 530 – Audit sampling (44% of visits)

Further detail on the common issue identified relating to these ISAs, and some guidance with regards improving levels of compliance, is given within the report.

## Common breaches of the Audit Regulations

As may be expected, the most common Audit Regulation breached in 2023 was Audit Regulation 3.10, as it related to compliance with the ISAs. 92% of visits saw this regulation breached, which reflects every visit on which an audit file was reviewed. Other than the ISA breaches noted above, the most common breaches of the Audit Regulations related to:

- Audit Regulation 3.08 – Statutory requirements (40% of visits)
- Audit Regulation 3.02 – Acceptance and reappointment / Ethical compliance (36% of visits)
- Audit Regulation 3.10 – As it relates to compliance with ISQM(UK)1 (32% of visits)
- Audit Regulation 3.20 – Audit compliance review (32% of visits)
- Audit Regulation 3.03 – Acceptance and reappointment (24% of visits)

Again, further detail on the issue raised under these Audit Regulations is provided in the monitoring report, along with guidance aimed at helping firms improve compliance with these regulations as well as a few other key regulations that while breached less often can have a big impact on the visit outcomes.

Read the full report for more information on the common findings identified in the 2023 monitoring visits, along with some prompts to help make sure they don't happen on your files.

### [ICAS Audit Monitoring Report 2023 PDF](#)

*Author: Michael Lavender, Senior Reviewer*

## FRC publishes Revised Ethical Standard 2024

This *article* explains the main changes brought in by the *Revised Ethical Standard 2024*, which was published in January 2024, and becomes effective from 15 December 2024. Along with the *Revised Ethical Standard 2024*, the FRC also published guidance on the objective, reasonable and informed third party test.

Auditors undertaking an audit in the UK, and professional accountants undertaking other public interest assurance engagements in compliance with the engagement standards issued by the Financial Reporting Council (FRC), are required to comply with the requirements of the FRC's Ethical Standard.

In January 2024, the FRC published its *Revised Ethical Standard 2024*, which becomes effective from 15 December 2024. Along with the *Revised Ethical Standard 2024*, the FRC also published *guidance on the objective, reasonable and informed third party test*.

The main changes from the FRC's extant *2019 Ethical Standard* are highlighted below:

### **Part B: Section 1 – General requirements and guidance compliance: Breaches**

The 'breaches' provisions in extant paragraphs 1.21 and 1.22 are now included in paragraphs 1.21 to 1.25.

New provisions highlight the following:

- Firm monitoring arrangements are to be designed with the objective to effectively capture all relevant breaches of the ethical standard which are identified by the firm.
- Whenever a possible or actual breach is identified, in making the judgement as to the action to be taken the Ethics Partner and engagement partner are to consider the perspective of an objective, reasonable and informed third party.
- The firm is to report to the Competent Authority about individual breaches outside of the biannual timetable where the Competent Authority would reasonably expect notice. This may

be due to the nature or seriousness of the breach. For example, where the firm may need to consider resigning from an engagement.

- Whether a breach is inadvertent is a matter of professional judgement based on an objective assessment of the evidence.

## **Part B: Section 2 – Financial, business, employment and personal relationships**

### ***Financial relationships***

The provisions in relation to personal financial independence in paragraphs 2.3 and 2.4 have been reworded for clarification. This is not intended to create new requirements.

### ***Financial interests held as trustee***

An addition to paragraph 2.16 in relation to financial interests held as trustee states that a trustee interest is not to be held, in the case of a firm, where a covered person, a person closely associated with them, or a network firm is an identified potential beneficiary of the trust.

## **Part B: Section 3 - Long association with engagements and with entities relevant to engagements**

A new table has been added at the end of this section at paragraph 3.22 to summarise the rotation periods for audit partners, engagement quality reviewers, and other senior staff. Plus, a new paragraph 3.23 has been added which draws on guidance from the FRC Technical Advisory Group's (TAG's) *Rolling record of actions arising* when there are significant gaps of service.

## **Part B: Section 4 - Fees, remuneration and evaluation policies, gifts and hospitality, litigation**

In paragraphs 4.21, 4.22, 4.25, 4.27 and 4.29 (extant paragraphs 4.23, 4.24, 4.27, 4.29 and 4.31) there is a new restriction on fees from entities related by a single controlling party. This is an important new restriction and widens the applicability of the fees requirements.

## **Part B: Section 5 - Non-audit/additional services - Section A - General approach to non-audit/additional services**

### ***Documentation***

Paragraph 5.32 states that the engagement partner must ensure that the reasoning for a decision to provide non-audit/or additional services is appropriately documented. Paragraph 5.33 has been reworded to better highlight what the FRC expects practitioners to document:

“5.33 Matters to be documented include:

- threats identified;
- safeguards adopted and why they are considered to be effective in responding to the specific threats identified;
- any significant judgements concerning the potential threats and proposed safeguards; and
- where relevant, how the Objective and Reasonable Third Party Test was applied;
- communication with those charged with governance.”

## **Part B: Section 5 – Non-audit/additional services - Section B - Approach to non-audit/additional services provided to public interest entities**

The 'Reporting on the iXBRL tagging of financial statements in accordance with the European Single Electronic Format for annual financial reports' has been moved from the list of 'Services required by law or regulation and exempt from the non-audit services cap' to being included under the list of 'Services subject to the non-audit services cap'.

The *Revised Ethical Standard 2024* adds that: 'In situations involving a dual listed entity where iXBRL tagging assurance is required by the laws and regulations of another jurisdiction, then the part of the fee relating to such another jurisdiction is not subject to the fee cap.'

## **Part B: Section 5 – Non-audit/additional services - Section C - Approach to Non-audit/additional services provided in any statutory audit engagement**

### ***Internal audit services***

A new paragraph 5.46 provides clarity of the internal audit services definition.

### ***Information technology services***

New paragraphs 5.53 and 5.54 have been added in order to reflect the International Ethics Standards Board for Accountant's (IESBA's) 'Technology-related revisions to the Code' which will become effective 15 December 2024.

"5.53 Examples of services provided to an entity relevant to an engagement which create threats to the integrity, objectivity and independence of the firm and covered persons include:

Storing or managing the hosting of data on behalf of an entity relevant to an engagement. Such services include:

- Acting as the only access to financial or non-financial information system of such an entity.
- Taking custody of or storing the entity's data or records such that the entity's data or records are otherwise incomplete.
- Providing electronic security or back-up services, such as business continuity or disaster recovery functions, for the entity's data or records.
- Operating, maintaining, or monitoring such an entity's IT systems, network or website.

