



AUDIT MONITORING ANNUAL REPORT 2018



2018

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INTRODUCTION

We are pleased to present our annual report for 2018. We are aware that the recent period has been a challenging time, particularly with developments in the reporting and regulatory environments. Whilst there continues to be some examples of 'good auditing' among our firms, unfortunately, for the first year, you will see that more firms have been placed on follow-up action as a result of their monitoring visit, than those who have not. For this reason, the Foreword this year comes from the Regulation Board, so that we can underline some important messages for firms. 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 2018; and
- Key messages and detailed findings arising from monitoring visits.

We hope that you find it useful in considering how effectively your firm is complying with regulatory requirements. We encourage you to share the report with your colleagues, and also to utilise the key messages when conducting your own Audit Compliance Review process.

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

Foreword

Introduction

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

The Board is comprised of members of Council, the Chairs of both Regulatory Committees, four Public Interest Members (including two Public Interest Member of Council) and a number of CA members. The Authorisation Committee, which makes all regulatory decisions in relation to audit firms, reports regularly to this Board. The Investigation and Insolvency Committees also report to this Board.

This report highlights that, for the first time since audit regulation began, the Authorisation Committee has put more firms on follow-up than those who have not, with 65% of firms visited this now subject to ongoing Committee scrutiny.

Whilst the Board appreciates that the recent period has been one of significant challenge, with developments in the reporting and regulatory landscape, this is unfortunately not an acceptable level of compliance, and firms must take action to improve.

The Board would note that the 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.

Challenges

We understand the challenges being faced by firms that are causing this downward trend.



Regulatory landscape

In recent years, the audit market has faced increased regulation and regulatory oversight.

Changes have included:

- 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 transition to New UK GAAP;

to name but a few.

The latter, we understand, has been particularly troublesome, following the accounting software issues that arose in the immediate aftermath.

Whilst a number of these hurdles are now largely dealt with, regulatory changes are likely to continue with the impact of Brexit and the Kingman review, in particular. Both of these topics are covered in the “2019 News” section of this report.

The impact on our audit firms of the Independent Review of the FRC, led by Sir John Kingman, and the recommendation to establish a new Audit, Reporting and Governance Authority, to replace the FRC, is as yet unknown. However, following various corporate failures, it is not a stretch to expect that regulation can only increase.

Resources

Whilst the knock-on impact of these changes has been to increase the workload of firms, much of it has been of little interest to most clients, and the increased work has not translated into increased fees.

Our feedback from the monitoring teams are that fee levels continue to be squeezed. Staff shortages have also been felt in the various city-based firms.

This has inevitably resulted in some firms devoting less resources to audit work, and RIs spending less time on audit work, meaning some audits have become less robust.

All these factors together translate to the downward trend in compliance.

Regulatory impact

All Regulatory Supervisory Bodies (RSBs) have experienced tougher oversight from, and more reporting and accountability to, the Financial Reporting Council (FRC) and Irish Auditing and Accounting Supervisory Authority (IAASA) in the last two years. This is only set to continue, and the Financial Reporting Council (FRC) has already required that the Regulatory Supervisory Bodies (RSBs) set Audit Quality Key Performance Indicators (Audit Quality “KPIs”) to ensure that audit firms’ performance improves. The FRC, and most likely its successor, expects compliance targets to be set and Regulatory Supervisory Bodies (RSBs) will be required to “comply or explain” if collectively audit firms don’t start to improve their compliance standards.

ICAS considers itself a developmental regulator, in that we want to work with and support firms to make improvements, but this approach is becoming challenging in the current environment.

The clear message from the FRC is that poor audit quality cannot be tolerated. If improvements aren’t seen by our current follow-up measures (see the Follow Up Section of this report) the FRC may expect the RSBs to take more stringent enforcement measures, such as withdrawal of audit regulation, regulatory penalties with publicity or disciplinary measures. We hope that this is not needed and that firms will make the necessary improvements without ICAS having to resort to more severe sanctions.

Actions Needed

We acknowledge that there are no easy answers to these challenges. ICAS will continue to provide support, as outlined later in this report, however the onus is obviously on firms to consider how best to meet these challenges and this may require some difficult discussions with clients regarding audit fees, and consideration as to how to ensure that sufficient resources, including RI review time, is allocated to each audit engagement. This also involves investing in an effective compliance review process, which may have to be sourced externally.

The Audit Monitoring team will continue to help you improve compliance with advice and support on visits; follow-up checks; the quarterly edition of Audit News and our course Keeping Audit on the Right Track. More information on this support, and other support within ICAS, is included later in this report.

Conclusion

This report brings tough messages. We hope that you find this report useful and start to take action on any issues that could apply to your firm.

What we do

Background: Developmental Regulation

We aim to deliver Developmental Regulation. This means that our Audit Monitoring regime is designed to both:

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

Our primary aim is to work with, and to support, firms to make any improvements required. However, with the increasing regulatory landscape, we require to act as a robust regulator, when required. The regulatory framework and impending changes are covered in the section “2019 News”.

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: 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.

How we review

Our visit process is:



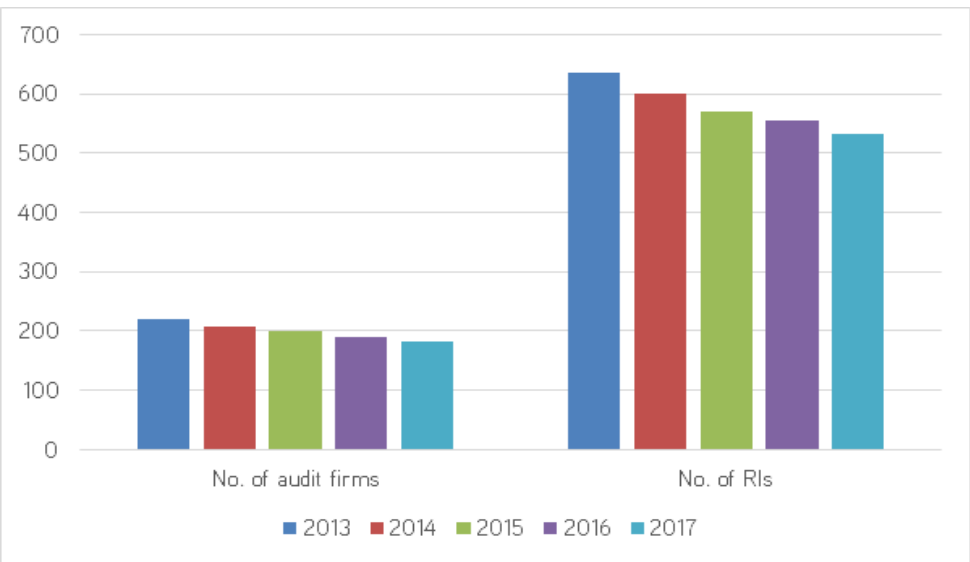
The size of firms registered with ICAS to conduct audit work varies and the monitoring visit approach is tailored to reflect the nature and client base of each firm.

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. This continues to be due to the increase in the audit threshold, and the increased regulatory framework.

Audit firm (and RI) Numbers

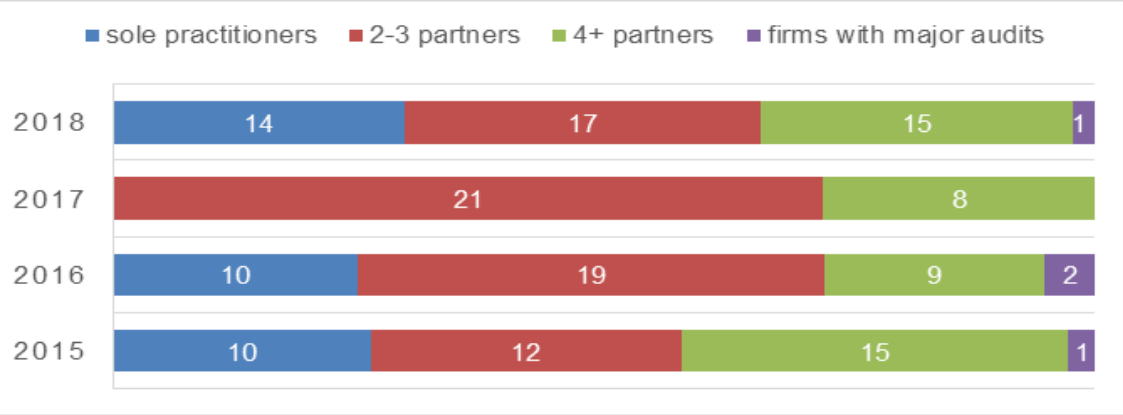


2018 Monitoring Results

In 2018 we conducted 47 Audit Monitoring visits (2017: 44, 2016: 40, 2015: 38), covering our full range of firms. The table below shows the size of the firms we visited in 2018.

