

AUDIT MONITORING REPORT 2023/24



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**PROFESSIONAL
STANDARDS
DEPARTMENT**

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INTRODUCTION



Rama Krishnan

Chair, Audit Registration Committee

FOREWORD

I am very pleased to introduce ICAEW's Audit Monitoring Report for 2023/24.

While it was disappointing not to see an increase in the overall audit quality result with 71% of audit files graded either good or generally acceptable, the indications are that the lack of improvement may be due to unprecedented challenges within the audit market, most notably the cascading of larger, more complex audits from larger to smaller firms and the need for the latter to ensure that their quality assurance processes are improved. It also needs to be borne in mind that the audit files selected for review are those more likely to be the most complex and/or risky at the firms visited with the expectation being that the average audit quality across all clients will be higher, and that there has only been a slight increase in the number of audits requiring significant improvement (from 7% to 8%).

Once the current changes in the audit market work through, my hope is that we will see at least a recovery to the overall pre-pandemic result of 75-76%. We are already seeing much better results at ICAEW's largest registered firms who have invested heavily in their quality assurance processes. 88% of audit files reviewed at the Financial Reporting Council (FRC) public interest entity (PIE) Tier 1 firms

were either good or generally acceptable and there was a welcome improvement in the audit files reviewed at FRC Tiers 2 and 3 firms from 72% to 79%.

This report highlights the challenges to audit quality evident from the reviews conducted by the Quality Assurance Department (QAD) during the year. Each month the Audit Registration Committee (ARC) is provided with insights as to the risks to audit quality. Some of the issues presented stem from resourcing issues, remote working practices, the movement of larger, more complex audits from the largest firms to mid-tier firms and the challenges created by increased consolidation activity. We have asked questions of some growing firms and in response to applications for registration from new consolidators, about how they will establish and maintain effective whole-firm procedures quickly across an expanding audit practice. QAD will be following up, through its visits, on the commitments made by these firms to address the matters identified and ARC will need reassurance that these firms are making sufficient progress.

We are also pleased to see that ICAEW has continued to invest in proactive monitoring through the Audit Risk Officer and the initiative to change the Audit Regulations to increase its visibility on the movement of audits.

INTRODUCTION (continued)

Whilst we as a committee get considerable reassurance from detailed and positive responses from the firms to audit quality issues identified by QAD, there are times when we require further information from firms. This is in cases where we are not convinced by the commitment shown by firms, as a result of limited or non-specific actions. In these instances, we may request further root cause analysis of issues, action plans and ongoing monitoring including accelerated visits by QAD. Our primary focus must always be the public interest and maintaining the public's confidence in the work of ICAEW's registered audit firms.

This report includes details as to the actions we have taken in relation to firms' registrations and in imposing regulatory penalties. It is important that all firms continue to focus on difficult areas of audit work such as estimates and judgements and group audits and that audit engagement teams work effectively, with clear direction, guidance and review by the responsible individual who, like all other members of the team, needs sufficient time to perform their role well.

We have started to see more references in reports relating to the recently implemented International Standard on Quality Management

1 (ISQM1). The committee understands that it takes time to embed new processes and systems however we believe that every firm needs to have a clear commitment to invest in a robust system of quality management to support audit quality alongside their commercial objectives.

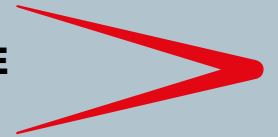
I would like to thank all the staff in ICAEW's Professional Standards Department, including QAD, for their work from scheduling and undertaking visits, producing reports for ARC, and implementing our decisions including follow-up with individual firms and reporting back to us on progress. I would also like to extend a special thank you to Trevor Smith, the outgoing QAD director, who retired in March 2024 for all his support and guidance to the committee over many years. I would also like to take this opportunity to introduce Nick Reynolds, QAD's new Head of Audit, who has taken over the commentary on this year's monitoring results and wish him every success in his new role.

Finally, I would like to express my thanks to all members of ARC who continue to give their valuable time and commitment to the work of the committee.

Rama Krishnan



ICAEW'S AUDIT MONITORING ROLE





ICAEW'S AUDIT MONITORING ROLE

ICAEW plays a significant role monitoring the quality of non-PIE audit work in the UK as the largest UK Recognised Supervisory Body (RSB), with responsibilities delegated by the Financial Reporting Council (FRC), the UK Competent Authority.

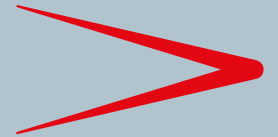
ICAEW registers about 2,000 firms to conduct audit work.

Our philosophy is to be a robust, proportionate and transparent regulator. Audit firms require an effective system of quality management tailored to their individual circumstances and we support this objective through our approach to regulation. We recognise the challenges and complexities inherent in audit work and that 'one size' of quality management processes and procedures does not 'fit all' audit firms. We offer insights and guidance to our firms where appropriate to support them to maintain compliance.

Further information about our audit monitoring visit process is available on our website at [icaew.com/auditguidance](https://www.icaew.com/auditguidance)



AUDIT MONITORING OVERVIEW





AUDIT MONITORING OVERVIEW

Nick Reynolds, Head of Audit in the Quality Assurance Department (QAD), sets out the results of monitoring visits undertaken by QAD in 2023/2024, developments in the market, the monitoring of audit quality risks and audit quality challenges.

NUMBER OF REVIEWS COMPLETED IN 2023/24

In the year to 31 March 2024, QAD reviewers carried out 476 audit monitoring review visits to ICAEW registered audit firms (in the year to 31 March 2023, there were 496 visits).

AUDIT MONITORING RESULTS

The overall result in 2023/24 was that 71% of 761 audits reviewed were either good or generally acceptable, which is the same figure as in 2022/2023. While this overall result may initially seem disappointing, it needs to be put into the appropriate context:

- the audit files selected by our reviewers are those considered to be the audit firm's most complex and/or risky audits so the overall result is not representative of the average audit quality across all firms' audits which is likely to be higher; and

- only 8% of audit files were rated as 'requiring significant improvements' with the balance requiring improvements (which can be limited to missing documentation).

It must also be borne in mind that year-on-year comparisons are of limited value because most of the firms reviewed in 2023/2024 were different to those reviewed in the previous year as most audit firms are only reviewed once every six years.

While it is still disappointing that the overall result has not yet recovered to the pre-pandemic average of 75-76%, there are a number of interesting dynamics in the current audit market which are contributing to the lack of overall improvement which we have analysed below.

The overall result was more impressive for the audit files reviewed at our largest registered audit firms – the firms who fall into FRC Tier 1 category – as 88% of the audit files reviewed at those firms were rated good or generally acceptable (where, again, we selected what we considered to be those firms' most complex and/or risky non-PIE audits). While the overall figure dropped from the very high average of 95% in 2022/2023, it is still a very good result.