5.54 The collection, receipt, transmission and retention of data provided by an audited entity in the course of an audit or to enable the provision of a permissible service to that entity do not create the threats described in paragraph 5.53."

### ***Tax services***

The FRC has added (d) to paragraph 5.67 (extant paragraph 5.64) in relation to the range of activities covered by the term 'tax services':

"5.67 The range of activities encompassed by the term 'tax services' is wide. They include where the firm:

- (a) Provides advice to the entity on one or more specific matters at the request of the entity.
- (b) Or undertakes a substantial proportion of the tax planning or compliance work for the entity.
- (c) Or promotes tax structures or products to the entity, the effectiveness of which is likely to be influenced by the manner in which they are accounted for in the financial statements, or in other subject matter information.
- (d) Performs any of the services described in paragraphs a-c to individuals who are the controlling shareholders of an entity relevant to an engagement. Firms need to identify threats to independence from the provision of such services, including familiarity threats, and any relevant safeguards that can be applied."

Paragraph 5.74 has been included to be in line with the provisions in the IESBA Code highlighting that the preparation of tax calculations of current and deferred tax liabilities (or assets) for an audited entity for the purpose of preparing accounting entries that support such balances creates a self-review threat.



Paragraph 5.80 has also been added which incorporates FRC Technical Advisory Group guidance to the prohibition in paragraph 5.79 on providing tax services where this would involve acting as an advocate for the entity in the resolution of an issue.

### **Legal services**

Paragraph 5.87 (extant paragraph 5.83) has been amended to bring the provision in line with the prohibition in the IESBA Code stating that “the firm shall not provide legal services to an entity relevant to an engagement, where this would involve acting as the General Counsel of that entity, or a solicitor formally nominated to represent the entity in the resolution of a dispute or litigation.”

### **Recruitment and remuneration services**

Paragraph 5.89 (extant paragraph 5.85) has been changed to be more in line with the provisions in the IESBA Code by extending the prohibition on recruitment services as set out in this paragraph to network firms and adding bullets noting services which could be considered ‘recruitment services’.

### **Corporate finance services**

The FRC has amended paragraph 5.97 (extant paragraph 5.93) to be more in line with the provisions in the IESBA Code by extending the prohibition on corporate finance services being provided when the service would involve the firm taking responsibility for dealing in, underwriting, or promoting shares, debt and other financial instruments, or providing advice on investments in such shares, debt or other financial instruments.

## **Other entity of public interest (OEPI)**

The FRC’s consultation sought views on whether to withdraw the category of ‘OEPIs’. Entities which fall within this category are subject to enhanced restrictions on the types of non-audit services which their auditors can provide. In its *Feedback Statement and Impact Assessment*, the FRC noted the following:

“The FRC does not have the statutory powers to revise the definition of a UK Public Interest Entity (PIE). That is a decision for government. However, the FRC does have the power to amend or withdraw the OEPI category, and given the unanimous nature of this consultation feedback it is highly likely that we will do so once details of any new statutory definition are known. We believe this will be an effective de-regulatory action, reducing complexity and helping the competitiveness of the UK economy. The FRC entirely agrees with the objective to have a simple and straightforward definition of a UK PIE, including one that is as closely aligned as possible to the IESBA Code.”

## **The 70% non-audit services fee cap for PIE auditors**

In our *response to the FRC’s consultation* we noted that, with regard to the provision of assurance on sustainability-related matters to PIEs being exempted from the 70% cap, in order to ensure a level playing field with other potential assurance providers, we believe that where such a service is provided by an entity’s financial statement auditor, the fee concerned should not form part of the non-audit services cap calculation.

In its *Feedback Statement and Impact Assessment*, the FRC noted that while the FRC has no powers to amend the 70% non-audit services fee cap for PIE auditors, they acknowledge the large volume of feedback received, which they will share with the Department for Business and Trade.

## **Further information**

For further information, the FRC’s news article about the publication of the *Revised Ethical Standard 2024* is available [here](#).

## FRC's Tier Two and Three Inspection Results

ICAS shares the main findings from FRC tier two and three inspections, which resonate with the findings of ICAS Audit Monitoring visits and are of relevance to ICAS audit firms.

### Background

The Financial Reporting Council (FRC) undertook 13 inspections of audits conducted by Tier 2 and Tier 3 audit firms during 2022/23 when there were 5 firms in Tier 2 and 24 firms in Tier 3. A summary of the key findings is included below. Of these inspections:

- 5 (38%) were assessed as requiring no more than limited improvements (36% average in this category over the period 2016/17 to 2021/22).
- 5 (38%) were assessed as requiring significant improvements (highest in this category since 2019/20).

These percentages should be treated as indicative, given the small sample, that different firms and audits are inspected every year, and that the results of individual firms may vary. However, the FRC has stated that the overall results of inspections for 2022/23 continue to indicate an urgent need for improvements in audit quality in this sector of the market.

### Key Findings

The key inspection findings for the year were common across the period and largely consistent with previous years, with the significant majority relating to the audit of:

- Judgements and estimates, reflecting that complex and judgemental audit areas require audit teams to exercise robust professional scepticism in their audit response.
- Going concern, with weaknesses in the rigour of the audit work and the challenge of the underlying evidence provided by management.
- Journal entry testing, including the lack of linkage to the presumed fraud risk of management override of controls.

The FRC noted that weaknesses in firms' related quality control procedures, such as shortcomings in the reviews of audit work performed by Engagement Partners and/or Engagement Quality Control Reviewers, were contributory factors to the deficiencies noted in the audit work performed. However, they did see a reduction in the number of findings in the audit work over inventory and the financial statements.

The audit quality monitoring activities conducted on Tier 2 and Tier 3 firms' non-PIE audits by the Recognised Supervisory Bodies (RSBs) including ICAS, continue to show an improving trend with 76% of audits reviewed in 2022/23 being assessed as good or generally acceptable. The FRC believes that these results may reflect the lower complexity of these non-PIE audits or differences in the scope of the review. The FRC supervises and reviews the RSBs' audit quality monitoring activities and reports annually on this to the Secretary of State.