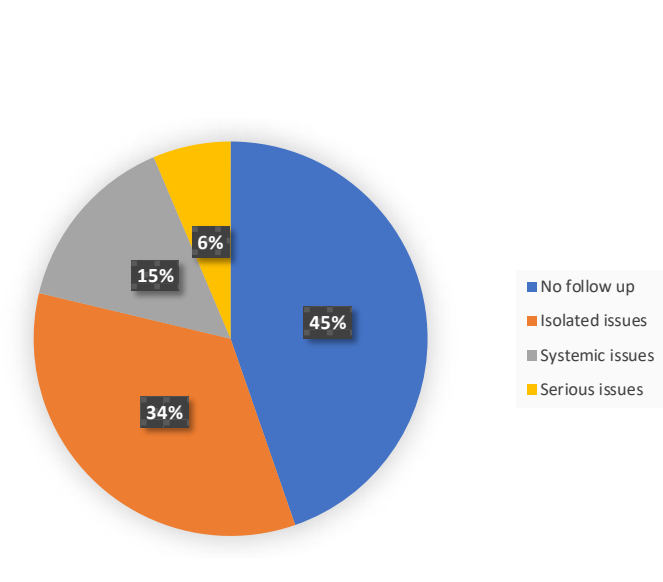
Firms visited

As can be seen, a higher proportion of larger firm visits were conducted this year, compared to 2017 and 2016.

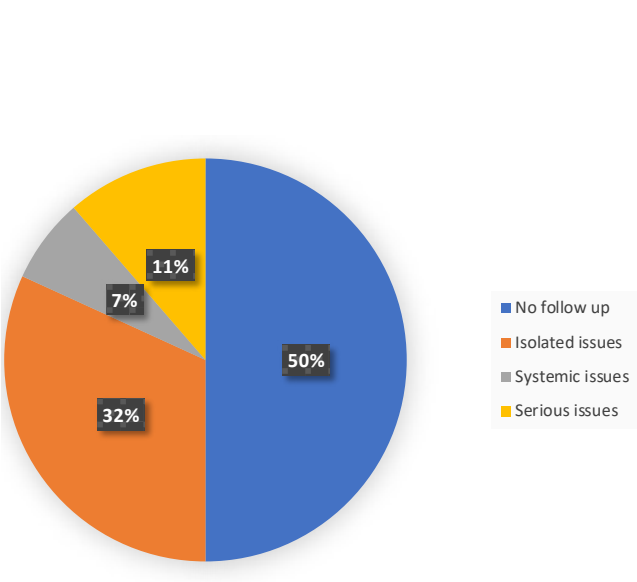


Visit outcomes

2018 visits



2017 visits



It is difficult to make comparisons year-on-year as:

- different firms are visited each year; and
- the regulatory landscape has been changing significantly.

First, the good news – there are nearly half the number of firms considered in the most “serious” non-compliance category this year compared with last year.

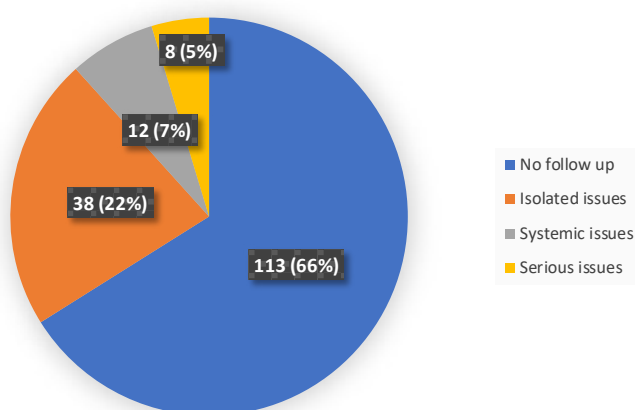
However overall standards of compliance have continued on a downward trend. 79% of firms receiving a full-scope visit during 2017 had no systemic/serious audit quality issues, compared to 82% in 2017 and 89% in 2016. The biggest change has been the rise in the number of firms considered to have “systemic” audit issues this year compared to previous years.

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, if the firm’s audit registration is continued. All other monitoring reports are reviewed on a sample basis by the Committee.

The main issues resulting in firms requiring follow-up are explained in the next section “Key Themes”.

Last visit result for all audit firms

The graph below shows the last visit for all our current audit firms – these visits were all conducted within the last six-year period.



This indicates that ‘66% of all our current audit firms visited had good standards of compliance and required no follow up action; and 34% of firms required, or require, follow up action, albeit that 22% of these firms only require follow up action on a small number of isolated issues’

Audit file standards

All Recognised Supervisory Bodies in the UK use a common method of assessing audit quality on individual files reviewed. In 2018, 123 audit files were reviewed in full (and 51 in overview) (2017 – 101; 2016 -113; 2015-96; 2014-110; 2013-112 files) across the visits conducted. The larger number of files reviewed in 2018 reflects the larger size of the firms visited this year. The majority of the visits were cyclical rather than targeted, and the fact that larger firms were visited was incidental.

Follow-up

The firms requiring a greater level of action to enhance quality are those falling into the more “systemic” and “serious” groups (18% during 2017 (11% in 2016)).

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.

Developmental regulation means that as well as the range of follow up measures above, ICAS provides a range of audit support (see our “ICAS Support” section) and includes our mandatory audit course and Audit News. Firms are also encouraged to engage with external compliance reviewers, to make the necessary improvements.

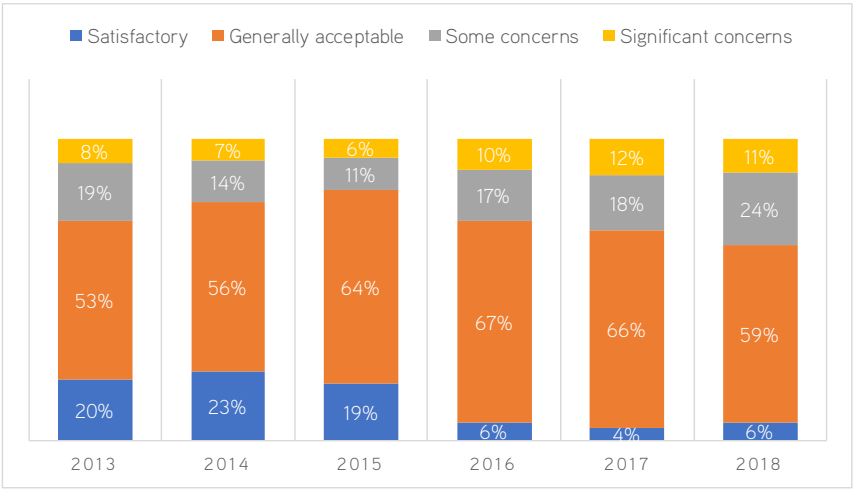
The aim of this combination of follow-up action and support is to encourage firms to improve audit quality quickly, but ICAS can withdraw audit registration if progress cannot be made within the timescales set by the Committee.

Of the 58 firms subject to follow-up at their last visit, many have now successfully shown improvement and cleared the visit process.

File standards

The file gradings show consistent findings to the overall visit outcomes. Whilst there has been a slight reduction in the number of files with the worst quality standards (i.e. “significant concerns”), there has been a 6% increase in the number of firms with “some concerns”, consistent with the higher number of firms considered to have “systemic” audit quality issues.

There has been some reduction in file standards seen during 2018, primarily due to the issues highlighted in the Key Themes. Appendix One provides more detailed analysis of our findings.