REVIEW VISITS

476

audit monitoring review visits to firms by QAD reviewers

OVERALL RESULT

71%

of audits reviewed were either good or generally acceptable in 2023/24

LARGE FIRMS

88%

of audits reviewed at the largest audit firms were either good or generally acceptable



AUDIT MONITORING OVERVIEW (continued)

It is also pleasing to see that only one of the 50 audit files reviewed at those firms required 'significant improvements'.

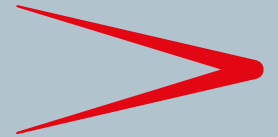
The biggest improvement we have noted this year is in the overall result for Tier 2 and Tier 3 PIE audit firms, as 79% of the non-PIE audits we reviewed at those firms were considered to be either good or generally acceptable. While the sample size is small (we reviewed only 19 audit files at these firms), it is an increase from the overall result of 72% for these firms which we reported in last year's report although we did review three audit files where 'significant improvements' were required.

This diverse group of firms are actively pursuing strategies to grow the scale and complexity of their audit client portfolios in the PIE and non-PIE market. In many cases their portfolio of audit clients has changed substantially compared to 3-5 years ago with significant investment in enhancement of their quality control systems.





GENERAL REFLECTIONS





GENERAL REFLECTIONS

All audit firms are unique and so there are many factors within each firm that will influence audit quality. The nature of audit work, skills required and inherent complexity of some businesses and transactions mean that very few audits are 'perfect' and, indeed, even firms with the most sophisticated quality control systems will produce audits that do not meet a good or generally acceptable standard from time to time.

Smaller audit firms do not generally need complex quality control systems, particularly those with one or two responsible individuals and a limited number of experienced and well-trained staff. However, even these firms need appropriate procedures alongside the ability to regularly monitor audit quality and ensure that those procedures remain fit for purpose and evolve with their audit client base, changes in auditing standards and external pressures. The results of some audit visits during 2022/23 and 2023/24 illustrated the consequence of procedures at smaller firms that were not robust enough to deal with the pressure on clients, staff and responsible individuals in recent years, including the impact of the coronavirus pandemic.

We believe from our work that there are several factors that are contributing to the drop in the

headline result from pre-pandemic levels. For audits conducted both during and since the pandemic, firms have been adapting to:

- new ways of working remotely;
- a significant shortage of staff (mirroring pressures in the wider UK economy);
- audit client staff working remotely, sometimes reluctant to engage with the auditor in person; and
- some increased workload from new auditing standards.

We focus our reviews on areas that we know are the most challenging for auditors and so continue to find weaknesses in certain audit areas including estimates and judgements and group audits (see **Audit quality challenges** section below).

Other audit market factors which, we believe, are impacting audit quality include:

- the movement of larger and more complex private company audits from the largest audit firms to mid-tier firms which has accelerated in recent years (see **Proactive monitoring of quality risks** section below); and

- the increasing consolidation activity among firms (see **Consolidation in the audit market** section below).

The annual ISQM1 evaluation requirement is the opportunity for all firms from sole practitioners to the very largest, to stand back and assess whether their procedures are adequate, or whether further work is required. We remind firms of common audit quality challenges and provide some insights from our visits into progress with ISQM1 quality management in firms, and an update on our own approach to monitoring the transition of firms to this principles-based and scalable standard that is central to maintaining audit quality. The new standard on quality management is still at a relatively early stage, but properly implemented, it will enable firms to identify and remediate weaknesses before these are highlighted at a regulatory visit (see **Quality management and ISQM1** section below).

Where we see poor quality audit work, there is a range of options available to bring about improvement and where possible we try to support firms to identify and remediate issues for themselves, including engagement with training organisations to provide ongoing support and guidance.



GENERAL REFLECTIONS (continued)

We can, and will, also refer firms producing poor quality audit work or where there are ethics and/or eligibility concerns to the Audit Registration Committee (see **Audit Registration Committee** section below).

It is, of course, important to highlight that we also see a lot of good practice during our audit monitoring work with high-quality audits at all sizes of audit firms, supporting public confidence in UK businesses and other entities. With experienced audit team members' involvement, producing documentation that 'tells the story', it is clear on many of our audit file reviews that there is high-quality audit evidence and demonstrable professional scepticism applied in these audits.

PROACTIVE MONITORING OF QUALITY RISKS

Another significant factor impacting the overall monitoring result is the continued movements of some larger and more complex private company audits from the largest audit firms into the mid-tier firms over recent years. Some of the firms we visit every three to four years have very different and sometimes much larger audit portfolios today compared to three to five years ago. This transition of some firms towards a more challenging audit portfolio means that

our risk-based sample of files to review on visits more frequently includes audits that are inherently more difficult, with more opportunity for weaknesses to occur.

This movement, and the risks it brings, emphasises the increasing importance of our proactive monitoring work through the Audit Risk Officer and her team. This work is carried out primarily to protect the wider public interest and confidence in the audit profession. Many firms will now have been contacted by the Audit Risk team, either to discuss a recently accepted audit client, or to receive an accelerated visit to enable us to review the work done on one of these audits. Wherever possible we provide firms with some guidance to better manage any potential risks and prevent problems from occurring. However, the Audit Risk Officer will refer firms to the Audit Registration Committee if they are considered to be taking on work which is beyond their expertise and which they may not have the resources to carry out.

Despite ICAEW failing in its efforts to see legislation passed which would require companies to file a notification at Companies House within a short period after changing auditors, we believe it is important to increase our visibility over the movement of

audits which is why the Regulatory Practice and Regulatory Policy teams launched a consultation proposing that changes be made to the Audit Regulations to require all of our audit registered firms to notify us of their acceptance of any new audits which have certain criteria. The proposed change, if adopted, will assist us to proactively identify risks arising from the changes in the audit market which will hopefully help to improve audit quality results in the future.

CONSOLIDATION IN THE AUDIT MARKET

A feature of the current market is the increasing consolidation of audit firms, including new firms with private equity finance growing rapidly through the acquisition of existing practices. These 'new firms' with newly formed audit teams, working across multiple offices, will require a period of time to implement suitable whole-firm procedures. While acquired firms will have legacy procedures that will prove adequate in the short term, we expect to do more work with these new firms in the coming years to ensure that appropriate quality management systems are implemented in a timely manner rather than continuing to rely on fragmented legacy procedures.



GENERAL REFLECTIONS (continued)

However, we can also see the potential benefits which should come from consolidation with sufficient critical mass to create dedicated risk and quality management teams and make greater investment in in-house training, development of staff and specialist expertise.