The FRC's 2022/23 reviews of Tier 2 and Tier 3 firms' quality control procedures also found similar themes to previous years with actions required by firms in:

- Developing competency frameworks for audit partners and staff, and improving links between audit quality and reward.
- Improving procedures for archiving audit files in line with the requirements of auditing standards.
- Establishing adequate procedures to monitor compliance with ethical standards, in particular regarding non-audit services and fees.
- Formalising acceptance and continuance procedures for audit engagements.

- Improving the depth and rigour of firms' internal quality monitoring procedures, including processes to follow up and remediate findings.

## Review of individual audits

The following themes reflect the most common areas of inspection findings that drove the FRC's assessment of audits requiring improvements or significant improvements.

### 1 **Estimates and judgements**

The FRC had findings in this area on 77% of the audits that they inspected (previous report: 60%), more than half of which were assessed as requiring improvements or significant improvements. Similar to the FRC's previous inspection cycles, many of their key findings were as a result of audit teams not demonstrating sufficient professional scepticism, which is essential for an appropriately robust audit of these areas, given the significant levels of management judgement and the potential for bias. Examples of key findings:

- Expected Credit Loss (ECL) provisions: Weaknesses in the audit procedures performed to test the methodology, assumptions and data inputs used in ECL calculations, including in relation to significant increase in credit risk criteria and macro-economic and other overlays.
- Investment valuation: Insufficient audit procedures to challenge the accounting treatment for unlisted investments, and to test management's valuation of these investments.
- Impairment: Weaknesses in audit procedures performed to corroborate and challenge cash flow forecasts used in management's impairment assessment of intangible assets.

### 2 **Going concern**

The FRC had findings in this area in 38% of the audits that they inspected (previous report: 37%), all of which were assessed as requiring improvements or significant improvements. Going concern continues to be an area of particular challenge for audit teams, with several of the entities the FRC inspected experiencing financial difficulties. Many of the FRC's findings were linked to weaknesses in the rigour of the underlying going concern assessments and supporting evidence provided by management. It is vital that audit teams exercise appropriate professional scepticism when assessing and challenging management's assessment of going concern. Examples of key findings include:

- Insufficient procedures to test cash flow forecasts and to assess the impact of related sensitivities in the going concern model.
- Inadequate procedures to evaluate the impact of breaches of loan covenants during the reporting period on the continued availability of cash resources from financing arrangements.
- Insufficient procedures to assess the refinancing of debt, in a case where this was a key assumption in management's going concern assessment.

### 3 **Journal entry testing**

The FRC had findings in this area on 69% of the audits that they inspected (previous report: 31%), of which the majority were assessed as requiring improvements or significant improvements. The increase in the number of audits with findings in this area reflected the FRC's inspection focus on fraud and on the audit of journal entries as a key response to the fraud risk of management override of controls. Many of the findings that the FRC had identified related to weaknesses in the planned audit approach and the linkage of this to the audit team's fraud risk assessment. The design of the audit approach and executed procedures should be appropriately robust and responsive to the potential fraud risks identified. Examples of key findings include:

- Weaknesses in the fraud risk assessment performed by the audit team, which informed the selection of journals for testing.
- Insufficient or no procedures performed to test journals that were identified as meeting fraud risk criteria.
- Insufficient procedures to test the completeness of journal entry listings obtained from management.

### 4 **Other findings resulting in lower quality assessments**

Key findings in the following areas also supported the FRC's lower quality assessment of individual audits:

- Revenue: On two audits that the FRC inspected, insufficient procedures had been performed to respond to audit risks identified related to revenue accuracy, completeness and/or cut-off.
- Accounting errors: On an audit that the FRC had assessed as requiring significant improvements, inadequate procedures had been performed to assess the accounting treatment for an acquisition occurring during the period. As a result, a material accounting error was not identified by the audit team.

## **5 Examples of good practice the FRC observed in 2022/23**

- On one audit, the effective use of bespoke data analytic tools as part of a robust audit approach over lease accounting.
- On another audit, the engagement of specialists to support the audit team's evaluation of management's going concern assessment and related financial statement disclosures.

The FRC encourages audit teams to refer to the What Makes a Good Audit publication which includes best practices observed during inspections.

## **Review of quality control procedures**

During 2022/23, the FRC inspected the quality control procedures at seven (out of 11) firms inspected. Their inspection programme covered each area set out in International Standard on Quality Control (UK) 1 (ISQC (UK) 1): leadership, compliance with ethical requirements, acceptance and continuance procedures, human resources, engagement performance and monitoring. As well as reviewing a firm's system of quality control, the FRC also evaluate samples of the application of individual policies and procedures (usually as part of the review of individual audits). For 2022/23, the FRC performed their inspection based on the policies and procedures the firm had in place on 30 September 2022.

The following themes reflect the FRC's most common inspection findings in relation to firms' quality control procedures.

### **1 Human resources**

The FRC had findings across the human resources component of ISQC (UK) 1 at all seven of the firms inspected, with numerous key findings at the majority of firms. Recruitment, performance management and reward processes are key to creating and maintaining a culture and environment that supports high quality audits. Examples of key findings include:

- Lack of a formalised appraisal process for partners in the audit practice.
- Where a formalised appraisal process was in place, the lack of linkage between audit quality and reward.
- Lack of a competency framework for staff and partners in the audit practice.

### **2 Engagement performance**

The FRC had findings in this area at five of the seven firms inspected. Many firms do not have formalised procedures to lock down and appropriately archive audit files in line with the requirements of auditing standards. Consequently, most of the FRC's inspections were performed on files which had not been appropriately archived. The FRC expects firms to take immediate action to implement appropriate archiving procedures. Examples of key findings include:

- Shortcomings in processes for the archiving of audit files in line with the requirements of the auditing standards.
- Insufficient measures to ensure that working papers added after the date of the auditor's report, but before the date the file was archived, are logged and the reasons for their addition are recorded.
- Inadequate controls to prevent or detect inappropriate edits to an audit file after being archived (and the FRC identified such edits in one audit).

