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Audit & Beyond

REST ASSURED

Summarising new guidance on testing internal controls at service organisations

Challenging times

Many auditors may feel currently that they are facing an unusually broad range of significant challenges and threats to audit quality.

At one end of the spectrum are practical difficulties in carrying out audits as a result of the coronavirus (COVID-19) pandemic; at the other end of the spectrum is the prospect of more consultations on the hundreds of recommendations that emerged from the independent reviews of UK audit. In between are challenges around Brexit, the new Ethical Standard, changes to auditor responsibilities on going concern, expectations that auditors do more to detect and prevent financial statement fraud, and more.

This edition covers all of these matters. In the news section, there are insights from Michael Izza, Chief Executive of ICAEW, on how it is looking ahead and showing leadership on audit reform; and pointers to helpful information for companies and auditors on matters to consider in relation to the impact of COVID-19, from ICAEW and other expert sources.

This issue of *Audit & Beyond* also includes news and reminders on guidance, technical releases, webinars and other resources addressing various topical issues.

It's a demanding time for the profession, but the faculty and other parts of ICAEW are working hard to provide timely, practical and technical support.

Best wishes. Keep well.

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Director, Technical Strategy Accountability Group, and Faculty Head

ICAEW

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NEWS & EVENTS

ICAEW CORONAVIRUS HUB

ICAEW is monitoring developments closely and collating resources as conditions unfold.

Practical guidance from ICAEW and other expert sources is available on audit (see below), business interruption, financial reporting implications, supply chain management and other matters affected by the coronavirus (COVID-19) pandemic, at tinyurl.com/AB-Corona

CORONAVIRUS AND GROUP AUDIT

As part of its work to get information out quickly, the faculty has issued guidance for group auditors with component auditors in jurisdictions affected by coronavirus (COVID-19). The guidance offers practical considerations relating to component auditors' work, to address requirements in UK auditing standards and may also be relevant for auditors in other jurisdictions.

The guide is available to download at tinyurl.com/AB-CoronaGroup

FRC GUIDANCE ON CORONAVIRUS RISK DISCLOSURES

The Financial Reporting Council (FRC) has published guidance for auditors and companies affected by the coronavirus (COVID-19) pandemic. Information on addressing practical difficulties with preparing accounts and carrying out audits was available at tinyurl.com/AB-CoronaFRC at the time of going to press. However, auditors are advised to check for the latest updates and advice from the FRC at tinyurl.com/AB-FRC-News

AUDIT NEWS – REGULATORY UPDATE

Audit news 65 was issued in March 2020, offering the latest technical guidance and best practice advice. It covers: new *Audit Regulations and Guidance* for 2020 for ICAEW-registered firms; a reminder that the Irish Audit Register application deadline passed on 31 January; new *Crown Dependencies' Audit Rules and Guidance*, effective from 15 March 2020; and advice on professional indemnity insurance cover.

Visit tinyurl.com/AB-News65

AUDIT REFORM: GETTING FIVE OUT OF THREE

The UK audit market is going to change. Following reviews by Sir Donald Brydon and Sir John Kingman – as well as a Competition and Markets Authority study – around 150 recommendations on reform have emerged. Time will tell how these will be refined, reconciled and turned into new laws and regulations that make sense and make a difference. Meanwhile, Michael Izza, ICAEW Chief Executive, believes the tenor and tempo of the debate should change.

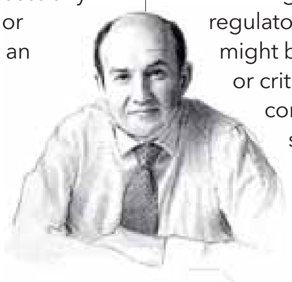
Four more consultations are expected this year, then 12 months or so of legislative procedure; but with the parameters of the challenge defined, there is an opportunity for the profession to show leadership. There are indications that this will be welcomed by government and the FRC.

Looking forward and considering what the net effect of the reforms should be, ICAEW sees five clear goals. "These constitute not just a set of desirable end states against which we can assess any individual proposed measure or combination of measures, but an agenda for action," Izza says.

The goals are:

1. Establish the Audit, Reporting and Governance Authority (ARGA) – replacing the current regulator, the FRC.
2. An inclusive audit profession – attracting talent from accountancy and from non-accountancy academic and vocational backgrounds of comparable standing and relevance.
3. A more reliable core audit – with a renewed (and improved) focus on internal controls, going concern and viability, and fraudulent financial reporting.
4. On-demand audit extras – with checks and assurance commissioned on areas of corporate activity, ranging from cyber security to sustainability delivery.
5. Pre-tested requirements – that have been carefully considered by government to assess their impact on the financial reporting system and attractiveness of the UK as a place to do business.