AUDIT QUALITY CHALLENGES

Estimates and judgements

Estimates and judgements are, by their nature, the most common challenges on any audit. These may be in relation to:

- valuation of assets – for example property or intangibles;
- determination of a provision – such as those booked against stock, or a legal liability; and
- cashflow forecasts – underlying directors' going concern considerations.

In all cases, the audit team needs to articulate on the file how they have approached the audit of that estimate – the work done on appropriateness and integrity of any underlying models, understanding key assumptions, and sensitivity to changes in those assumptions. Assessment of experts (either managements' expert or auditors'

expert) and the out-turn of estimates in the previous period may be necessary, and where this work is well documented, it will then demonstrate how the team has applied professional scepticism and challenge to that area of the audit.

We see good examples of this work, for instance, where audit teams have clearly documented their consideration of the competence and independence of an expert, held meetings with experts to discuss their work in detail, and conducted audit work on key information provided by management to the expert.

Weak examples include valuation or other reports simply copied and included on the audit file with little or no other information on work done, showing a lack of professional scepticism.

Group audits

The challenges associated with group audits, and UK auditors interacting with component auditors, were set out in our 2022/23 report.

UK holding companies who often have little UK presence, but substantial foreign operations, are some of the more challenging audits taken on by smaller UK audit firms. Often these were previously clients of larger audit firms.

The key principle is that the UK group auditor must be able to supervise and direct the audit work. Revisions to ISA 600 for periods commencing 15 December 2023 make this responsibility even clearer, with the need to adopt an audit approach that starts at the group/consolidated accounts, with audit risk assessment conducted across the group rather than a 'bottom up' approach as we've commonly seen in the past. Auditors may need to educate audit clients on the requirements for their audit work, as often the consolidation and group accounts are only prepared late in the audit process for some smaller groups.

We see some firms who have successfully embraced the opportunity to take on this work with a clear understanding of their obligations. It may not be easy for a relatively small UK audit firm to have effective engagement with overseas firms that are members of international networks but, where firms get this right, there can be good evidence of direction of component auditors and review and assessment of their audit.

The risks arise from a firm that underestimates the true challenge of this work, seeing the role as more administrative and a relatively simple consolidation and accounts preparation exercise, taking inappropriate assurance



GENERAL REFLECTIONS (continued)

from the involvement of component auditors without the necessary timely engagement and review of their work.

Audit team structure and resources

Although there are some particularly challenging audit areas such as those set out above, audit quality issues in the visits considered by the Audit Registration Committee are often more pervasive and cover multiple aspects of audit work. These challenges to audit quality will vary considerably across individual firms as they are linked to the individuals performing audit work, and the environment that they are working in. These challenges are identified through a combination of the work we do on audit visits and the firm's own root cause analysis. They include factors such as:

- involvement of the responsible individual in the audit;
- staff recruitment and resources; and
- the impact of new or revised audit systems and methodology.

Mitigation, monitoring and resolution of all audit quality challenges are something that a fully effective system of quality management should enable each audit firm to do for itself.



CASE STUDY

PROBLEMS AT A SMALLER FIRM IMPACTED BY COVID-19

Smaller audit firm with about 35 audits.

There were no significant concerns about the quality of audit work or audit procedures at the audit monitoring visit in 2017.

When we visited in early 2023, we reviewed two audit files that required improvement or significant improvement due to a range of weaknesses in audit evidence, financial statement errors and omissions.

The firm acknowledged all the issues, explaining that there had been a failure of leadership and training of the audit team. It cited the pressure from the start of the pandemic to concentrate on supporting its whole client base over such challenging times, including government support schemes and rapidly changing rules and

regulations. Staff from all areas of the practice helped each other but the firm now appreciated that training and support of those involved in audits fell below the necessary standard. Before our visit the firm had already recognised some of the issues, and its efforts to recruit additional experienced audit staff continued into 2023. The firm set out several actions including training and undertook to assemble the missing audit files.

Based on the firm's responses, the Audit Registration Committee continued audit registration but required external Hot File Reviews on a series of audits and Cold File Reviews on a sample of the audit files assembled following our visit. It further required CPD records to be submitted for the subsequent year and placed restrictions on acceptance of new audit clients and conducting file reviews for other firms.

QUALITY MANAGEMENT AND ISQM1 ISQM1 implementation

Our audit visits in 2023/24 included assessment of ISQM1 implementation. At this early stage following introduction of the

standard from 15 December 2022, our work focused on a high-level understanding of the risk assessment and key areas of whole-firm procedures to address quality objectives. Our visits will continue to evolve, with more focus on the monitoring, remediation and evaluation



GENERAL REFLECTIONS (continued)

elements of the standard. These are critical to the long-term effectiveness of a system of quality management as compared to the previous, less dynamic quality control standard.

The results of audit visits in 2023/24 supported findings of our survey of a random sample of firms at the beginning of that year, with about 90% of firms having implemented the new standard. In many cases where there had been delays these were small firms with few audits and some had already planned to give up audit registration. Where we had concerns about the lack of progress with implementation, we asked for follow-up information to check progress following our visit.

From discussion with firms of all sizes, embedding effective root cause analysis for identified deficiencies in the system of quality management is seen as one of the more significant challenges as they operationalise ISQM1. A key concern has been around who will do this work, including uncertainty over how open and honest the meetings and discussions will be. Some firms plan to engage with training organisations to assist, with the view that they will provide both the necessary skills and objectivity to perform root cause analysis effectively.



CASE STUDY

INVESTMENT IN ISQM1 IMPLEMENTATION

Medium-sized firm with more than 10 responsible individuals and 300 audit clients.

The firm has a good history of audit quality from previous monitoring visits.

The firm had invested significant time in implementation of ISQM1, starting with a clear risk assessment detailing risks specific to the firm and its portfolio, with responses.

Interviews with audit staff demonstrated the firm's open culture and commitment to training and development. A comprehensive range of whole-firm procedures included a well-established process for requesting, undertaking, and logging a high volume of internal technical consultations.

Formal root cause analysis is a relatively new concept for most audit firms, so good practice will evolve. Our initial observations for firms to consider are as follows.

- Development of ability within the firm to conduct effective root cause analysis, facilitating open and constructive discussion on 'what went wrong' is likely to have wider

benefits in strengthening a positive culture of accountability rather than blame.

- Training organisations will provide valuable support and independence and objectivity to the process, but the effectiveness of their work will be very reliant on those in the firm arranging interviews and meetings with relevant individuals and so this is more complex to outsource than routine reviews of completed engagements or provision of training courses.
- Whoever performs the root cause analysis, it must be a timely process to enable development of action plans and implementation of any changes within a reasonable timeframe.