### **3 Compliance with ethical requirements**

The FRC had findings in this area at five of the seven firms inspected. Some firms do not have formalised procedures to deal appropriately with ethics-related matters. The FRC's Revised Ethical Standard 2019 requires additional measures to be implemented by firms over and above those required by ISQC (UK) 1. Examples of key findings include:

- Insufficient measures to ensure ethics and independence consultations are formally completed and documented.
- Inadequate processes to monitor audit and non-audit fees.
- Absence of appropriate ethical walls between accounting and audit functions.
- Lack of formalised processes to monitor gifts, hospitality and entertainment.
- Inadequate measures to monitor and address audit partner rotation and long association.

#### **4 Acceptance and continuance procedures**

The FRC had findings in this area at four of the seven firms inspected.

Robust acceptance and continuance procedures are essential in ensuring that a firm's audit portfolio is within its capacity and capability to perform high quality audits. Examples of key findings include:

- Lack of a policy and formal process, driven by a risk-based assessment, for accepting new clients and re-accepting existing clients.
- Failure to consider appropriately factors such as staff availability, profitability and recovery rates, reputational risks, potential conflicts, requirements relating to regulated entities or the need for specialist skills.

#### **5 Internal quality monitoring**

The FRC had findings in this area at three of the seven firms inspected that were subject to firm quality control inspection. It is important that a firm's quality monitoring function is independent of the audit function and that appropriate root cause analysis is performed to understand how deficiencies have occurred. Examples of key findings

- Inappropriate grading of files subject to monitoring reviews.
- Failure to communicate thematic findings to the wider audit practice.
- Lack of appropriate guidance on how to perform root cause analysis.
- Insufficient identification of themes, which indicated that additional training or supplemental methodology guidance is required.

#### **6 Examples of good practice the FRC observed in 2022/23**

- Where a firm's leadership takes an active interest in driving audit quality, the FRC see improvements in audit quality in the files inspected.
- Firms with robust client acceptance procedures are able to make better informed decisions on resources required to perform high quality audits.

Audit firms are encouraged to focus on the implementation of ISQM (UK) 1 and ISQM (UK) 2 which came into effect on 15 December 2022.

*Author: James Barbour, Director of Policy Leadership*

## **FRC proposed revisions to auditing standards on laws and regulations**

### **Introduction**

In October 2023, the Financial Reporting Council (FRC) issued an exposure draft of a proposed revised *International Standard on Auditing (ISA) UK 250 Consideration of Laws and Regulations in an Audit of Financial Statement* and *Proposed International Standard on Auditing (UK) 2X0 (Revised) 'Special considerations for Public Interest Entities - Communicating and Reporting to an Appropriate Authority Outside the Entity'*. The former would replace extant ISA (UK) 250A and the latter ISA (UK) 250 B.

The *proposed revisions* aim to strengthen auditor requirements to detect and report material misstatements from non-compliance with laws and regulations and to clarify instances auditors should report such breaches, and other significant matters, to the relevant regulators. The FRC believes that this will enhance the useability and informativeness of the audit and provide greater assurance to

users of financial statements that potential material misstatements have been properly assessed by the auditor.

## **Proposed revisions to ISA (UK) 250 (revised November 2019 (updated May 2022)) Section A - Consideration of laws and regulations in an audit of financial statements**

Non-compliance with laws and regulations can result in potential fines, litigation or other consequences which could have a material effect on the audited entity.

The extant ISA (UK) distinguishes the auditor's responsibilities into two different categories of laws and regulations as follows:

- (a) The provisions of those laws and regulations are generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and pension laws and regulations. and
- (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements.

Differing requirements are specified for each of the above categories of laws and regulations. For category (a), it's the auditor's responsibility to obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations. For category (b), the auditor's responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a material effect on the financial statements.

Under the proposed revised standard this differentiation would be removed and the objectives of the auditor would be:

- (a) To identify those laws and regulations with which non-compliance may have a material effect on the financial statements.
- (b) To identify and assess the risks of material misstatement of the financial statements due to fraud or error relating to non-compliance with laws and regulations.
- (c) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud or error relating to non-compliance with laws and regulations.
- (d) To respond appropriately to identified or suspected non-compliance with laws and regulations identified during the audit.

The FRC acknowledges that auditor's responsibilities cannot be open-ended to the effect of identifying and determining compliance with all laws and regulations relating to the entity. To assist the auditor the FRC proposes that a more robust risk assessment process building on the risk assessment performed in accordance with ISA (UK) 315 will be introduced to help auditors identify those laws and regulations that have, or may potentially have, a material effect on the financial statements.

## **ISA (UK) 250 (revised November 2019) Section B—The auditor's statutory right and duty to report to regulators of Public Interest Entities (PIEs) and regulators of other entities**

The proposed changes to ISA (UK) 250B build on existing UK laws where auditors of public interest entities are expected to comply with statutory duties to report to regulators if significant matters relevant to the regulator, such as breaches in law or regulation, come to the auditor's attention. The FRC is proposing to introduce a more principles-based approach so that information that is of such

significance is reported to regulators even where law, regulation or relevant ethical requirements do not require it.

## **ICAS view**

In response to the FRC we advised that we are not convinced of the need to update ISA (UK) 250 at this time. We are not aware of significant issues being identified in relation to the application of this standard by auditors in practice. Although we acknowledge that the FRC recognises that the auditor's responsibilities cannot be open-ended to the effect of identifying and determining compliance with all laws and regulations pertaining to the entity, we have concerns that this will be the inevitable direction of travel if these proposed revisions are implemented as currently drafted. Particularly in large complex international group audits, the need for auditors to seek the use of experts (legal and potentially others) will be significantly enhanced.

We also stated that the proposed new standard to replace ISA (UK) 250 Section B should not be introduced until the Government has enacted, and made effective, the supporting legislation to provide auditors with appropriate protection when making any reports under this framework. We are currently led to believe that the Government has no imminent plans to enact the necessary legislation. Therefore, we have major concerns about extending the reporting requirements applicable to auditors without providing them with the necessary protection to do so.

The Government's position in relation to audit and corporate governance reform appears to have changed since it published its proposed future actions on this subject matter in its response paper in May 2022 to its 'Restoring trust in audit and corporate governance' consultation paper. There has not yet been an audit and corporate governance reform bill, and it is not envisaged that there will be one soon. This change in the business regulatory environment needs to be taken into consideration, as does the Government's desire to grow the UK economy, when assessing whether these proposals are in the public interest at this time. The FRC has not set out specific reasons as to why these revisions are necessary at this time.