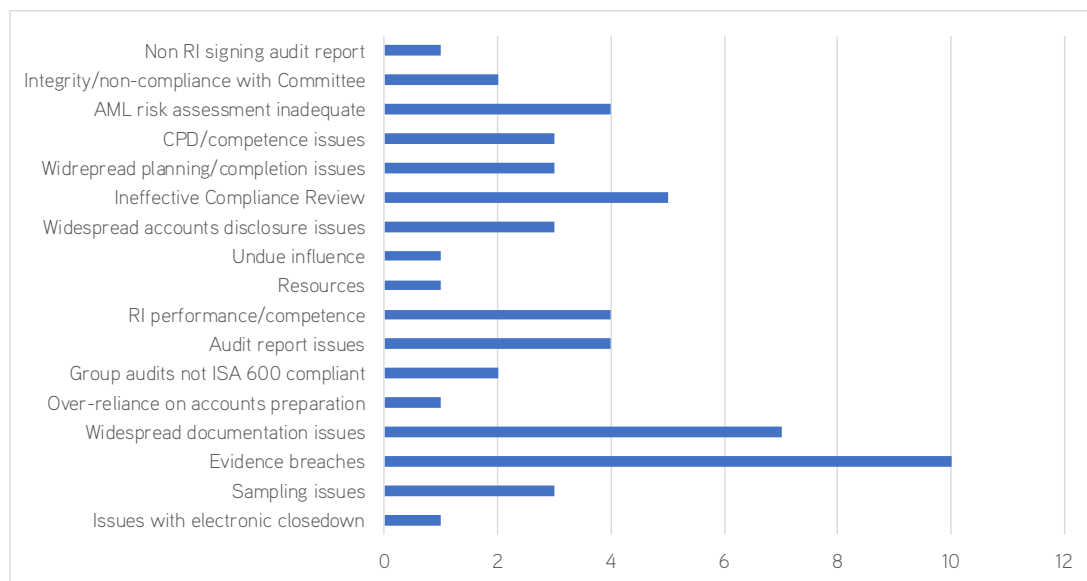
Key Themes

Appendix One of the report covers all the main trends in audit compliance. This section focusses on the worst visit outcomes and why these happen. The aim is not to scare firms, but to provide insight into why firms can end up with more serious reports, with the hope that these issues can be prevented from happening in your firm.

Firms requiring follow-up

The key themes that have caused firms to fall into our bottom two categories of compliance are noted below. A number of firms had multiple issues as reflected below:

Key themes of firms with “serious” and “system issues” (number of firms)



Non-RIs signing audit reports and integrity issues (low incidence, high importance)

Of the above, whilst the incidence is low, the most serious issues are:

- Non-RIs signing audit reports; and
- Firms demonstrating integrity issues or non-compliance with Committee conditions, or failure to cooperate.

These were the main, but not only, causes of the three firms considered to have the most serious visit outcomes. The Committee has taken robust action in each of these cases. It is worth saying more about each.

Non-RIs signing audit reports

Over the last few years we have found a number of cases where principals in firms have signed audit reports, when they are not ICAS authorised RIs. These issues have been covered in a number of editions of Audit News in the past.

There have been different circumstances in each case, but a number of reasons include:

- **A new principal joining the firm who had RI status in his previous firm:** firms are reminded that RI status is attached to the individual firm's audit licence – the RI is designated as an RI for that firm. This means if an RI moves firm, the new firm needs to apply for RI status for that individual. A number of firms have overlooked this.
- **RIs assuming applications have been submitted/approved:** It is the Audit Compliance Principal's ("ACP's") responsibility for submitting RI application forms to ICAS, but the RI is responsible too. All RIs are required to provide various competence, experience and fit and proper information with their signed application. RIs should be aware that an application is needed and should check the status of their application with their ACP before acting as RI. You cannot act as an RI until your firm has received written notice of approval by ICAS.
- **RI assuming their audit qualification is sufficient:** The audit qualification (or PCAQ for ACCA members) only signifies that you received enough audit training to apply for RI status, it does not confer RI status.

Integrity/Non-compliance with Committee conditions

It goes without saying that integrity issues, non-cooperation with the Committee or monitoring team, or provision of false or misleading information, including in the Firm's Annual Return, is taken very seriously by the Committee. The Committee has a wide range of powers to deal with these.

When a firm is subject to follow-up action after a monitoring visit, it is important that the firm deals with the Committee promptly and complies with all of the conditions. There have been a number of recent cases where firms have misinterpreted the Committee condition and not complied.

Firms are always advised to keep an open and cooperative dialogue with ICAS. Failure to comply with Committee conditions or information requests will be viewed seriously by the Committee.

The most common issues

Off the firms, with serious or systemic issues, the most common issues were:

RI performance/ competence	A number had a particular RI or RIs whose files were of a poorer standard (some due to competence issues)
Evidence breaches	Most have areas of the audit where there was insufficient audit evidence to support the audit opinion
Widespread documentation issues	Most have widespread recording issues
Ineffective compliance reviews	Many have ineffective (usually internal) or no cold file reviews
Audit report issues	A number had issues with audit reports not complying with ISA 700 or 705 – particularly limitations in scope. This is explained further in Appendix one.
Inadequate AML risk assessment	Whilst not an audit issue, it was clear that some firms are not applying appropriately robust risk-based due diligence to client acceptance.

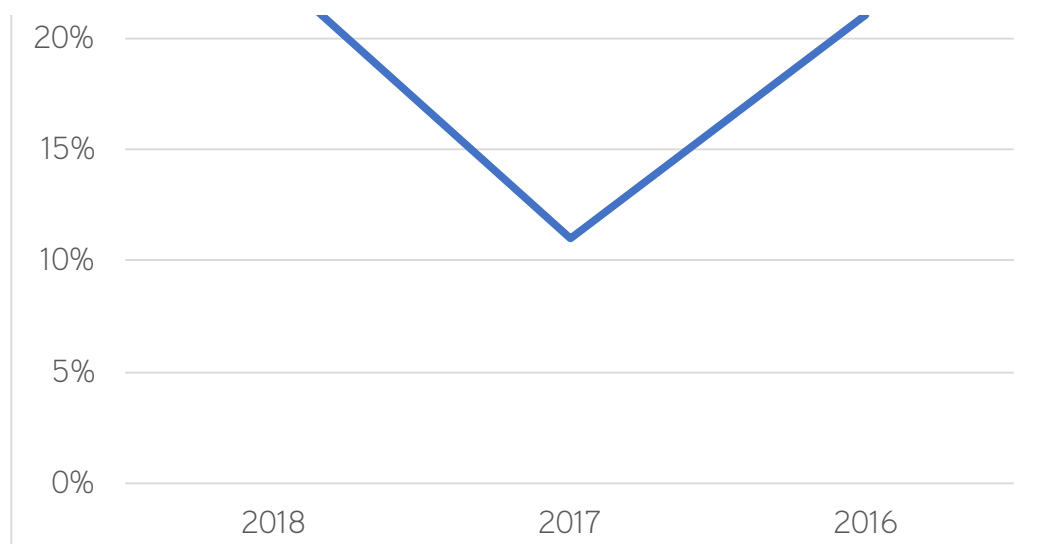
RI performance: competence & resource issues

First a word on resources, you will see that only one firm has been noted above as having resource issues. This was the only firm who admitted when, discussing root causes of issues, to having resource shortages. We consider this vastly underestimated and think that one of the main causes of poor compliance has been a lack of resources devoted to the audit.

Firms are facing a challenging time. Fees are being squeezed, regulatory requirements are increasing, and staff retention is difficult in a number of firms. This results in RIs not (a) allocating sufficient resources to the audit, and (b) not spending enough time on a through quality control review of the audit (ISA 220), resulting in less robust audits.

23% of firms reviewed, had audit files where the RI review was considered ineffective.

ISA 220 Quality Control Breaches (expressed as % of firms visited)



We understand the difficulties being faced. However, if your firm intends to stay in the audit market, adequate resources do need to be allocated including, most importantly, sufficient RI review time.

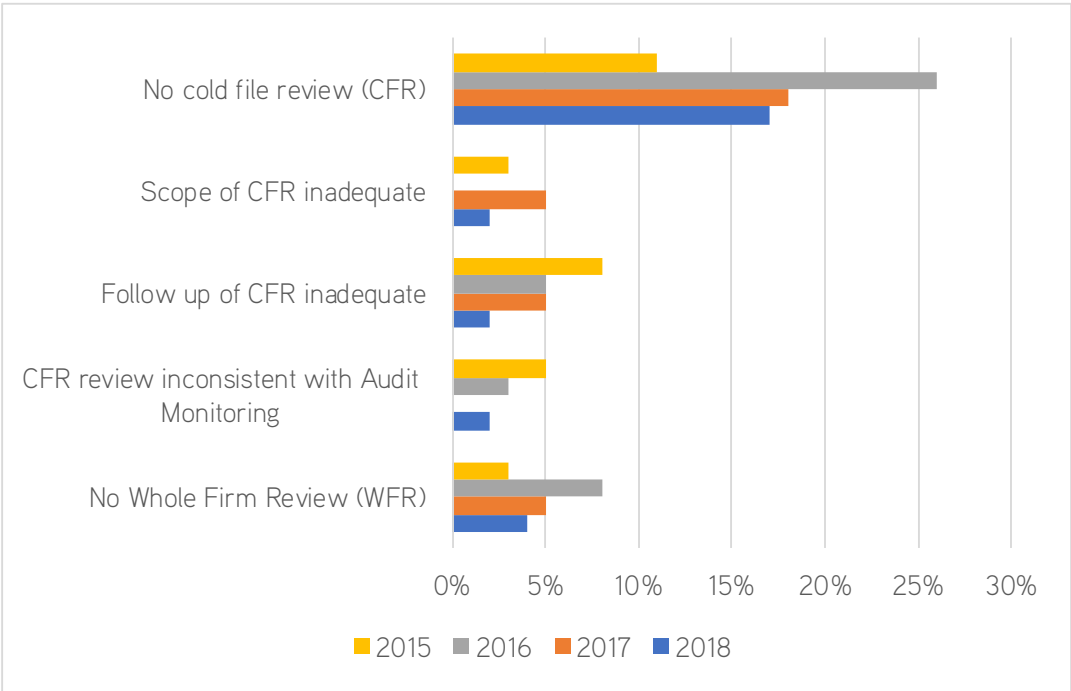
In a lot of firms with more “systemic” issues it was the performance of a number of isolated RIs which tipped the firm into requiring follow up action. It is therefore important that the compliance review process is robust and identifies any RI performance issues that require to be addressed.