We have requested root cause analysis as part of firms' responses to the findings from our audit monitoring visits since February 2020. Whilst our experience does reinforce the challenges of root cause analysis for some firms, results provide valuable insights into the reasons behind audit quality issues that have given us and the Audit Registration Committee more confidence in those firms' commitment and ability to resolve the matters identified on our visits.



GENERAL REFLECTIONS (continued)

Insights from root cause analysis

In our 2021 Audit Monitoring Report we shared some initial feedback on the root causes identified by firms in response to our audit monitoring visits. These were:

- lack of knowledge by the audit engagement team;
- flawed design of audit tests;
- inadequate review; and
- knowledge of accounting standards.

More recent review of firms' responses to 36 of our visits where we had more significant concerns about audit quality reveal some consistent themes in 2023/24. However, several of the observations reflect circumstances originating in the pandemic and its aftermath.

CHANGES TO CPD REGULATIONS

In November 2023, significant changes were made to the Continuing Professional Development (CPD) Regulations with new minimum requirements for ICAEW members and non-members who are regulated by ICAEW replacing the previous Reflect, Act, Impact, Declare (RAID) scheme. Monitoring of compliance with the new CPD Regulations is



WHAT THE FIRMS TOLD US:

RESPONSIBLE INDIVIDUAL (RI) INVOLVEMENT

"The main issue was lack of time spent at the review stage."

STAFF RECRUITMENT/RESOURCE CHALLENGES

"Following a long period of furlough, our audit manager effectively resigned followed by three more senior staff redundancies."

IMPACT OF NEW AUDIT SYSTEMS/RELIANCE ON SOFTWARE

"The gaps identified are a result of the firm moving from a paper-based audit to using online working papers. Audit staff at the time filed evidence in both places and sometimes on their desktops during the transition period."

CPD/TRAINING

"There is a lack of knowledge of both charities and the audit of charities by the RI."

"The root cause indicates further training is required for field staff to ensure that they understand when supporting documentation needs to be uploaded into the electronic audit file."

CLIENT FACTORS

"Time pressure has been an issue to meet filing deadlines for this client ie, receiving accounts to check close to deadline dates. Hence greater emphasis has been on ensuring that the numbers are correct leading to overlooking accounts/audit report wording."

"Our client is an immaterial component of an international group. The consequence is that the client does not give enough appropriate resource or consideration to our component."

HEALTH (INCLUDING COVID-19)

"Due to the stresses of COVID-19 upon the practice and its impact upon audit-qualified staff, family bereavement and sickness, with the associated disruption this entails, it has been difficult for the firm to maintain the standard of monitoring procedures."

We are confident that, although many audit firms have successfully navigated the challenges of recent years, there will be some firms, when reading the above, that will recognise some circumstances that may present (or have presented) risks to audit quality in their own practices.

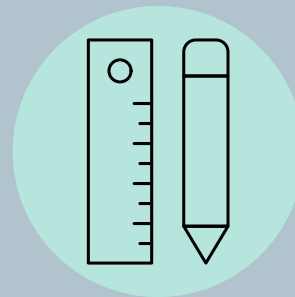


GENERAL REFLECTIONS (continued)

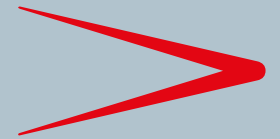
being transferred in November 2024 to QAD and this will allow us to review compliance with CPD Regulations and see whether the increased expectations on auditors to keep themselves up to date with relevant developments and best practice translate into higher quality audit work. The requirement to provide verifiable evidence of continuing professional development efforts will also provide us with an insight into how auditors are maintaining and developing their competence.

The Audit Registration Committee, as well as ICAEW's conduct committees, will also be using new powers to increase the CPD requirements specified in the CPD Regulations where they see examples of poor work in order to assist with the required remediation and improvement.





**CASES REFERRED TO
THE AUDIT REGISTRATION
COMMITTEE**





CASES REFERRED TO THE AUDIT REGISTRATION COMMITTEE

The Audit Registration Committee (ARC) receives reports on our monitoring of the largest audit firms and any reports on medium-sized firms and other firms with listed audits where we recommend any follow-up action after our visit. It also receives reports on any audit firm where the results of audit monitoring suggest that action should be considered for a failure to comply with the Audit Regulations. In 2023/24, ARC considered 21 large, listed and medium-sized firm reports, and 56 reports on smaller firms.

ARC has the following powers to:

- impose conditions or restrictions;
- issue a regulatory penalty;
- refer the firm or RI (or both) to the conduct committees; and
- withdraw an audit registration.

CONDITIONS AND RESTRICTIONS

The imposition of conditions and restrictions allow ARC to safeguard the public interest while allowing a firm time to resolve audit quality issues, normally with the assistance of external reviews.

A condition that some or all of a firm's audits

should be subject to Hot File Reviews (a review before a firm signs an audit) is a short-term protective measure, which also provides an opportunity for some coaching for the audit team to help bring their work up to the necessary level. It is very important that firms engage with these reviews effectively and ensure that their work is as complete as possible before the review, otherwise results can be inconclusive, and firms remain under this condition for too long.

A condition that some or all of a firm's audits should be subject to Cold File Reviews (a review which takes place after an audit is signed) may be imposed by ARC as an initial condition, or otherwise requested as a step after reasonable progress has been demonstrated by Hot File Reviews.

These reviews should provide stronger evidence of the firm's improved audit quality and enable ARC to release the firm from conditions as soon as results indicate that this is appropriate.

ARC also commonly places restrictions on a firm over a period where Hot or Cold File Reviews are required, for example, it may require that the firm cannot undertake external reviews for others and must request permission to accept new audit clients.

During 2023/2024, ARC imposed conditions or restrictions on the audit registration of 43 firms.

REGULATORY PENALTIES AND REFERRALS

Some matters arising on audit monitoring visits cannot be addressed through conditions and restrictions. More significant issues generally relate to serious independence matters where the firm has not complied with the FRC Ethical Standard.

These independence matters generally related to family relationships between covered persons within the firm and directors of audit clients, and cases where a covered person was a trustee of a trust with a material interest in an audit client. Other independence matters related to contingent fee arrangements for non-audit services, particularly research and development (R&D)/capital allowances work, which are prohibited.

Audit firms need to be very alert to these risks and bear in mind that the definition of a covered person extends beyond those directly involved in the audit engagement. They need to ensure that all those in the firm providing services to audit clients are aware of the restrictions that apply, with robust procedures to ensure that the audit partner/responsible



CASES REFERRED TO THE AUDIT REGISTRATION COMMITTEE (continued)

individual is aware of all non-audit services and their terms, and must approve these services before work is accepted.

Other regulatory penalties relate to a variety of circumstances, including issues relating to a firm's eligibility for audit registration or late/inaccurate information provided by the firm. Whenever audit firms plan to appoint new principals or change ownership/shareholdings they must ensure that they inform us within 10 business days. Firms must assess the impact of the changes on eligibility under the rules set out in the Audit Regulations, including control by audit-qualified individuals, and audit affiliate status for any principals who are not members of a UK Recognised Supervisory Body.