We acknowledge that the FRC is seeking to place the requirements on auditors in relation to laws and regulations on a more risk-based footing. Conceptually, this may appear an appropriate approach, however, we have concerns as to its practical application and the work effort that will be required of auditors to meet these proposed revised requirements. Given the wide spectrum of laws and regulations that may be applicable to a particular entity the proposed revisions could lead to a considerable increase in the need for auditors to utilise the assistance of legal, and potentially other experts, on a range of different topics to properly satisfy the proposed requirement.

We also expressed concerns over the proposed effective date for audits of financial statements for periods commencing on or after 15 December 2024. We believe that the applicable date should be at least 12 months after the approval of the revised standard to allow audit firms appropriate time to update their methodologies and provide the relevant training for their staff.

Additionally, we believe that the proposed revised standard should not become applicable until after the related legislation has been enacted and taken effect.

Read more about the proposed changes [here](#).

*Author: James Barbour, Director of Policy Leadership*

# Share your views on the ISA for LCEs

## Introduction

The International Auditing and Assurance Standards Board (IAASB) published the *International Standard on Auditing for Audits of Financial Statements of Less Complex Entities* in December 2023. *We are keen to hear the views* of audit practitioners as to whether the adoption of this standard in the UK would be beneficial.

Commonly known as the ISA for LCE, this global auditing standard recognises the importance of smaller businesses and their specific audit needs and is known as the ISA for LCE.

This is a standalone global auditing standard tailored to the specific needs of smaller and less complex businesses and organisations, making it easier for practitioners to navigate these types of engagements. Built on the foundation of the International Standards on Auditing (ISAs), audits performed using this standard provide the same level of assurance for eligible audits: reasonable assurance.

The standard is effective for audits beginning on or after 15 December 2025 for jurisdictions that adopt or permit its use. At present, the Financial Reporting Council is not minded to approve the standard for use in the UK. However, given the challenges that certain smaller entities are currently experiencing in finding an auditor, this may need to be revisited.

Released alongside the ISA for LCE are a *Basis for Conclusions*, which details feedback from the public consultation period, a high-level fact sheet, and a frequently asked questions document.

Additional materials to help jurisdictions navigate adoption will be issued in 2024, including supplementary guidance, a fact sheet on adoption, and a first-time implementation guide. All materials can be accessed on the IAASB website.

## Entities excluded from scope

The ISA for LCEs cannot be used where:

- (a) Law or regulation prohibits the use of the ISA for LCE or specifies the use of auditing standards other than the ISA for LCE for the audit of the financial statements in that jurisdiction.
- (b) The entity is a listed entity.
- (c) The entity falls into one of the following classes:
  - (i) An entity one of whose main functions is to take deposits from the public (for example, banks);
  - (ii) An entity one of whose main functions is to provide insurance to the public.
  - (iii) A class of entities where use of the ISA for LCE is prohibited for that specific class of entity by a legislative or regulatory authority or relevant local body with standard-setting authority in the jurisdiction.
- (d) The audit is an audit of group financial statements (group audit) and:
  - (i) Any of the group's individual entities or business units meet the criteria as described in paragraph A.1.(b) or A.1.(c) above; or
  - (ii) Component auditors are involved, except when the component auditor's involvement is limited to circumstances in which a physical presence is needed for a specific audit procedure for the group audit (for example, attending a physical inventory count or physically inspecting assets or documents).



The requirements in the ISA for LCE have been designed to reflect the typical nature and circumstances of an audit of an LCE and it has therefore not been designed to address:

- Complex matters or circumstances relating to the nature and extent of the entity's business activities, operations and related transactions and events relevant to the preparation of the financial statements.
- Topics, themes and matters that increase, or indicate the presence of, complexity, such as those relating to ownership of the entity, corporate governance arrangements of the entity.

The standard contains an illustrative but not exhaustive list of characteristics of an LCE for the purpose of determining its appropriate use. Each of the qualitative characteristics may not, on its own, be sufficient to determine whether the ISA for LCE is appropriate or not in the circumstances.

Therefore, the matters described in the list are intended to be considered both individually and in combination. For the purpose of group audits, these considerations shall apply to both the group and each of its individual entities and business units.

Examples from the list are as follows:

**Business activities, business model & industry** - The entity's business activities, business model, or the industry in which the entity operates, do not give rise to significant pervasive business risks. There are no specific laws or regulations that govern the business activities that add complexity (for example, prudential requirements). The entity's transactions result from lines of business or revenue streams.

**Organisational structure and size** - The organizational structure is relatively straightforward, with few reporting lines or levels and a small key management team (for example, five individuals or less).

**Ownership structure** - The entity's ownership structure is straightforward and there is clear transparency of ownership and control, such that all individual owners and beneficial owners are known.

### Structure of ISA for LCEs

The standard is split into the following sections:

1. Preface
2. Authority
3. Fundamental Concepts, General Principles and Overarching Requirements
4. Audit Evidence and Documentation
5. Engagement Quality Management
6. Acceptance or Continuance of an Audit Engagement and Initial Audit Engagements
7. Planning
8. Risk Identification and Assessment
9. Responding to Assessed Risks of Material Misstatement
10. Concluding
11. Forming an Opinion and Reporting

### We want your views

We are keen to hear the view of practitioners on this new standard. Would its use in the UK be beneficial to your firm in terms of proportionality, effectiveness and efficiency? Email your views to James Barbour CA, Director, Policy Leadership @ [jbarbour@icas.com](mailto:jbarbour@icas.com).

*Author: James Barbour, Director of Policy Leadership*

## FRC's thematic review of audit sampling

The Financial Reporting Council (FRC) has recently published its *thematic review of audit sampling*.

Although the review was conducted of Public Interest Entity (PIE) audit registered firms, the outcomes of the sampling review should still resonate with all ICAS audit firms. We outline the main findings of this review and summarise what can be learned by ICAS firms.