Evidence breaches, widespread documentation, audit report issues and inadequate AML risk assessments

All of these issues are covered in detail in Appendix One.

Ineffective Compliance Reviews

The key issues in relation to ineffective compliance reviews are:



A high percentage of firms are still not conducting annual cold file reviews, which the Committee will view seriously. The cold file review is an important tool for firms reflecting on where there could be weaknesses and takings steps to address them. If your firm is small, an external review by an experienced reviewer could be invaluable to keeping you on the right track.

Please contact our Practice Support team if you would like a list of available external reviewers at practicesupport@icas.com.

We take a developmental approach to regulation, and we have a number of initiatives to assist our audit registered firms in complying with the ISAs and Audit Regulations.

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. It lasts three hours and is presented by the Audit Monitoring team.

The course has continually been re-developed and updated to reflect comments received and continues to be well-received. Whilst we continue to run our mandatory course in the central belt and Aberdeen we also deliver the course in a range of different venues each year. The key dates for 2019 are:

- Glasgow - 28 May 2019: 200 SVS Conference & Events, 9am for 9.30am, until 12.30pm;
- Aberdeen - 18 June 2019: Park Inn By Radisson, 9am for 9.30am, until 12.30pm
- Perth 17 - September 2019: Perth Racecourse, 9am for 9.30am, until 12.30pm;
- London -26 November 2019: Wallacespace Spitalfields, 9am for 9.30am, until 12.30pm;
- Edinburgh - 23 October 2019: CA House, 9am for 9.30am, until 12.30pm

We have also delivered bespoke versions of this course to a number of audit firms, onsite at their firm's premises, which have been well-attended and have proved successful, allowing for a more discursive training session. We are happy to take enquiries from firms who wish to discuss this approach, although we note that this will only be considered when cost effective for both parties.

Firms are reminded of the mandatory course attendance requirements:

- The current cycle for ACPs commenced on 1 January 2019. As such, each ACP will be required to attend at least once in the three-year period from 1 January 2019 to 31 December 2021.
- The current cycle for RIs commenced on 1 January 2016. As such, each RI will be required to attend at least once in the five-year period from 1 January 2016 to 31 December 2020.
- Newly approved RIs will be required to attend the course within 12 months of approval; and
- Previously inactive RIs (i.e. approved RIs who are not signing audit reports), who have re-commenced an active role (i.e. has taken on an audit), will be required to attend the course within 12 months of becoming active

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 on "Audit News".

Revised International Education Standard 8 (IES 8)

We have published a web-page dedicated to providing guidance on the education standard which came into force on 1 July 2016 and is applicable to all RIs. The web-page can be accessed by first logging onto [icas.com](https://www.icas.com) and searching on IES 8.

ICAS New Technical and Regulatory Help: New Online Bank of Resources and a New Digital Service.

The new online bank of resources is the first port of call for members with regulatory or technical queries. FAQs on ICAS regulatory matters and links to technical guides can now be accessed via one central point.

Our comprehensive FAQs and guides should resolve the majority of queries, but if an answer can't be found, a question can now be logged with our technical teams using the new digital technical queries portal.

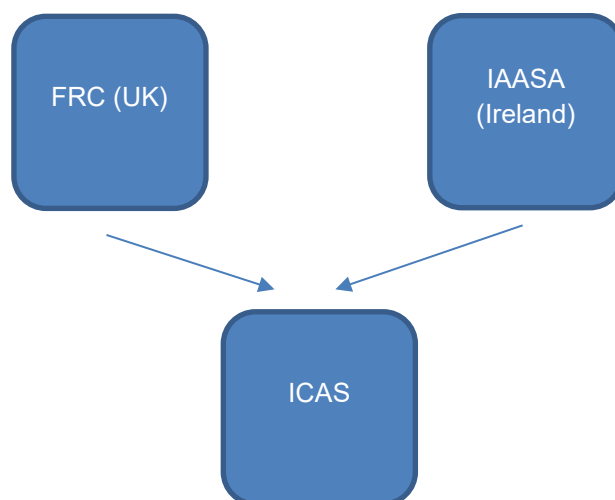
The digital portal makes it easier for members to identify and contact the appropriate technical team, which will help provide a faster response time. It replaces the process of submitting queries by email. The new digital portal also offers greater security and data protection.

You can submit technical and regulatory queries on:

- Accounting and auditing
- Tax
- Practice support
- Anti-money laundering and GDPR
- Insolvency
- Ethics

Changes to the regulatory framework: Kingman & Brexit

Following the implementation of the EU Audit Regulation & Directive, ICAS became accountable to two audit Competent Authorities, the Financial Reporting Council (“FRC”) in the UK and The Irish Auditing and Accounting Supervisory Authority (“IAASA”) in Ireland, both of which had increased powers.



Since then, there have been developments in relation to the regulatory landscape, primarily due to Brexit and the Kingman review, which are set to change the landscape as explained below.

UK: Impact of Kingman

Current regime

Under the EU Audit Regulation & UK legislation, the Financial Reporting Council (FRC) holds all statutory powers in relation to audit regulation.

The FRC delegates to ICAS, and other RSBs, the responsibility for monitoring all firms audit licensed by that RSB, except for firms auditing PIEs (“Public Interest Entities”).

ICAS audit registered firms that audit PIEs are monitored by the Audit Quality Review team of the FRC. The FRC, however, delegates to ICAS the review of non-PIE audits. This means that PIE audit firms are reviewed by both the FRC and ICAS.

All of the monitoring work we do is governed by the aforementioned legislation and a delegation agreement with the FRC.

Kingman

In April 2018, the Government requested that Sir John Kingman lead a root-and-branch independent review of the FRC as part of the government’s modern Industrial Strategy commitment and following on from the issues surrounding various corporate failures. [The outcome of the review was published on 18 December 2018](#) and set out 83 recommendations, the most significant of which is a recommendation to replace the FRC with an independent statutory regulator called the Audit, Reporting and Governance Authority, with clear statutory powers and objectives and a Government remit. The audit profession is therefore set to have a statutory competent authority. It is early days, and any impact on audit firms is not yet known.

It is, however, clear from the recommendations that there will be changes in relation to those firms auditing Public Interest Entity audits (“PIEs”). The report recommends that the approval and registration of audit firms conducting PIE audits should be reclaimed from the RSBs. It also recommended that the Government should review the UK’s definition of PIEs.

Ireland: Impact of Brexit

Current regime

Until now, audit registered firms in the UK have been authorised by their RSB to conduct audits of both UK and Irish entities. ICAS, as an RSB, was therefore required to meet the requirements of Irish legislation and be subject to oversight by the Irish Competent Authority, the “Irish Auditing & Accounting Supervisory Authority” (“IAASA”). Similar to the UK, Irish PIE audits are the responsibility of IAASA and not the RSBs.

Impact of Brexit

ICAS and the other recognised accountancy bodies (RABs), BEIS and the FRC have been engaged in numerous discussions with the Irish audit authorities to understand the implication of Brexit on audit registered firms with Irish audit clients.

All our audit firms auditing Irish audits have been kept up to date on the outcome of these discussions, including what will happen if the UK audit firms are no longer eligible to audit Irish entities under the UK audit registration.

If you have Irish audits, and you have not been contacted or you want to know more, please contact regulatoryauthorisations@icas.com.

Firms Annual Return

We are currently transitioning to a new online Firms Annual Return. Firms with September 2018 month-end return dates onwards will be asked to complete their return online. If you have any questions about your new return please contact far@icas.com or phone 0131 347 0281.

Appendix One: Detailed visit findings

This Appendix provides further detail on the level of compliance noted on visits and where the most common ISA findings were identified during file reviews conducted by ICAS Audit Monitoring (AM) in 2018.