In 2023/2024, ARC issued over £140,000 in regulatory penalties. Over £90,000 of these penalties related to independence issues (penalties ranging from £2,000 to £15,000). In these cases, the firms accepted the penalty and

took appropriate action to resolve threats to independence for the future.

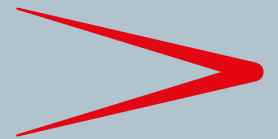
Where independence issues arose from visits to nine audit firms that either needed further investigation or were so serious as to merit a non-financial sanction in addition to a financial sanction, these were referred to the Conduct Department.

WITHDRAWAL OF REGISTRATION

ARC provides opportunities to a failing firm to show it can improve by imposing conditions, requiring checks to be made on future audits, while protecting its clients and the wider public. If sufficient improvements are not seen, ARC may decide to withdraw a firm's registration. This was not necessary in 2023/24 although ARC did accept the requests for voluntary withdrawal from three firms following adverse visit outcomes.



**OTHER AUDIT
MONITORING WORK**





OTHER AUDIT MONITORING WORK

LOCAL PUBLIC AUDIT

We continue to review local public audit engagements at firms registered with ICAEW to carry out local public audit work. There have been well-publicised delays in completion of local public audits in recent years, with consequential impact on the timing of our monitoring work. We are fully supportive of efforts by numerous stakeholders including the Government and FRC to facilitate recovery of this critical audit sector. We will continue to engage with our firms (including the new entrants to the market) and conduct audit monitoring activities, although the number of audits we review is likely to be reduced for a minimum of two to three years.

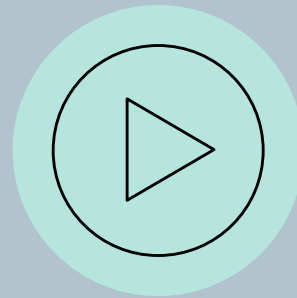
The results of our latest monitoring, reported to ARC in early 2024 were that 86% of the local public audit files reviewed were either good or generally acceptable. This is a consistent standard to the previous period of reviews included in our 2022/23 audit monitoring report.

CROWN DEPENDENCY VISITS

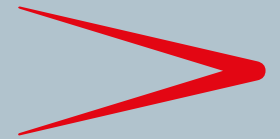
We completed five visits in 2023/24 (four visits in 2022/23). Four firms had no audits (one firm in 2022/23) and the one file reviewed was generally acceptable, with all files either good or generally acceptable in 2022/23.

MONITORING FOR OTHER REGULATORS

We undertake audit monitoring under contract for a range of organisations, including Audit Wales, Northern Ireland Audit Office, Audit Scotland, the Tynwald Auditor General, NHS England and several overseas bodies. This work helps to further support overall trust in the profession, both in the UK and overseas. It also provides our QAD reviewers with a broader breadth of experience and this variety of work helps ensure we continue to attract high-quality candidates for positions available within the QAD review team.



LOOKING AHEAD TO 2024/25





LOOKING AHEAD TO 2024/25

ISQM1

Firms should now have their routine monitoring, root cause analysis of deficiencies, remediation and action plans in place. There must be an annual documented evaluation of the system of quality management (ISQM1 paragraphs 53 and 54) indicating:

- a. reasonable assurance;
- b. reasonable assurance except for deficiencies that have a severe but not pervasive effect; or
- c. does not provide reasonable assurance.

This evaluation must, where necessary, drive prompt and appropriate action at all firms, and it is important that firms recognise that they may be required to communicate this evaluation externally, particularly to those charged with governance of listed audit entities.

ETHICAL STANDARD 2024

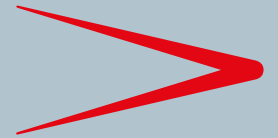
Amongst other changes, all firms must carefully consider the requirement to assess fee dependency from a collection of entities with the same beneficial owner or controlling party, rather than simply for a company and its subsidiaries that was previously the case.

CONTINUING CHANGES IN THE AUDIT MARKET

The movement of larger and more complex audit clients from larger firms to the mid-tier firms including expanding consolidators is likely to continue. Audit firms wanting to take advantage of these opportunities must ensure that they have robust audit acceptance criteria to ensure that they have sufficient resources with the necessary competence to undertake this work to an acceptable standard.



HELP AND SUPPORT





HELP AND SUPPORT

If viewing this report on a digital device, select the icon or text to link to the relevant webpage.



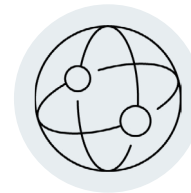
CPD LEARNING
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ON-DEMAND
WEBINARS