## The key takeaways for ICAS audit firms

While we have included the FRC's main findings below a short summary of the findings most relevant to our firms is noted below. View our list below which considers the main findings from the FRC and sets out those most relevant to our firms:

- Key professional judgements over sampling were often not being executed or documented well.
- Assurance was placed on other audit procedures to reduce sample sizes without sufficient justification of why sufficient assurance could be derived from that other work
- This reduction in sample size often resulted in too small a sample size
- The judgements over the selection of key items required improvement. Often this was size driven without explaining whether/why this particular size measure or approach was an appropriate threshold for the test.
- Haphazard sampling was used frequently rather than random sampling, leading to potential sampling bias and a failure to project errors accurately. Whilst haphazard sampling is permissible in the context of the ISAs, the FRC advocates the use of random sampling.
- There was audit team confusion over dual-purpose tests, resulting in monetary value samples being too small.

These findings are broadly consistent with those identified by ICAS Audit Monitoring as summarised in our *2023 ICAS Audit Monitoring Report*. The additional issue of capping sample sizes that we find regularly on monitoring visits does not feature in the FRC findings, given large firms generally no longer allow sample capping.

## Scope of the review

The audit sampling guidance and methodology of seven Tier 1 audit firms was the focus of this review and the three key areas within scope were:

- Methodologies relating to sampling as described in ISA (UK) 500 Audit Evidence and ISA (UK) 530 Audit Sampling as a means of selecting samples for tests of detail.
- Sampling methods deployed in testing information produced by the entity ('IPE') and attribute testing.
- Sampling methods deployed in tests of controls.

## Summary of sampling approaches

Most of the firms reviewed make use of mandated internally developed tools to execute their sampling methodologies:

- Sample size calculators – These range from simple spreadsheet-based tools to more complex bespoke solutions.
- Monetary unit sampling (MUS) tools – These tools are used at some firms to help the semi-automated use of MUS and require similar inputs as more general sample size calculators but will typically select a sample automatically for the engagement team to examine.

The FRC found that key professional judgements used in the approach to sampling were not well evidenced, despite being one of the biggest factors driving the quantum of samples used. This was especially the case where engagement teams relied on assurance gained from other procedures with very little explanation given as to why the team believed it had derived sufficient assurance from this other work. This often substantially reduced the number of items selected, with instances of teams selecting too few items to be able to conclude.

There was also confusion as to the function of testing IPE and the use of attribute testing. Some engagement teams did not understand that IPE testing assesses the reliability of the information to be used as audit evidence, rather than being a test over the monetary value of a population.

## **Sampling for test of details**

In instances where engagement teams overestimate the amount of evidence obtained from other procedures, such as substantive analytical procedures, data analytics and tests of controls, they are likely to select too few items to allow them to conclude.

The confidence level (CL) that an engagement team is required to meet is a matter of professional judgement and is not defined in the ISAs (UK). Given the principles-based nature of the ISAs (UK) and the application of judgement, there is variation across the audit firms as to the required CL for different risk levels.

Given the importance of this key professional judgement on the sample size calculator, audit firms should ensure that they provide audit teams with sufficient guidance to support professional judgement in this area.

## **Key items selection and selecting specific items**

All of the methodologies reviewed allow engagement teams to select and test key items from the population before then selecting a sample of the residual population. All of the sample size calculators reviewed allowed for the removal of key items tested elsewhere.

Audit Quality Review (AQR) comments in this area noted that in several reviews, there was insufficient documentation of the reasons for selecting items either as key items when audit sampling, or as specific items. When there was justification, it generally focused on size, such as “selecting everything over 50% of PM”, with no consideration or documentation of why that was an appropriate threshold.

Given the significance of these judgements, the FRC encourages firms to communicate the importance of recording judgements and consider if their methodologies would benefit from additional guidance.

## **Haphazard sampling**

A sample selected haphazardly rather than randomly has a greater risk of bias.

The review identified instances where sample calculators incorrectly stated that the sampling method was random, but haphazard sampling was actually used by the engagement team. This led to potentially inaccurate projection of errors and to improper consideration of bias in the sample.

In multiple reviews, there was no documentation or consideration of why haphazard sampling would be the most appropriate method when random was clearly a plausible option and would have reduced bias.

Although haphazard sampling is permissible in the context of the ISAs (UK), the FRC considers that firm methodologies should actively encourage the use of random sampling over haphazard sampling wherever possible.

All firms involved in this review agreed that they will consider amending their guidance to ensure random sampling is clearly labelled as the preferred method over haphazard.

## **Sampling methodologies for IPE and attribute testing**

Dual-purpose testing is where a sample is selected for both IPE or attribute testing and additional procedures to obtain assurance over the monetary value of the population are undertaken.

IPE and attribute testing sample sizes are generally lower than those required to conclude on a population's monetary value. IPE or attribute testing need only be performed on the number of samples required for that purpose, with the monetary value also being tested on these samples. Only the monetary value will be tested on the remaining samples.

Though most firms explain this concept clearly in methodologies, AQR findings indicate that engagement teams appear to struggle with practical application and are sometimes unclear as to the dual objective of their tests.

For example, this led to teams only selecting the smaller number of samples and testing the monetary value on that sample, without including the additional samples needed to be able to conclude on the monetary value of the population.

## Controls testing and sampling

Three of the firms have used predominantly the American Institute of Certified Public Accountants (AICPA) Audit Sampling Guide and three other firms have used the guide as well as aspects from another statistical model, such as the Poisson probability distribution model, to inform their controls testing sample sizes. One firm, however, does not base its sample sizes on a statistical model.

When testing a control operating multiple times a day, sample sizes ranged from 10-60. Two firms allow the audit team to design their tests allowing for one deviation when testing controls operating multiple times a day. However, this requires an increase in sample sizes from 25 items to 40.

For less frequently operating controls, sample sizes are broadly in line with each other across the firms, as well as with AICPA guidance:

• Weekly:	AICPA suggested	5-9	Range of all firms	4-11
• Monthly:	AICPA suggested	2-4	Range of all firms	2-4
• Quarterly:	AICPA suggested	2	Range of all firms	1-3

As with audit sampling in substantive testing, the application of appropriate professional judgement is the key to ensuring the effective use of audit sampling methodology in test of controls. Firms should ensure that engagement teams understand the importance of appropriate professional judgements and are able to evidence their judgements appropriately.

Audit firms should also remind engagement teams that the prescribed sample sizes are minimum levels.

## Sampling and International Standard on Quality Management (ISQM) (UK) 1

All of the firms' methodologies were driven by a global methodology. Almost all of the firms reviewed had additional UK-specific material to:

- address either ISA (UK) requirements (where they are higher than the international version), and/or;
- respond to specific inspection findings at a firm level.