Six-year visit history

The table below shows the monitoring visit outcomes in the last six years.

Audit Monitoring visit outcomes	2013	2014	2015	2016	2017	2018
No follow up	24 (58%)	23 (59%)	28 (73%)	21 (58%)	22 (50%)	21 (45%)
Isolated issues - firm to submit evidence of action	6(15%)	11 (28%)	3(8%)	11 (31%)	14 (32%)	16 (34%)
More systemic issues - firm to submit evidence of action	6(15%)	3 (8%)	4 (11%)	2 (5.5%)	3 (7%)	7 (15%)
Serious issues - follow up/other regulatory actions	5 (12%)	2 (5%)	3 (8%)	2 (5.5%)	5 (11%)	3 (6%)
Total Full Visits	41	39	38	36	44	47
Restricted reviews	0	0	0	0	0	0
Total visits	41	39	38	40	44	47

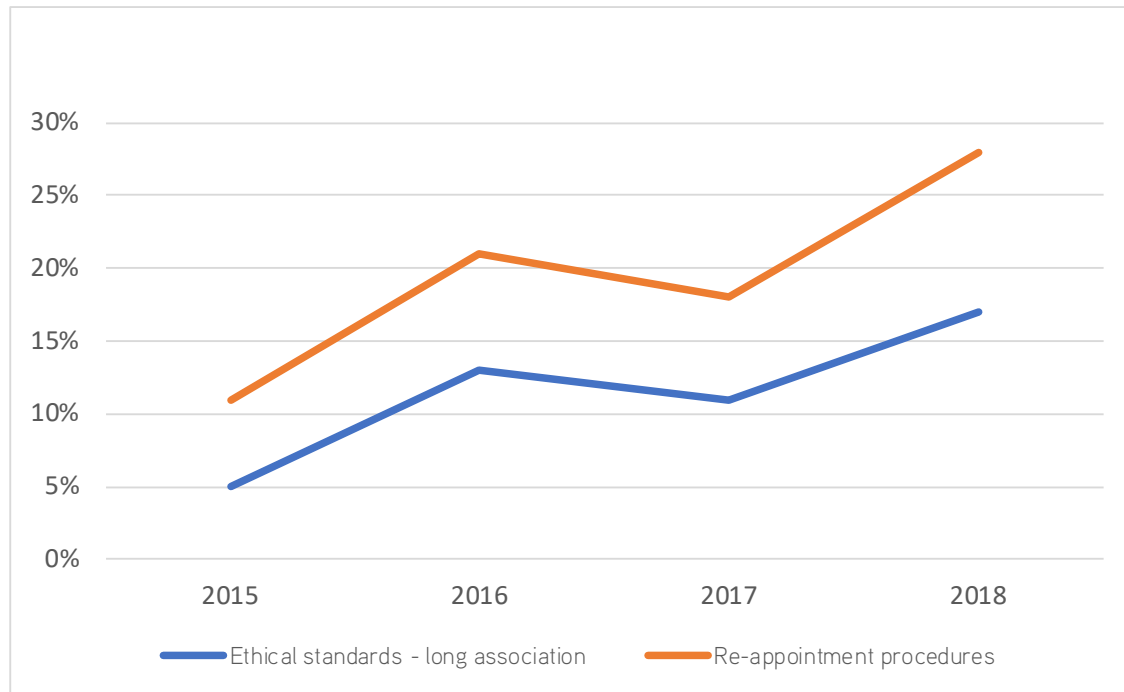
The number of firms at the poorest compliance level have halved from last year but there has been an overall downturn in compliance, particularly with more firms considered to have “systemic” or widespread compliance issues.

Cumulative results of full audit registered firm population

Visit Outcomes	Number of Live Firms
No follow up	113
Isolated issues	38
More systemic issues	12
Serious issues	8
Total visited full-scope	171
Zero audit firms (restricted scope)	3
New firms	9
Total live firms	183

Client acceptance/re-appointment

Client acceptance & ethical issues (expressed as % of firms visited)

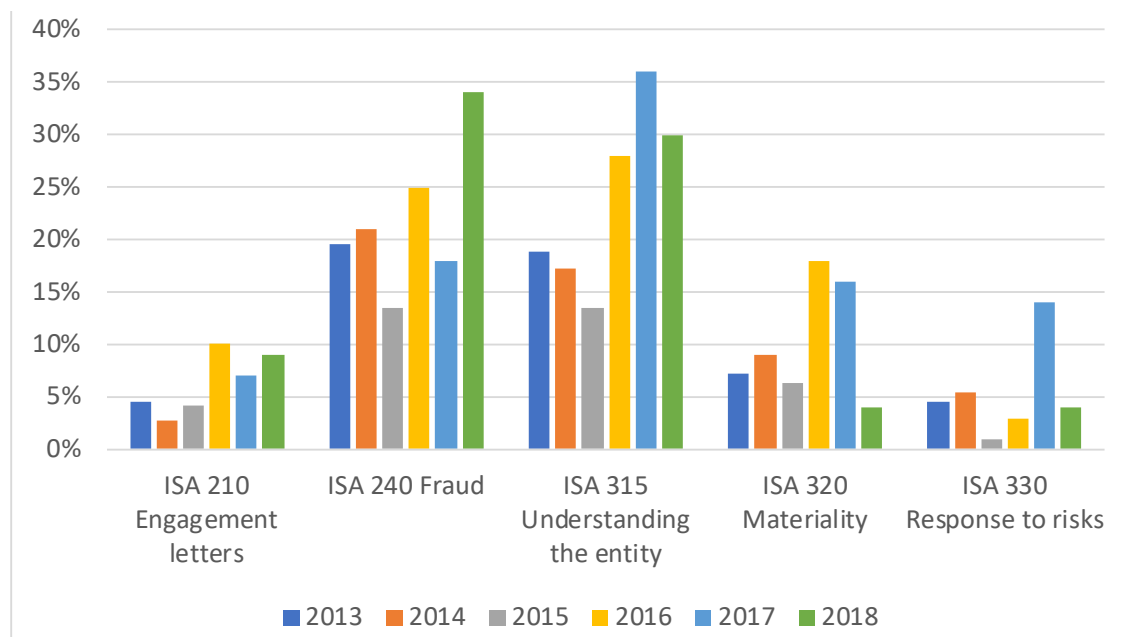


Approximately 28% of firms visited had client acceptance issues. The main recurring issue is a lack of documented consideration of apparent ethical threats and the required safeguards in the audit, particularly in relation to Long Association as can be seen above.

However, a newer issue emerging is the lack of AML risk assessment of the audit client and ultimate beneficial owners. With the change in Anti-Money Laundering (AML) requirements brought about by the Money Laundering Regulations 2017, firms must ensure that all engagement files demonstrate sufficient consideration of AML risk assessment of the client and of the ultimate beneficial owners. This goes well beyond client identification and requires a well-documented assessment of the AML risk posed by the client, supported by know your client information and client identification.

Planning

Common planning issues (expressed as % of firms visited)



Whilst different firms are visited each year, there has been some improvements in 2018 compliance in relation to:

- ISA 315 Understanding the entity;
- ISA 320 Materiality; and
- ISA 330 Response to risks.

However, there is a marginal increase over the firms visited last year in engagement letter issues, mainly as a result of firms not updating engagement letters for FRS 102.

ISA 240 Fraud

There are however more issues in relation to compliance with ISA 240 Fraud. The most significant issue has been:

Journal Testing

Journal testing: one of the most common ISA 240 issues is the failure to test journals as part of the work required to address the significant risk of management override. This is not an area that is well-tested, and even where testing has been conducted, it is often not recorded well. Firms also often omit to test journal completeness.