AUDIT NEWS



REGULATORY
AND CONDUCT
NEWS



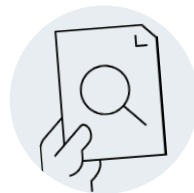
TECHNICAL AND
ETHICS ADVISORY
SERVICES



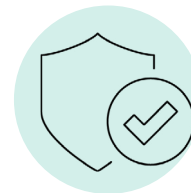
HELPSHEETS



GROUP
AUDIT
HELPSHEET



ISQM 1
RESOURCES



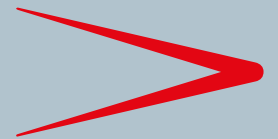
AUDIT AND
ASSURANCE
FACULTY



CORPORATE
REPORTING
FACULTY



APPENDICES



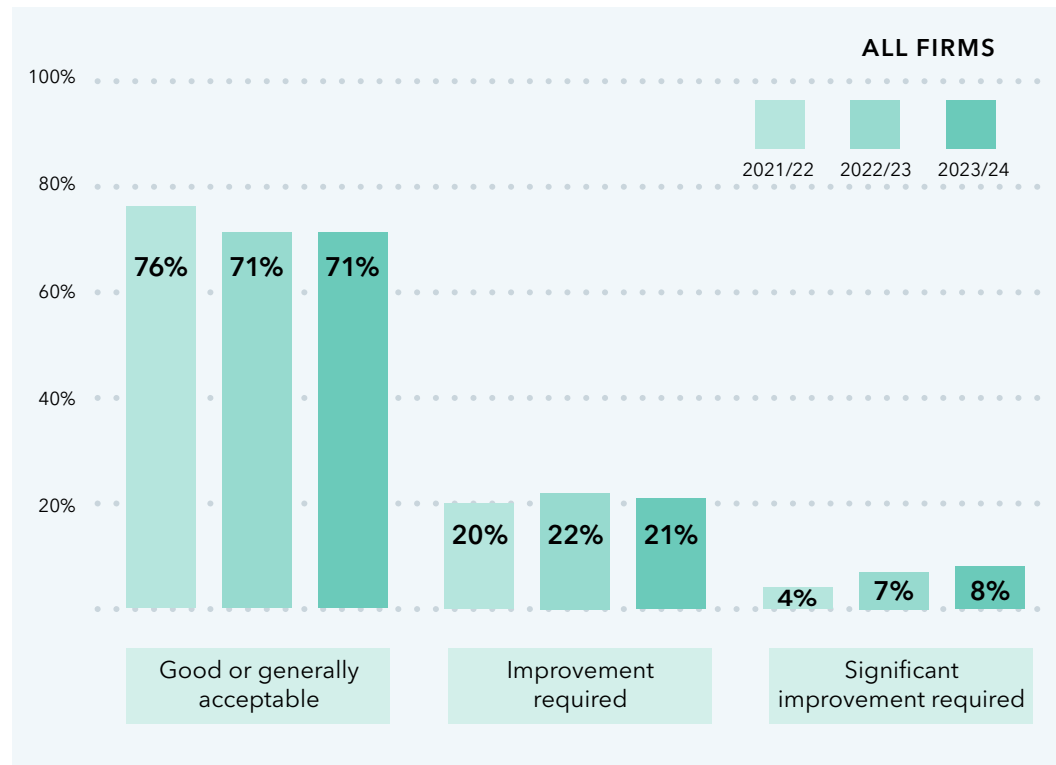


APPENDIX 1: DETAILED RESULTS

AUDIT QUALITY: ALL FIRMS

This chart shows the results of all audit file reviews carried out for the year ended 31 March 2024 compared to the years ended 31 March 2023 and 31 March 2022.

Results of 761 audit file reviews in 2023/24 show that 71% of these audits were either good or generally acceptable, and 29% required improvement or significant improvement. This is a similar position to the previous year, and below the overall level of audit quality assessed in 2021/22.





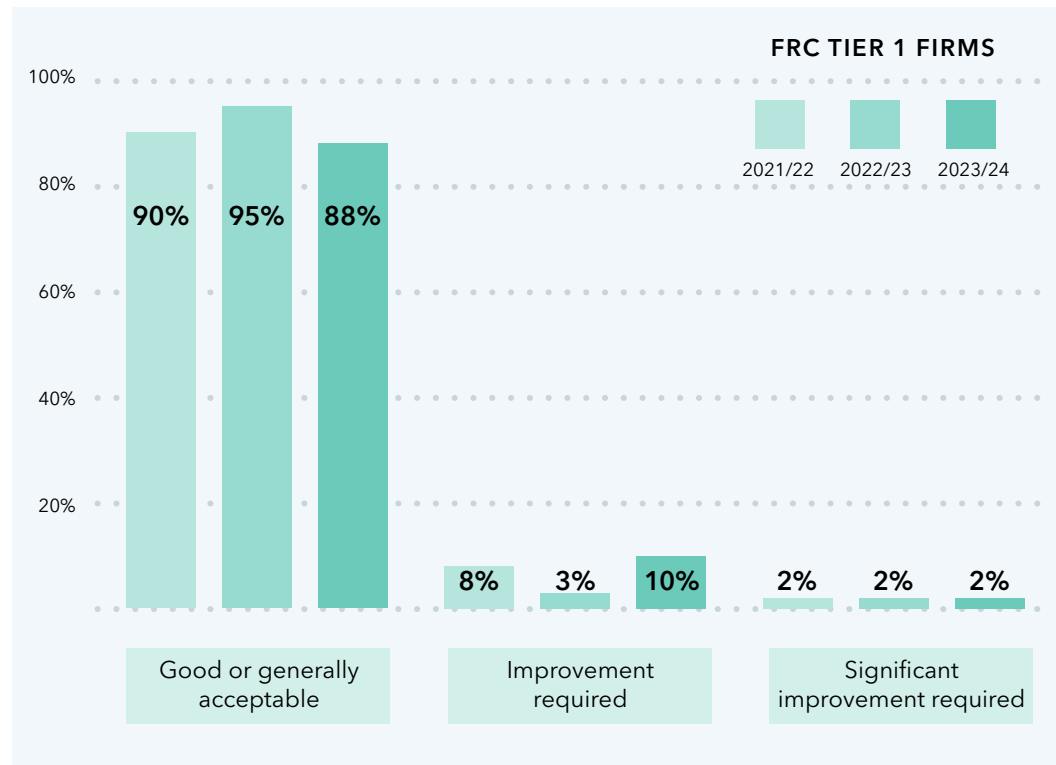
APPENDIX 1: DETAILED RESULTS (continued)

AUDIT QUALITY: LARGEST PIE AUDIT FIRMS (FRC TIER 1 FIRMS)

The six (up to 2022/23: seven) largest audit firms are subject to an annual review of their PIE audit work by FRC and to non-PIE audit file reviews by ICAEW every one or two years. FRC retains full responsibility for whole-firm procedures including compliance with ISQM1. ICAEW is solely delegated the review of non-PIE audit work and additionally undertakes some monitoring of individual CPD for non-PIE audit staff in the firms.

2023/2024 data reflects the results of 50 non-PIE audit file reviews across five firms (2022/2023: 60 files at six firms, 2021/2022: 51 files at five firms).

This chart shows the aggregate results of reviews of non-PIE statutory audits at these largest firms over the past three years, with 88% of audits reviewed judged to be either good or generally acceptable in 2023/24. The results of ICAEW reviews of non-PIE audits at individual Tier 1 firms can be seen in the FRC’s July 2024 Audit Quality Inspection Reports.