Three firms heavily on their global methodology teams to address the FRC's questions. While support from the global central functions is appropriate, the FRC concluded that audit firms need to ensure they have a proper and full understanding of the sampling techniques developed globally and are able to understand and apply those methodologies in the UK.

## The FRC's final observations and recommendations

### *FRC Observations*

- Audit sampling for tests of details and controls is still prevalent, despite the advent of tools such as audit data analytics (ADA).

- Most firms' methodologies are based on similar statistical models with firms building on these with their own guidance and preferences. This has led to substantial variation in the firms' final methodologies.
- When applying methodology in practice, professional judgement is key. Judgement is needed to use firms' sample size calculators, including to assess inherent risk and determine the contribution of evidence from other procedures. The extent of firms' guidance to support these judgements is variable.
- There is insufficient evidence of the key professional judgements made when determining sample sizes. Evidencing these key judgements is vital.

### **FRC Recommendations**

- Audit committees should understand how auditors obtain audit evidence to support their choice of auditor when tendering and to aid understanding of how their auditor undertakes the audit.
- Audit firms should ensure that they provide engagement teams with sufficient guidance and training to support their use of professional judgement in audit sampling.
- All audit firms should update their methodologies and guidance to drive better documentation of key judgements made when determining sample sizes.

For more information on the FRC's thematic review see the FRC's website (<https://www.frc.org.uk/news-and-events/news/2023/11/frc-publishes-thematic-review-of-audit-sampling>).

*Author: Rachel Barrie, Monitoring Reviewer*

## **FRC areas of supervisory focus for 2024/25**

The Financial Reporting Council (FRC) has announced *its areas of supervisory focus for 2024/2025*. These areas of focus include priority sectors for corporate reporting reviews and audit quality inspections. This article is not just relevant to PIE audit registered firms but has wider relevance to all audit firms as these sectors are considered by the FRC to present higher audit / review risk and so, by extension, ICAS Audit Monitoring will also take these areas of supervisory focus into account when conducting monitoring visits.

### **Priority sectors**

Priority sectors are considered by the FRC to be higher risk for corporate reporting and audit because of economic, commercial and financial pressures. The priority sectors for selection of company accounts and audit in 2024/25 are:

- Construction and materials
- Food producers
- Gas, water and multi-utilities
- Industrial metals and mining
- Retail

The financial sector, including banking and insurance, continues to be a focus of FRC reviews.

### **Areas of focus**

The FRC also identifies areas of public concern and instances where there's been recurring findings in audit inspections. In response, the FRC's programme of corporate reporting reviews and audit quality inspections will pay particular attention to the following areas:

- Risks related to the current economic environment, for example going concern, impairment, recoverability and recognition of tax assets/liabilities
- Climate related risks, including Task Force on Climate Related Financial (TCFD) disclosures
- Implementation of IFRS 17 - Insurance Contracts

- Cash flow statements.

The FRC emphasised in its announcement that the priority sectors are only one risk factor amongst the many it considers when making review selections and that companies and audits from all sectors are included in its monitoring regime. The same considerations also apply to ICAS Audit Monitoring.

For more information on the FRC supervisory refer to the FRC website [www.frc.org.uk](http://www.frc.org.uk).

*Author: Rachel Barrie, Monitoring Reviewer*

## Revised guidance for ICAS members acting for Scottish charities

The ICAS Charities Panel has published *a revised edition of its guidance for members acting for Scottish charities*.

The *Guide* has been designed to remove some of the heavy lifting needed to understand the requirements placed on accounts preparers, auditors, and charity independent examiners. It also provides information on Scottish charity law and the regulatory approach of the Office of the Scottish Charity Regulator (OSCR), with a focus on aspects of law and regulation relevant to the preparation and scrutiny of charity accounts.

While it is not practical to cover all the requirements that have a bearing on the preparation and scrutiny of charity accounts, the guide covers the key requirements placed on both company and non-company charities, including Scottish charitable incorporated organisations (SCIOs).

This edition of the guide has been updated to reflect the legal and regulatory environment, and standards and guidance in issue on 1 December 2023. It also highlights related developments expected to impact the sector in the near future, when commencement dates are unknown or uncertain.

With significant changes to FRS 102, and the Charities SORP (FRS 102) not expected until periods beginning on or after 1 January 2026, this edition of the Guide is relevant with immediate effect.

### **The Charities (Regulation and Administration) (Scotland) Act 2023**

This Act received Royal Assent in August this year and makes changes to the Charities and Trustee Investment (Scotland) Act 2005. The changes are intended to:

- Make charities more accountable and transparent.
- Strengthen OSCR's powers.
- Bring Scottish charity law up to date with certain aspects of the law in England and Wales, and in Northern Ireland.

The provisions of the 2023 Act will be brought into effect in three tranches. Key provisions being brought in, in each tranche are set out below.

From the 1 April 2024, OSCR acquires stronger regulatory powers as follows:

- Increased powers of inquiry, including the power to direct charities to take particular actions.
- The power to remove charities for the Scottish Charity Register that fail to submit accounts and to respond to OSCR's inquiries about their late accounts.
- An obligation to refuse an application to be registered as charities from organisations that, in OSCR's judgement, have no or a negligible connection with Scotland.

Further measures are expected to commence on 1 October 2024, including the creation of a publicly searchable record of individuals who have been permanently disqualified by the courts from being a charity trustee so that charities can carry out due diligence on prospective new trustees.

The remaining parts of the 2023 Act are planned to come into force in summer 2025. This should give charities and OSCR the time needed to prepare for these changes, which include:

- The establishment of schedule of charity trustees containing information which will not be made public, such as home addresses.
- The publication of trustee names on the Scottish Charity Register.
- A record of charity mergers.
- Updates to the disqualification criteria for charity trustees.

Under measures to make charities more accountable and transparent, OSCR intends to publish the trustees' annual reports and accounts of all Scottish charities. It will no longer be necessary for OSCR to redact names from reports and accounts, as in publishing these, OSCR will meet its new legal obligation to make 'statements of account' available to the public. This change is likely to take place from summer 2025 but there has been no official confirmation of this to date.