In Izza's blog (tinyurl.com/AB-FiveThree) he expands on these five goals and ICAEW's intention to push them as a way of judging the potential effects of reform, and an agenda against which suggestions for technical, regulatory and legislative change might be measured – and supported or criticised. He says: "We will continue to be ready to discuss specific proposals in detail and in depth, but we will do that – as far as possible – with achievement of these goals in mind."



TECHNICAL UPDATES

BREXIT INFORMATION FROM GOVERNMENT

The Department for Business, Energy and Industrial Strategy and the FRC have published joint letters for accountants and auditors around auditing, accounting and corporate reporting standards during the transition period following the UK's exit from the EU. Read them at tinyurl.com/AB-BrexTransition

FRC TO REVIEW CLIMATE CHANGE REPORTING

The FRC plans to review how companies and auditors assess, respond to and report on the impact of climate change. It will consider how the quality of information can be improved to support informed decision-making by investors and other stakeholders, by monitoring how companies and their advisers fulfil their responsibilities, and taking steps that will encourage better practice.

Learn more about how by visiting tinyurl.com/AB-ClimateFRC and also by listening to a podcast discussion among the FRC's climate review team at tinyurl.com/AB-ClimatePod

IFAC AUDIT QUALITY RECOMMENDATIONS

The International Federation of Accountants has outlined five factors for high-quality audit and issued a call to action for audit stakeholders. Learn more at tinyurl.com/AB-FiveFac

REVISED ETHICAL STANDARD NOW EFFECTIVE

Auditors are reminded that the FRC's *Revised Ethical Standard 2019* became effective on 15 March 2020. The standard and associated resources are available from the FRC at tinyurl.com/AB-EthicalStan and ICAEW outlines key changes for audit firms at tinyurl.com/AB-NewStan

EVENTS & WEBINARS

Details of forthcoming faculty events, including webinars, are at icaew.com/aafevents

SPRING ROADSHOW

Because of the COVID-19 pandemic, the faculty will be hosting its spring roadshow events online, during May, June and July. Bookings can still be made through the ICAEW events website. Delegates will be sent details by email on how to participate.

AUDITING REVENUE: WEBINAR

This one-hour webinar (on 15 April) will provide insights into where problems arise and guidance on how to address them, with a focus on small and medium-sized audits. Topics will include:

- which revenue streams to look at and how much evidence to gather;
- what the 'rebuttable presumption' means in practice;
- directional testing – common traps and tips on how to avoid them;
- benefits of effective analytical review and control work;
- avoiding common Quality Assurance Department concerns;
- the role of professional scepticism; and
- effective documentation.