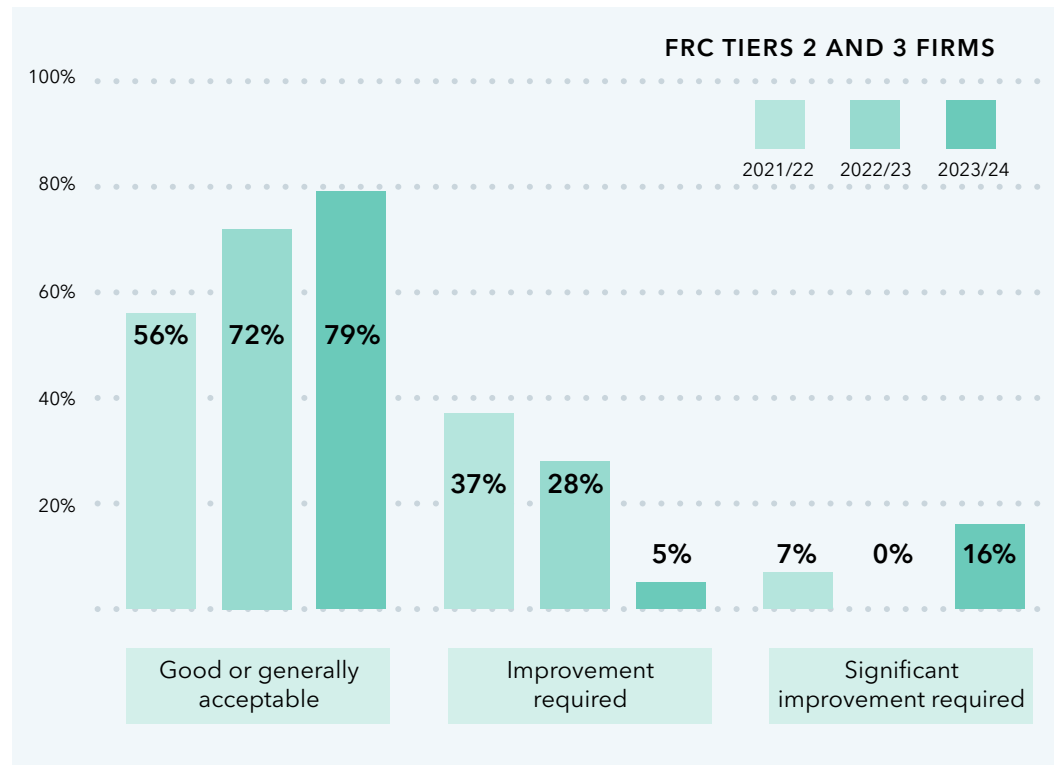
APPENDIX 1: DETAILED RESULTS (continued)

AUDIT QUALITY: OTHER PIE AUDIT FIRMS (FRC TIERS 2 AND 3 FIRMS)

Other PIE audit firms are subject to review of their PIE audit work and non-PIE audit work by FRC and ICAEW respectively over cycles of between two and six years. FRC retains full responsibility for whole-firm procedures including compliance with ISQM1, ICAEW is solely delegated the review of non-PIE audit work and additionally undertakes some monitoring of individual CPD for non-PIE audit staff in the firms.

2023/2024 data reflects the results of 19 audit file reviews across four firms (2022/2023: 40 files at seven firms, 2021/2022: 27 files at five firms).

The chart shows the aggregate results of reviews of non-PIE statutory audits at other PIE firms over the past three years. 79% of audits reviewed at these firms in 2023/24 were judged to be either good or generally acceptable in 2023/24.

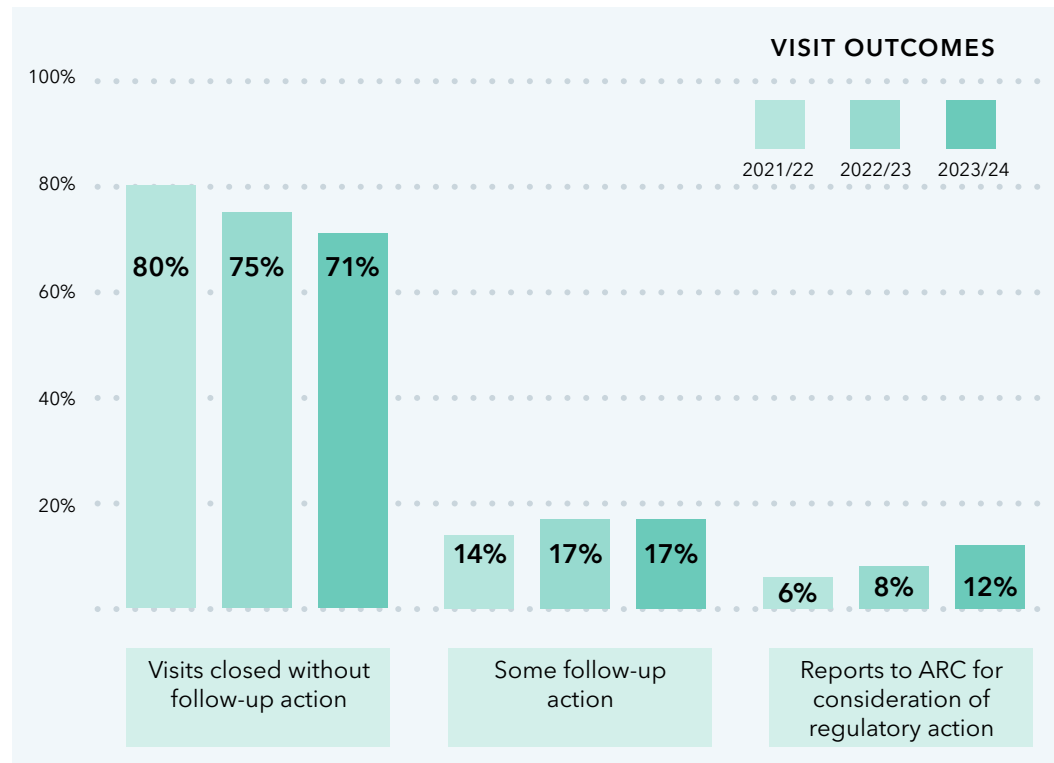




APPENDIX 1: DETAILED RESULTS (continued)

AUDIT MONITORING VISIT OUTCOMES: ALL FIRMS

Overall conclusions are drawn at a firm-wide level for each monitoring visit. The visit outcome for each firm incorporates not only an assessment of overall audit quality (considering all file reviews carried out at the firm) but also an assessment of the adequacy of the firm’s policies and procedures (non-PIE firms only), evaluation of the firm’s root cause analysis for more significant findings and the firm’s commitment and ability to address the findings. These assessments can result in very different visit outcomes.





APPENDIX 1: DETAILED RESULTS (continued)

Visits closed without follow-up action

As part of the visit process, firms must provide a written response to the matters raised, including details of actions planned and taken. If ICAEW is satisfied with the firm's response and considers that the firm has both the commitment and ability to make any improvements needed, the visit will close without any further action. The final assessment considers a range of factors, including the scale of improvement required and previous visit history.

Some follow-up action needed

Where some follow-up action is needed, firms are asked to provide further information. This ranges from providing further details of planned actions, to submitting the results of external Cold File Reviews, details of training courses or improved audit programmes. Submission of this information usually gives ICAEW the reassurance required that the firm is addressing the matters raised. If not, additional evidence of improvement may be required, or we may decide to bring forward its next review visit.

Where audits require improvement

This will attract strong follow-up action unless firms can demonstrate that these are isolated

examples and that they have taken appropriate steps to understand root causes and prevent recurrence. If, for example, four audits are found to be 'generally acceptable' with only one needing improvement, ICAEW may conclude that the firm is able to address any issues.