Fraud discussions

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 also 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 315 Identifying risks

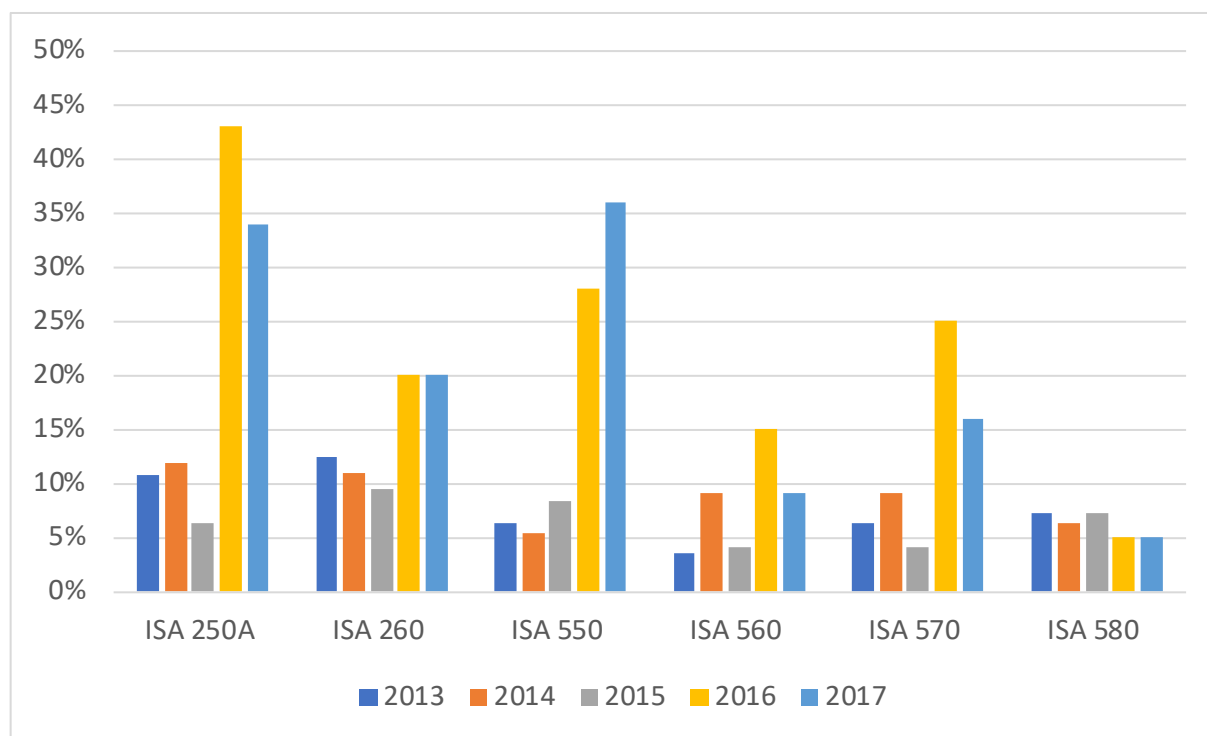
Compliance with ISA 315 has improved since last year. Most firms now document a good understanding of their client, along with detailed systems notes. Firms are, however, omitting to confirm their understanding of the systems (e.g. by walkthrough tests) which is a requirement of ISA 315.

Fieldwork

Recording omissions continue to be the single biggest area of non-compliance.

Half of the firms visited also had audit files with evidence omissions which can quite often lead to a more serious visit outcome.

These issues are all explored below.



Recording

As in previous years, documentation failings are the most prevalent finding on all monitoring visits - 96% of firms visited (compared to 75% in 2017). You will note that widespread documentation issues are still one of the biggest findings on firms with "systemic" or "serious" issues.

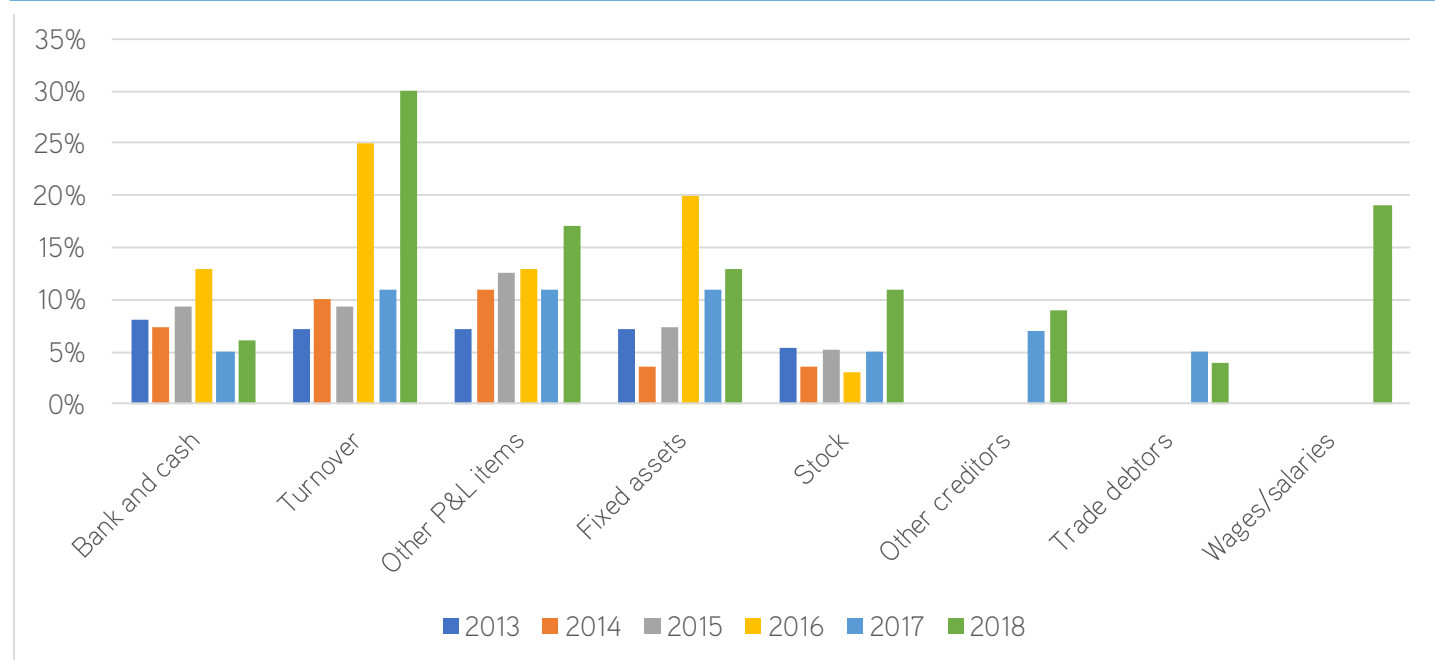
We still encourage all RIs and audit teams to conduct a robust self-review and ask the question that underpins ISA 230: "could an experienced auditor reperform this work and draw the same conclusions based on what has been recorded?"

Firms are also advised to consider the firm's approach to documentation during cold file reviews and identify areas which could improve.

Evidence

Evidence issues were identified on 57% of monitoring visits (compared to 52% in 2017 and 66 % in 2016, and 63% in 2015).

Audit evidence issues (i.e. where there is not sufficient audit evidence to support the audit opinion) significantly impact the monitoring outcomes of monitoring visits and are viewed seriously by the Committee. They mainly centre around the profit and loss account as explained below. However please see our important point about nominal ledger and journal testing, which is becoming a common issue.



Consistent to last year, the biggest area of concern is the lack of effective audit work over the profit and loss account, particularly in relation to turnover completeness and wages/salaries existence/overstatement. There are number of key underlying causes:

- A number of firms have been placing inappropriate reliance on analytical review to reduce sample sizes, when the analytical review is not of a good enough standard to produce substantive evidence.
- A number of firms have also reduced sample sizes on the basis of reliance on controls testing, but the testing has been more in the nature of a walkthrough test than controls testing aimed at testing key controls over that audit area.
- Reliance on analytical review which is not substantive in nature;
- Wrong direction of testing, or selecting a sample from the wrong point in the system;
- Testing performed not covering all material income or cost categories.

A number of these areas were covered in detail in our 2017 and 2016 monitoring reports which are still available on [icas.com](https://www.icas.com).

Nominal ledger and Trial Balance

Whilst not captured in this graph, one other recurring issue is the lack of work surrounding the Nominal Ledger, particularly where the client has produced a Trial Balance outside of the accountancy system which has not been checked back to the Nominal Ledger. ISA 240 Fraud addresses Management Override risk and a client-prepared Trial Balance certainly increases that risk. This is addressed by testing between the Nominal Ledger and Trial Balance, combined with robust journals testing. This risk had been overlooked in a number of files reviewed.

Group Audits

The increase of non-compliance in this area is more reflective of the fact that larger firms have been visited this year and hence more group audits have been reviewed, rather than any downturn in compliance.