Under the 2023 Act, charities have an option to apply to OSCR for dispensation from certain information being included publicly on the Scottish Charity Register, for example the names of trustees, where the publication of that information is likely to jeopardise the safety or security of a person or property. This dispensation will also apply to the trustees' annual report and accounts of non-company charities. The trustees of charitable companies, who its company directors, must continue to meet the transparency requirements of the Register of Companies and the reports and accounts disclosure requirements under the Companies Act 2006.

## **OSCR's regulatory priorities and annual return changes**

OSCR has published updated regulatory priorities for 2024 to 2026. These include a focus on charity trustees' understanding of core governance matters and activities and the risk that these can be flawed and incomplete in areas such as:

- Trustee disqualification
- Governing documents
- Trustee quorum
- Narrative reporting and accounts

It will support its new priorities through:

- Enhancing the guidance it provides to charity trustees;
- Monitoring trustees' annual reports and accounts, and analysis of other intelligence and data about charities; and
- Working with sector bodies, professional bodies, and stakeholders to provide training and support to charities, advisers, and trustees.

New annual return questions will be asked of all charities with a financial year ending on or after 30 November 2023. These will include new questions relating to a charity's accounts.

## **Companies House reforms**

Amendments to Section 444 of the Companies Act 2006 under the Economic Crime and Corporate Transparency Act 2023, remove the option for small non-charitable companies, including trading subsidiaries, to prepare abridged accounts. Small companies will also no longer be permitted to file filleted accounts which removes any dubiety around the ability of charitable companies to file filleted accounts with Companies House.

The effective date of amendments to Section 444 has not been made public.

## The periodic review of FRS 102 and the next edition of the Charities SORP (FRS 102)

The FRC is finalising amendments to FRS 102, following its periodic review of UK GAAP and public consultation on its proposed changes.

The next edition of FRS 102 is due to be published in the first six months of 2024 and is not expected to be effective before periods commencing on or after 1 January 2026. This should mean that there is at least 18 months between notice of the amendments and implementation.

The Charities SORP (FRS 102) will be updated, and its effective date will coincide with the effective date of the next edition of FRS 102. A consultation draft of the Charities SORP (FRS 102) will be published after the final amendments to FRS 102 are known.

### Supplier finance arrangements

FRS 102 is to be amended to introduce additional disclosure requirements to be made alongside the statement of cash flows in relation to supplier finance arrangements. The amendments are being made to reflect changes to IFRS accounting standards. The new disclosure requirements are not expected to be relevant to many charities, and do not apply if a charity does not prepare a statement of cash flows.

Disclosures about supplier finance arrangements are to include:

- The terms and conditions of supplier finance arrangements; and
- The carrying amounts and associated line items presented in the balance sheet of the financial liabilities that are part of supplier finance arrangements at the beginning and end of the reporting period, including the carrying amounts, and associated line items, for which suppliers have already received payment from the finance providers.

Comparative information does not need to be provided in the first year of making these disclosures.

These amendments are expected to be published alongside the periodic review amendments but with an effective date of periods commencing on or after 1 January 2025. Charities with supplier finance arrangements preparing a statement of cash flows will therefore need to comply with these new disclosure requirements, in advance of the periodic review amendments to FRS 102 and the next edition of the Charities SORP (FRS 102).

### Keeping up to date

In addition to checking [icas.com](https://www.icas.com) on a regular basis for developments, members using the guide should monitor the OSCR website and the Charities SORP website to keep up to date with changes to accounts and scrutiny requirements, as well as any new guidance.

*Author: Christine Scott, Head of Charities and Reporting*

## ICAS Audit Monitoring file grade definitions

ICAS Audit Monitoring has changed its *file review gradings* for 2024 onwards to align with the FRC grading framework.

ICAS Audit Monitoring selects a sample of audit engagement files for review during each audit monitoring visit, a number of which will be selected for 'detailed' review and some for a 'restricted' review over limited aspects.



We grade those files which have been subject to a 'detailed' review at the end of the audit monitoring visit, once the visit has been completed and the visit has been internally quality control reviewed. Audit firms are informed of the file grading at the closedown of the visit by way of letter.

We previously operated the grading structure 1, 2A, 2B and 3. From 1 January 2024 onwards, we have moved to the file grading structure below in order to align with the FRC's grading structure. This won't have a significant impact on the monitoring visit as it's essentially a re-labelling of the previous grades.

File Grade	Description	FRC Guidance	ICAS additional context
1	Good	We identified no areas for improvement of sufficient significance to include in our report.	<ul style="list-style-type: none"> <li>• No concerns regarding the sufficiency and quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed.</li> <li>• Only limited weaknesses in documentation of audit work. AND</li> <li>• Any concerns in other areas are limited in nature (both individually and collectively).</li> </ul>
2	Limited improvements required	We identified one or more areas for improvement of limited significance.	<ul style="list-style-type: none"> <li>• Only limited concerns regarding the sufficiency or quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed. AND/OR</li> <li>• Weaknesses in documentation of audit work are restricted to a small number of areas AND/OR</li> <li>• Some concerns, assessed as less than significant (individually and collectively), in other areas.</li> </ul>
3	Improvements required	We identified one or more key findings requiring more substantive improvements.	<ul style="list-style-type: none"> <li>• Some concerns, assessed as less than significant, regarding the sufficiency or quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed. AND/OR</li> <li>• More widespread weaknesses in documentation of audit work. AND/OR</li> <li>• Significant concerns in other areas (individually or collectively).</li> </ul>
4	Significant improvements required	We identified significant concerns in one or more areas regarding the sufficiency or quality of audit evidence, the appropriateness of key audit judgments or another substantive matter such as auditor independence.	<ul style="list-style-type: none"> <li>• Significant concerns regarding the sufficiency or quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed (not limited to the documentation of the underlying thought processes). AND/OR</li> <li>• Very significant concerns in other areas (individually or collectively).</li> </ul>

*Authors: Lesley Byrne & Michael Lavender, Regulatory Monitoring*

*This Audit News edition was edited by Lesley Byrne, Director of Regulatory Monitoring*



CA House, 21 Haymarket Yards, Edinburgh, UK, EH12 5BH  
+44 (0) 131 347 0100  
[connect@icas.com](mailto:connect@icas.com)  
[icas.com](http://icas.com)

 @ICASaccounting

 ICAS – The Professional Body of CAS

 ICAS\_accounting

 ICAS\_accounting