However, ICAEW still needs to be satisfied that the firm has explored the root causes of the audit needing improvement and that it has developed an appropriate action plan. If ICAEW is not convinced about the firm's response, we will put in place some follow-up actions to enable the firm's progress to be monitored.

Where audits require significant improvement

If QAD considers that the quality issues are more widespread, or serious in nature, the firm will be reported to ARC and some form of regulatory or disciplinary action is likely to follow. ARC has a range of options at its disposal. It can:

- impose conditions; typically, these would include external Hot or Cold File Reviews with submission of the results in order to monitor firms' progress, and increasingly requirements for firms to conduct further root cause analysis and strengthen action plans;
- impose restrictions, for example restricting a firm from taking on any new audits without approval from ARC;
- offer a regulatory penalty or refer a firm to the ICAEW Conduct Department for further investigation; or
- withdraw the firm's audit registration (in the most serious cases).

ARC will usually seek to provide an opportunity to a failing firm to show it can improve by imposing conditions, requiring checks to be made on future audits, while protecting its clients and the wider public. If sufficient improvements are not seen, ARC may decide to withdraw a firm's registration. The majority of our 2023/24 visits concluded without any further regulatory action.

The proportion of visits requiring consideration of regulatory action has increased over the three years from 2021/22. This is in line with changes in the proportion of audit files that require significant improvement but reflects many factors, including ARC concerns about weak root cause analysis conducted by some firms in response to findings from an audit monitoring visit.



APPENDIX 2: OVERSIGHT OF AUDIT IN THE REGULATED AREA OF AUDIT

EXTERNAL OVERSIGHT BY THE FINANCIAL REPORTING COUNCIL (FRC)

FRC is the UK Competent Authority for audit and delegates responsibility for licensing, monitoring and enforcement work relating to non-PIE audits and auditors to Recognised Supervisory Bodies, including ICAEW. It carries out an annual inspection of ICAEW's audit licensing, monitoring and enforcement work and publishes the results of its inspections. FRC also undertakes reviews of complaints about ICAEW's handling of audit and accountancy complaints.

OVERSIGHT BY THE ICAEW REGULATORY BOARD (IRB)

IRB has overall responsibility for overseeing the regulatory and conduct work carried out by staff of the ICAEW Professional Standards Department (PSD) including the Regulatory Practice and Regulatory Policy teams, QAD, and the effectiveness of the regulatory and conduct committees. Its members (and chairs/vice chairs) are appointed by the Regulatory and Conduct Appointments Committee (RACAC).

IRB holds five to six meetings per year and reviews updates from the PSD Chief Officer on PSD's progress on current initiatives and

the impact of proposed regulatory changes. The IRB's quality assurance programme consists of IRB members observing meetings of the regulatory and conduct committees and meeting with committee chairs to discuss feedback on committee performance and ideas as to how to make the committees more efficient and effective.

IRB receives and reviews all the 'delegated powers review' reports prepared by the regulatory committees and the Conduct Committee. It also reviews the final inspection reports prepared by each of ICAEW's external oversight regulators.

THE AUDIT REGISTRATION COMMITTEE (ARC)

All significant decisions on audit regulatory matters are made by ARC. This committee is independent from staff and comprises of a parity of lay and chartered accountants with a lay chair who has a casting vote. This maintains an important balance of technical insight from the chartered accountant members and public interest insight from the lay members.

Where regulatory action may be appropriate following a QAD audit monitoring visit, the committee will consider whether such action is

appropriate, which could include one or more of the following outcomes:

- audit registration withdrawal;
- imposing conditions/restrictions; and/or
- proposing a regulatory penalty.

Every year a lay parity or lay majority subcommittee of the committee carries out a 'delegated powers review'. Sub-committee members review Regulatory Policy and Regulatory Practice files to check that licensing decisions taken by staff on new audit applications are within the criteria set by the committee and to check whether the Regulatory Policy and Regulatory Practice staff follow up on remedial action recommended by QAD or required by the committee following a visit. They also review the grading of a sample of QAD visits to gain assurance that remedial action is taken against all firms whose audit work has fallen below expected standard. Each 'delegated powers review' report is considered by the committee and then submitted to IRB.

ICAEW's regulatory and conduct roles

Our role as an improvement regulator is to strengthen confidence and trust in those regulated by ICAEW. We do this by enabling, evaluating and enforcing the standards expected by the profession, oversight regulators and government.

ICAEW's regulatory and conduct roles are separated from ICAEW's other activities through internal governance so that we can monitor, support or take steps to ensure change if standards are not met. These roles are carried out by the Professional Standards Department (PSD) and overseen by the ICAEW Regulatory Board (IRB) and oversight regulators including the Financial Reporting Council, Office for Professional Body Anti-Money Laundering Supervision, the Insolvency Service and the Legal Services Board.

We:

- **authorise** firms and individuals to undertake work regulated by law: audit, local audit, investment business, insolvency and probate;
- **support** professional standards in general accountancy practice through our Practice Assurance scheme;
- **provide** robust anti-money laundering supervision and monitoring;
- **monitor** registered firms and individuals to ensure they operate in accordance with laws, regulations and expected professional standards;
- **investigate** complaints and hold ICAEW Chartered Accountants and students, ICAEW-supervised firms and regulated and affiliated individuals to account where they fall short of standards;
- **respond** and comment on proposed changes to the law and regulation; and
- **educate** through guidance and advice to help ICAEW's regulated community comply with laws, regulations and expected professional standards.

[icaew.com/regulation](https://www.icaew.com/regulation)

* includes parent companies. Source: ICAEW member data February 2024, Interbrand, Best Global Brands 2023

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Chartered accountants are talented, ethical and committed professionals. ICAEW represents more than 208,000 members and students around the world. 99 of the top 100 global brands employ ICAEW Chartered Accountants.*

Founded in 1880, ICAEW has a long history of serving the public interest and we continue to work with governments, regulators and business leaders globally. And, as a world-leading improvement regulator, we supervise and monitor around 11,500 firms, holding them, and all ICAEW members and students, to the highest standards of professional competency and conduct.

We promote inclusivity, diversity and fairness and we give talented professionals the skills and values they need to build resilient businesses, economies and societies, while ensuring our planet's resources are managed sustainably.

ICAEW is the first major professional body to be carbon neutral, demonstrating our commitment to tackle climate change and supporting UN Sustainable Development Goal 13.

ICAEW is a founding member of Chartered Accountants Worldwide (CAW), a global family that connects over 1.8m chartered accountants and students in more than 190 countries. Together, we support, develop and promote the role of chartered accountants as trusted business leaders, difference makers and advisers.

We believe that chartered accountancy can be a force for positive change. By sharing our insight, expertise and understanding we can help to create sustainable economies and a better future for all.

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ICAEW is working towards becoming net zero