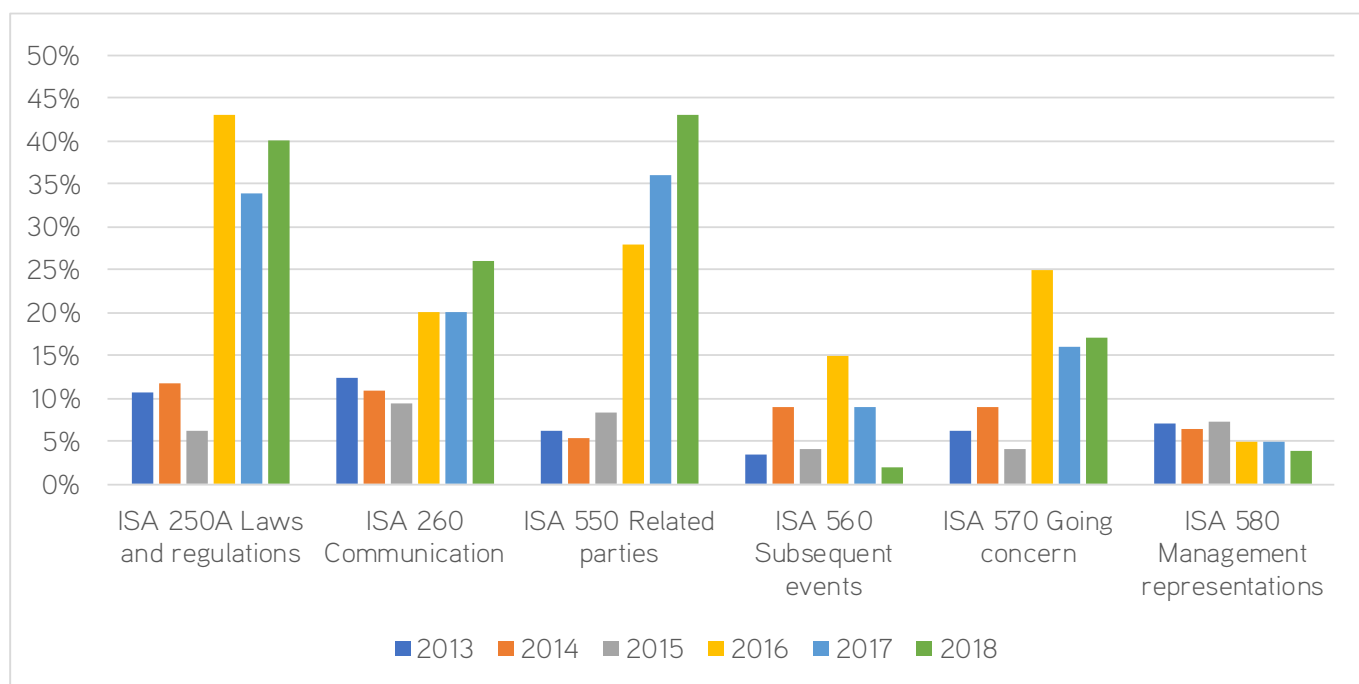
The main areas relate to the lack of work surrounding the group planning, particular in relation to assessing risk and the materiality of the group, including the individual components. Of particular concern is the number of apparently significant components being treated as insignificant to the group audit.

ISA 402 Service Organisations

There has been an increase in non-compliance with ISA 402, which we think is another area which reflects the fact that larger firms were visited this year, with clients with service organisations, rather than there being a reduction in compliance. Firms are reminded to record ISA 402 considerations, where applicable, on the audit.

Completion

Completion issues (expressed as % of firms visited)



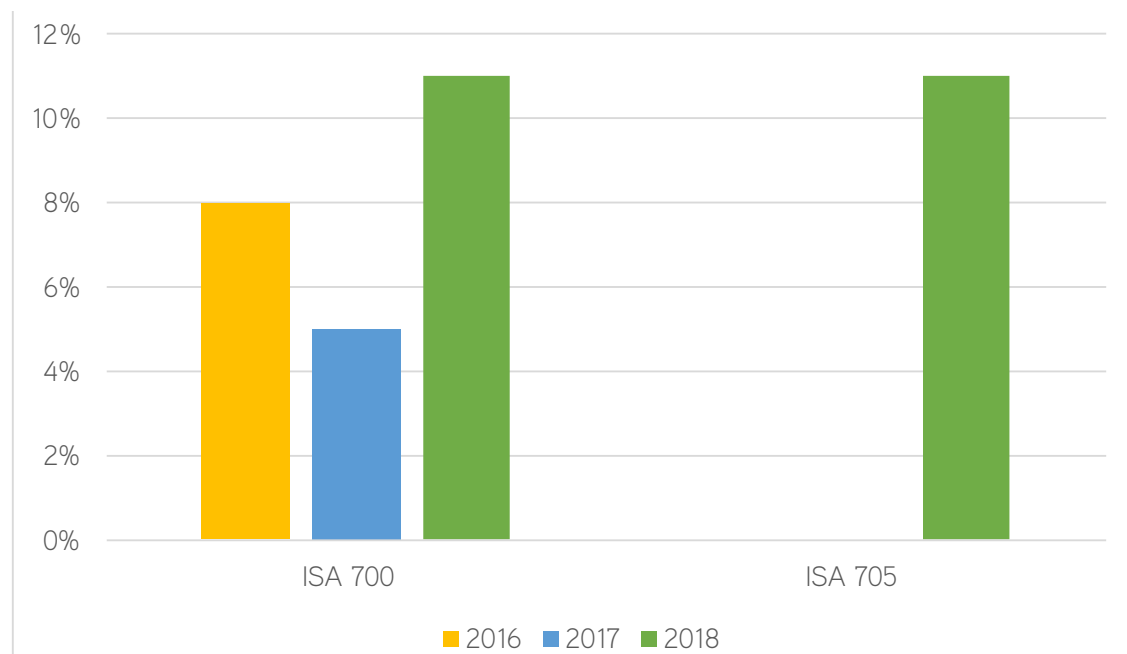
Whilst there has been some improvement in management representations, and subsequent events there has been a downturn in compliance in other completion areas. It is disappointing to see that the most common issues last year continue to be:

- **Related parties (ISA 550):** the planning stage often fails to identify all related parties or the risk of fraud in this area, and there is a lack of audit work on the completeness assertion, including adequate consideration of the disclosures in the financial statements.

- **Laws and regulations (ISA 250A):** a lack of identification of key laws and regulations at planning and a lack of subsequent audit work in this area, to support the conclusion that there are no issues.
- **Two-way communication (ISA 260):** the most common findings is a lack of evidence of two-way communication with those charged with governance at planning and/or completion. On a number of visits there have been more serious issues where audit firms have dealt with fiduciary directors or client staff rather than those actually charged with governance.

Audit reports

Audit report issues (expressed as % of firms visited)



The format of the ISA 700 audit report has changed, and this has resulted in more ISA 700 wording issues and format issues being identified. A number of wording issues have been identified in relation to modified opinions and material uncertainties. Firms are reminded that ISA 570 Going Concern, and not ISA 700, contains the guidance for considering whether the going concern basis is appropriate, the extent of any material uncertainties and the impact on the audit report. Guidance on this area was issued in Audit News 70 which is still available on the audit news section of icas.com.

ISA 705:

Of significant concern has been the number of firms where there has been ISA 705 issues. We have reviewed a number of audits where firms have accepted appointment as auditor to clients who have imposed a limitation on the scope of the audit i.e. the auditor has accepted the audit, knowing not all audit evidence will be available.

In a number of cases, there has been a repeat disclaimer of opinion in consecutive years' financial statements. ISA 705 is very clear in requiring firms, as soon as a limitation in scope is identified, to discuss this with those charged with governance and seek to remove the limitation. ISA 705 further requires that where a limitation cannot be removed that firms should assess whether it is:

- material, in which case, the opinion should be qualified; or
- if pervasive, withdraw from the audit, where practicable and possible under applicable law.

Charities: Reporting Matters of Material Significance

Whilst not in the above charts, firms' attentions are still drawn to the concerns of OSCR and the Charity Commission that firms are not reporting Matters of Material Significance:

Unsurprisingly, in light of recent press coverage on charity misconduct, this is a key area of concern for OSCR and the Charity Commission.

They are particularly concerned that a number of charities which it has investigated recently, where serious issues have arisen, have had no prior reports made by charity's Auditor/Independent Examiner. OSCR is concerned that there appears to be a misunderstanding as to the implications of reporting and highlights that the best reporting it sees is where the Auditor/Independent Examiner is working with the charity to make improvements i.e. that the charity is benefiting from the adviser's experience and that the reporting is not viewed only as negative whistleblowing. Your attention is, again, drawn to joint guidance issued on charity reporting, issued in November 2017. There are also a number of technical articles on this on icas.com.