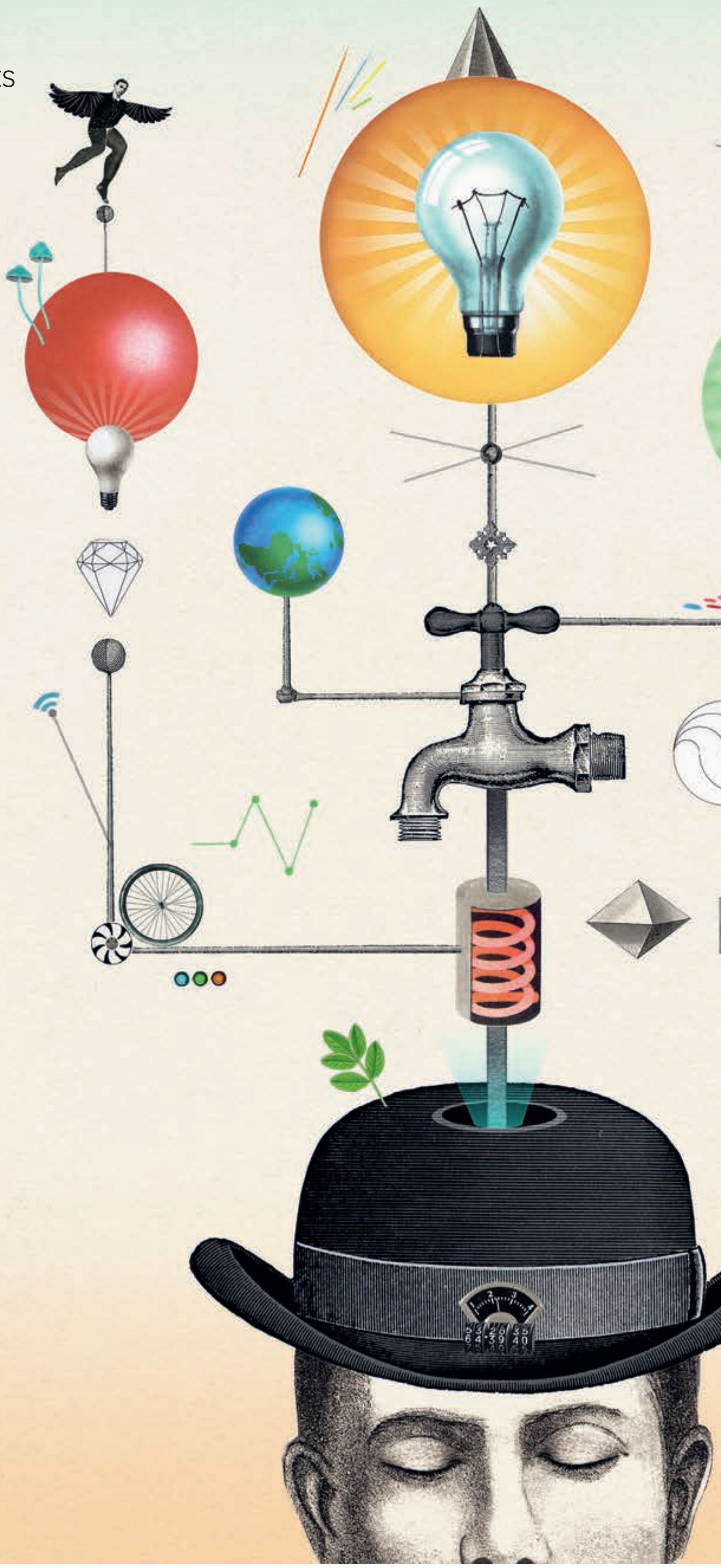
LATEST WEBINAR RECORDINGS

On-demand webinar recordings have recently been made available on: changes to ISA (UK) 570 *Going concern*; updated guidance for reporting accountants on Solicitors Regulation Authority Accounts Rules; and an exclusive Q&A with Sir Donald Brydon on his review of the quality and effectiveness of audit, at icaew.com/aafwebinars

OTTO STEININGER / IKON IMAGES

MOVING PARTS

There's a lot to consider when scoping non-audit assurance engagements. **John Ward** explores the main elements



Auditors are used to audits of financial statements that are heavily defined in form and content, based on accounting policies applied to accounting systems subject to internal control, financial reporting standards and, through the audit, to auditing standards.

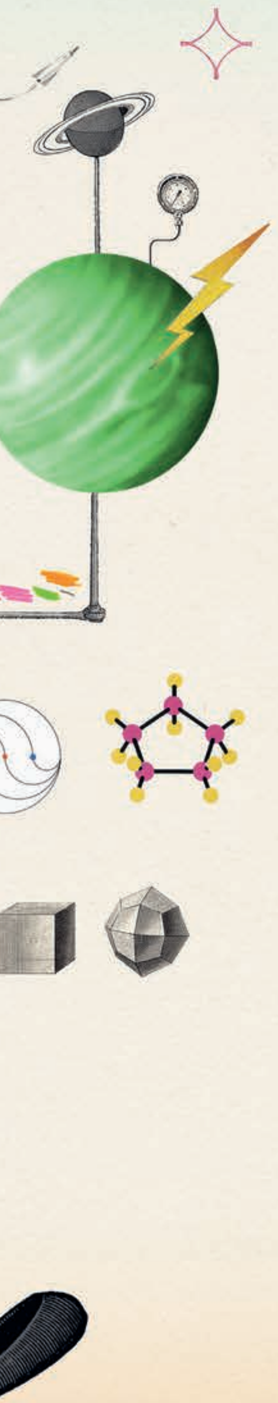
This extensive structure is not replicated in the world of assurance more broadly. Audit is part of that world of assurance - actually, the greater part - but it is also the more heavily defined. Consequently, audit has almost grown apart from assurance (for the main differences, see table, right), despite being based on the same underlying principles.

In the world of assurance the range of subject matters, users' interests, needs and relevant criteria is limitless. The assurance standard is, necessarily, principles based, and allows a sound assurance response to be developed against the endless list of topics that may arise. However, this freedom has consequences when defining and establishing an assurance engagement, as this requires more detailed analysis than an audit and the definition of many moving parts.

THE PARTS

If any one of the elements described below is not considered and defined when determining the scope of the engagement, then the assurance engagement itself can go wrong. With this in mind, it is important for the assurer to consider the following.

- **Subject matter (topic):** What will the topic of management's report be? Is it about compliance, sustainability, regulatory returns, key business indicators, future prospects or some other subject? Furthermore, will it contain narrative descriptions, descriptions about controls, data, methodologies or all of these things?
- **Boundaries:** How much is being covered by the management report? If there are limits, why? Do they make sense and how will the users regard those boundaries? Do they impact how useful or meaningful users will find the report? How does this impact the extent of assurance work that might be needed and the purpose of the engagement? Is the type of assurance to be limited or reasonable?



THE MAIN DIFFERENCES BETWEEN AUDIT AND ASSURANCE

	Financial statements	Non-financial information
Subject matter (SM)	Heavily pre-defined	Often defined by management and highly variable
Boundary – the limits of what management is reporting on	This is heavily pre-defined by reporting standards	Can be highly variable. May only cover the company internally or, for example, a supply chain policy may only go to major suppliers. Other information may relate to all customers and suppliers. Considerable variation is possible
Subject matter information (SMI) – what claims the management make about the subject matter	Heavily pre-defined, albeit variable by jurisdiction	Highly variable and often undefined by regulation or legislation; especially so for voluntary reporting
Criteria – the factors used by management and assurers to evaluate the SM and SMI	Largely defined through accounting and reporting standards, legislation and regulation	Highly variable. May be identified through dialogue with users but equally might be selected by management from publicly available standards or even developed by management themselves
Materiality – which impacts management's collation and the assurer's work in respect of testing tolerances	Implicit in the director's report and explicit in the auditor's planning	May be determined by management in conjunction with users if voluntary reporting. Else, may be only implicit in management decisions. Assurers need to be explicit in relation to materiality. This can become complex and require professional judgement to be exercised, particularly when assuring narrative reporting
User needs	Typically assumed for financial statements, albeit often not formally checked with shareholders and investment managers	Highly variable, depending on the topic and need to be investigated with users. May have been developed by management in conjunction with users. However, such needs of users may not have been thoroughly validated
Assurance focus	Heavily pre-defined; some variation by jurisdiction	Management reports are capable of infinite variation in content and may have a wide range of needs for the assurance focus
Form of report	Standardised forms available	Can be highly variable. In addition to the differences between reasonable and limited assurance, the latter contains limitless variations in terms of both the quantum and quality of assurance offered
Evidence	The quality and quantity of evidence required is implicit in auditing standards	Quality and quantity of evidence is derived from the scope definition but has limitless variations if limited assurance is being considered.

- **Subject matter information:** Exactly what do management intend to say about the topic? Will there be an explicit statement (claim) by management about some key aspects of their report? Or will their own claim be implicit; a consequence of the report's publication? Furthermore, are any management claims the main focus of assurance or just a part of the assurance brief? How does this sit with the subject matter report itself?
- **Criteria:** What processes and information do management intend to use in assembling the report? Will they be fit for purpose in the eyes of the users? What is the quality of control and governance over the collection and collation of the information? Is there any confirmation from the intended users that the criteria being used by management are suitable and acceptable?
- **Materiality:** Have management defined what they regard as material in the context of each type of information in the report? Have they considered what users might consider to be material? Have the users been consulted on what they may regard as material? Will the assurer need to perform more work to meet the users' demands for accuracy (materiality)? Has the assurer assessed the feasibility of assuring the range of topics in the report – and to the level of materiality that is implicit or explicit in the criteria?

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- **Users and their needs:** How well defined are the users' needs? How clear and evident are they? How do they impact matters such as the boundaries of the subject matter report and the tolerances to error implicit in any report? Have the users been consulted to identify their needs? Or have those needs been assumed by management?
- **Assurance focus:** Will assurance be over the content of elements of the report or over management's claims? Is the engagement to provide limited or reasonable assurance? How does management's request for assurance sit against their claims and the rest of the information in their report? Will the combination of the management report and assurance report address the users' needs?
- **Form of assurance report:** Management may not have considered the form of the report, but this can have a major impact on the amount of testing (and evidence to be collected). There are two important aspects to clarify here. First, has management specified whether the assurance should be over the report content or the management claims? Second, has management been clear as to which parts of the report need to be assured and what aspects (eg, description, operation of controls, etc)? The assurer has further matters to consider from here. Is the assurer sure that the scope of work is consistent with the planned form of the report? Is the form of assurance report sufficiently explicit that at least the buyer, typically the responsible party, has agreed to the form as being acceptable? Ideally, the users would also be consulted, if at all feasible.
- **Evidence:** Has the assurer contemplated the engagement overall and considered the evidence? Are they satisfied that the quantum and quality of evidence necessary to support the proposed engagement is available? Is the scope of the engagement, as defined, consistent with that evidence and the planned assurance report?