Data Analytics

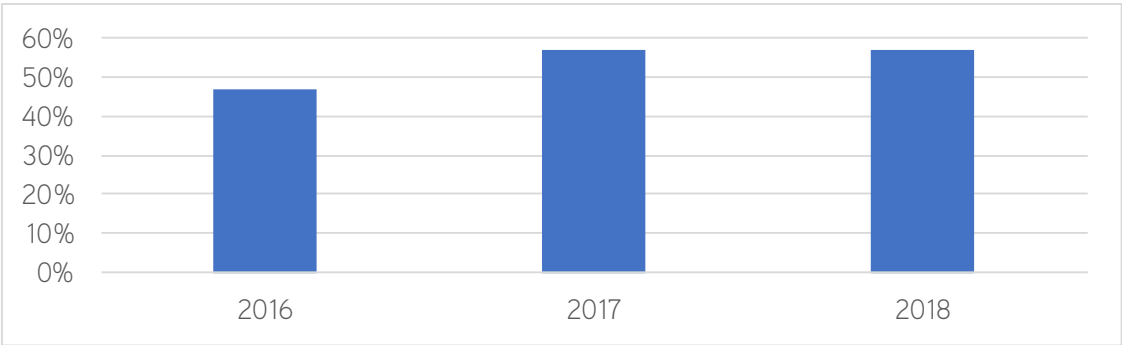
The uptake of data analytics is still relatively low. However, we have now reviewed a number of firms using these techniques. Whilst data analytics can be advantageous to the audit, benefits only come if there is careful planning of the objective of the tests and what evidence is required to be obtained.

We have seen a number of cases of tests being performed where the test is executed without any planning as to its objectives and parameters. For example, we have seen journal testing where 100s of pages of exceptions are produced and, too voluminous for the auditor to check, the auditor has then sampled checked the exceptions. This defeats the purpose of the test which was to ensure that there are no exceptions which are apparently indicating management override.

If you are using these techniques, plan carefully first.

Financial statement disclosures

Financial statement disclosure breaches(expressed as % of firms visited)

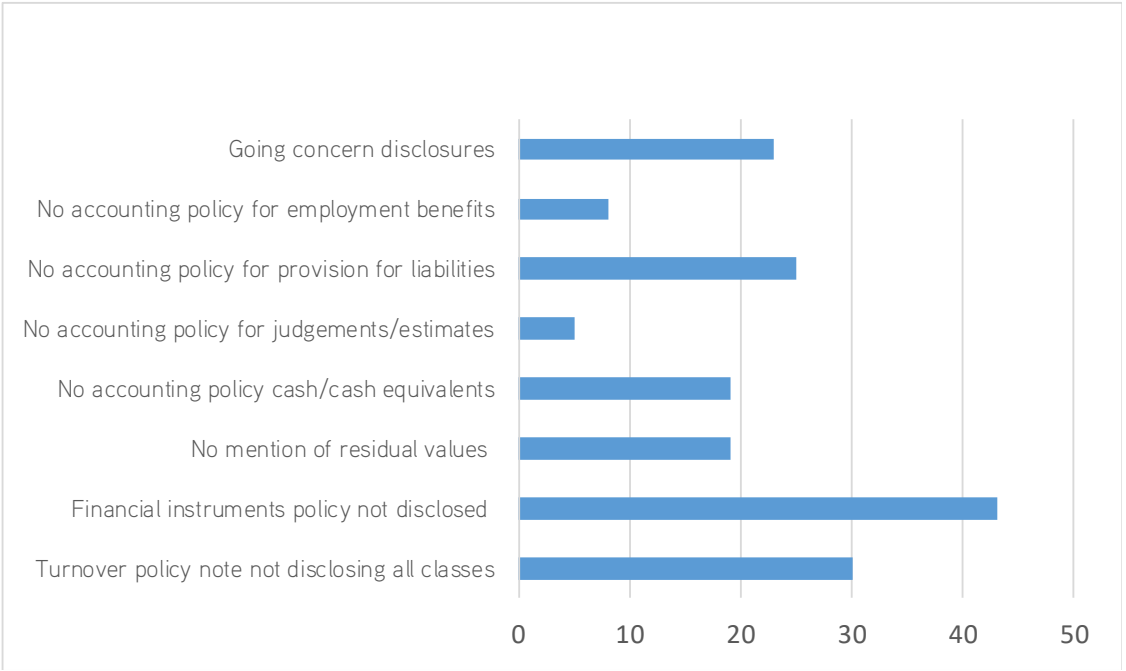


Whilst the number of firms with disclosure issues has not changed much, the extent of disclosure issues has reduced significantly.

In last year's Annual Report, serious UK GAAP issues arising from the implementation of FRS 102 dominated a number of visits, resulting in firm's requiring follow up action. The most serious issues identified last year were the number of firms adopting the wrong framework, particularly in relation to charity accounts. This was mainly caused by (a) accounting software issues and (b) learning curve.

Things have settled down. Now, whilst FRS 102 issues are still being identified, they are less widespread and mainly centre around the lack of accounting policies rather than any significant accounting treatment or accounts format issues.

FRS 102 Incidences (i.e. total number of breaches noted across all files reviewed)



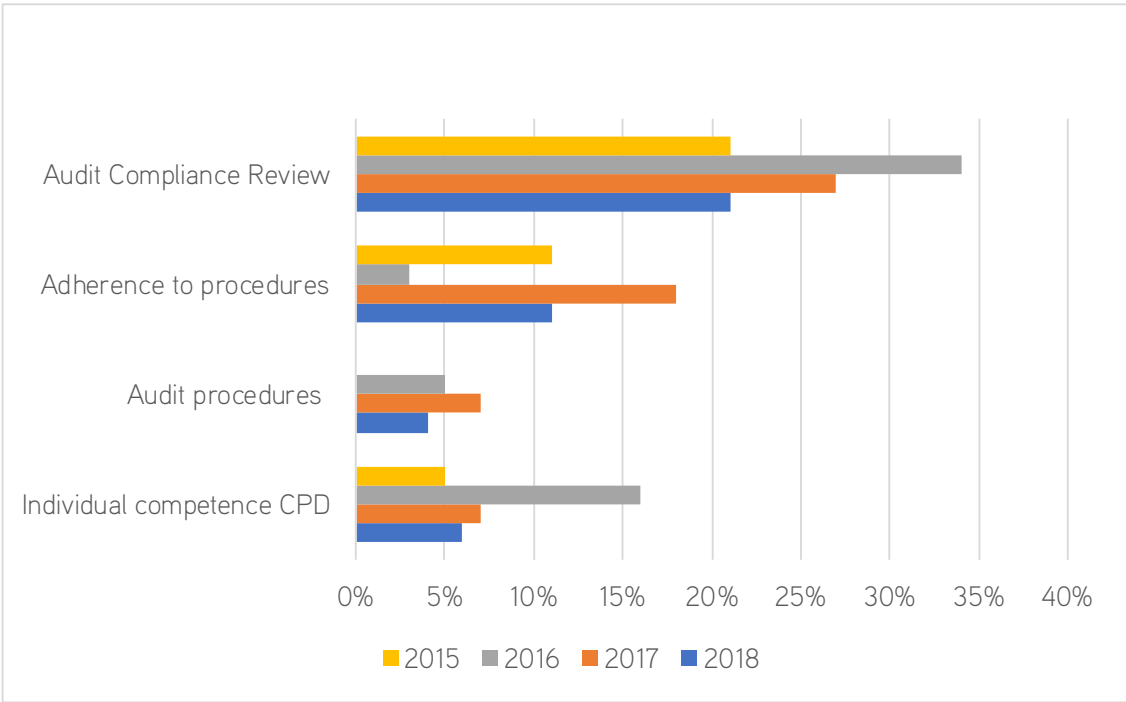
Charity accounts

A significant part of last year’s report was devoted to charity disclosures due to the problems experienced by firms on the transition to FRS 102 SORP. In 2018, there were very few recurring issues. The most common disclosure issues relate to accounting policies:

- Insufficient policy for apportionment of support costs
- Fixed asset policy doesn’t include residual values or impairment
- Insufficient policy re financial instruments

Other issues

Of a more firm-wide (ISQC1) nature, the incidence of other regulatory issues are noted below:



The most common firm-wide issue continues to be the lack of an effective compliance review process which has been covered in the Key Themes section of this report.

Appendix Two:

Other useful links and contacts

We hope you find this report useful, and if you have any comments or questions please contact us at auditandpracticemonitoring@icas.com.

Within ICAS there are a number of contacts which may be useful:

- Technical queries: for auditing, accounting, law or audit ethics queries please contact accountingandauditing@icas.com
- Money Laundering confidential helpline: if you have any potential money laundering issues, please contact our confidential helpline on 0131 347 0271.
- For queries in relation to audit, and other, licences and RI status: please contact regulatoryauthorisations@icas.com or phone 0131 347 0286.
- The ICAS Practice Support Service provides support to ICAS firms. It offers a variety of services on all aspects of practice, which can be tailored to meet the needs of your firm. The Practice Review Service no longer conducts audit compliance review services but can provide firms with lists of suitable reviewers practicesupport@icas.com.



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