Within the discussions there will inevitably be a need to consider the skills required to do the work.

John Ward, consultant and chair of ICAEW's Assurance Panel

THE BIGGER PICTURE

In the world of assurance there is a lot less that is pre-defined or prescribed than in audit, so there is a lot more variability to be discussed and considered before starting work on an assurance engagement. The many moving parts need to be pinned down to enable the target of assurance to be defined and a programme of work delivered. These parts do not work in isolation but form part of a whole, which drives both the content and focus of the assurance engagement.

Having concluded on all these matters and moving parts, there are two other crucial overall matters to consider: rational purpose and meaningful level of assurance. In practice both are often dealt with during the client discussions; however, the assurance provider will need to satisfy themselves and document the decision.

There does need to be a rational purpose to the engagement. This often involves clarification of the nature of the report and the users together with their needs and the focus of the assurance being sought.

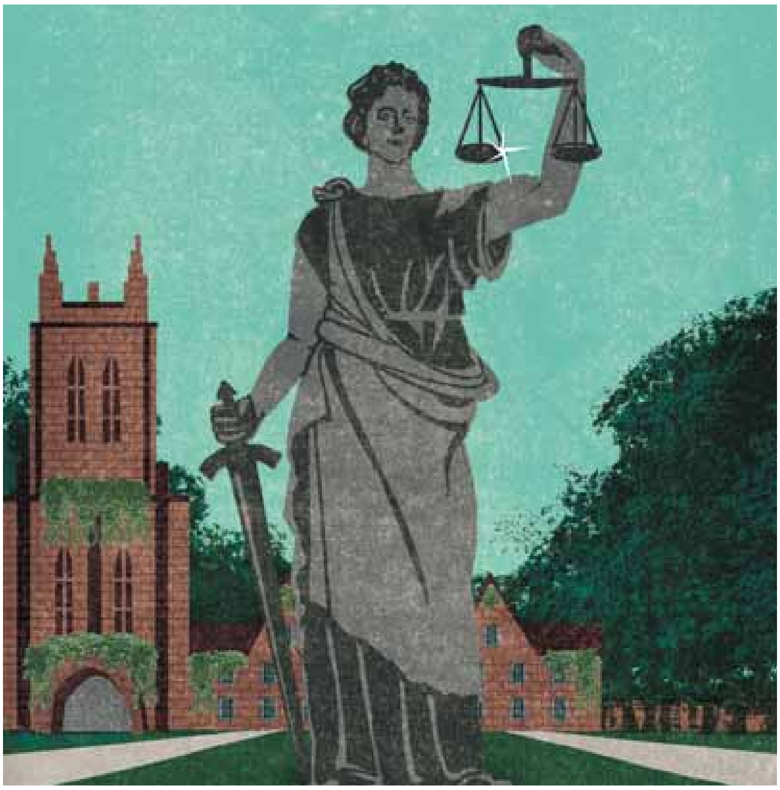
For more detail on this, visit ICAEW's website at tinyurl.com/AB-RP4AE

Whether the assurance is limited or reasonable is a key element in determining scope. In the case of limited assurance, the engagement needs to provide at least a meaningful level of assurance. More specifically, is the quantum and quality of evidence planned to be collected sufficient to enable a meaningful level of assurance to be provided to the users in the assurance report?

For example, an engagement to assure the compilation of information (when it is known that more than 90% of the risk to the subject matter is in the source data) might well be regarded as not meaningful.

At first glance, this may seem like a ridiculously long list of things to think about when scoping an assurance engagement, yet each one of these elements could give rise to later difficulties if it has not been thought through.

In practice, while the list seems long, it is normally quite a straightforward process that can be achieved in a single meeting. ●



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RULE OF LAW

Update your knowledge and understanding of the SRA Accounts Rules with our new Technical Release

Firms with law firm clients may be thinking about how the Solicitors Regulation Authority (SRA) introduction of new SRA Accounts Rules (effective 25 November 2019) will affect reporting accountants and the Accountant's Reports they prepare. There are now two related Technical Releases available (at tinyurl.com/AB-AuditTechReleases) to help reporting accountants perform these engagements before, after and for periods straddling the rule changes.

The latest Technical Release TECH 03/20 AAF *Solicitors Regulation Authority Accounts Rules: Guidance for reporting accountants following the 2019 changes* provides guidance for Accountant's Reports being prepared for law firms for any period that falls either in part or in full from 25 November 2019.

Our earlier Technical Release TECH 16/15 AAF *Solicitors Regulation Authority (SRA) Accounts Rules: Interim guidance for reporting accountants following changes to the Accountant's Report requirements* provides guidance for work under the previous rules for periods that fall in part or in full before 25 November 2019.

If the reporting period straddles the effective date of 25 November 2019 the reporting accountant will need to apply the previous rules to the part of the period up until the effective date.

For avoidance of doubt, the rest of this article will refer to the latest SRA Accounts Rules (effective from 25 November 2019) as 'the Accounts Rules'.

TECH 03/20 AAF explains the background to the changes in the Accountant's Report, considers the SRA objectives for the changes, and provides additional guidance to members on how the changes are likely to affect their day-to-day work in this area. It also offers insights into practical implications for reporting accountants, including suggested language for letters of engagement. The appendix provides updated examples of common scenarios as well as further considerations and conclusions reporting accountants may face.

WHAT'S CHANGED?

The Accounts Rules are now significantly shorter, and there are just 13 rules rather than the previous 52. They are focused on principles, rather than prescriptive rules for law firms.

Reporting accountants should also be aware that the detailed requirements and approach to be taken by the reporting accountant have also been removed from the Accounts Rules and moved to SRA guidance (at tinyurl.com/AB-AccountsRules). Reporting accountants will likely need to update their letters of engagement to reflect this change. TECH 03/20 AAF provides example language that reporting accountants may wish to use.

Although there are a number of key changes to the Accounts Rules that reporting accountants should be aware of, and you can learn more about these in TECH 03/20 AAF, its main focus is on how these changes affect the work of the reporting accountant. This was also the focus of a recent faculty webinar (see box), and will be covered in more detail in a follow-up article. Meanwhile, reporting accountants are advised to read the latest Technical Release and review the SRA Accounts Rules in detail to ensure that their knowledge and understanding of the rules is up to date for their work. ●

WEBINAR

Changes to SRA Accounts Rules and the impact on reporting accountants was recently the subject of a webinar, which is now available to members of the Faculty.

It features a Q&A with Janet Taylor, an SRA expert who has trained reporting accountants in checking and reporting on their law firm clients' compliance with the SRA Accounts Rules and she has provided consultancy support to fee earners and accounts staff in law firms.

See the recording at tinyurl.com/AB-SRAPod

ASSURED PERFORMANCE

It's all change for the guidance on assuring service organisations' internal control procedures. Discover what's new in Technical Release 01/20

WATCH ONLINE
A faculty webinar outlining the changes between TECH 01/20 and its predecessor TECH 01/06, which also included an extended Q&A session, is available to view at tinyurl.com/AB-TECH0120-VID

The faculty recently published a new technical release, TECH 01/20 AAF *Assurance reports on internal controls of service organisations made available to third parties*. It contains new guidance and replaces TECH 01/06 AAF. This article explains the purpose of the new technical release and the key changes to its predecessor.

WHAT'S IT ALL ABOUT?

Outsourcing business activities to service organisations is now common practice. A company might, for example, employ a service organisation to administer its defined contribution pension scheme or to select, manage or account for the investments of the company.

Given that many service organisations work for more than one entity, they may engage an independent practitioner to provide an assurance opinion on the controls in place over the outsourced activities that they perform for their clients. The service organisation can then share this independent assurance opinion with the entities they work for, providing comfort that the internal controls in place over the outsourced activities are effective and saving numerous sets of external auditors testing the same internal controls.

TECH 01/20 AAF provides guidance to assurance providers performing this type of assurance engagement and is intended to promote consistency in approach. The technical release also provides high-level guidance to senior management of the service organisation who prepare the report on internal controls on the specific services.
The guidance may also help entities that use service organisations to understand the scope and type of assurance provided in the assurance report.

While the guidance can be applied to any service organisation, it originated with reference to the asset management sector where the demand for this type of reporting has been more prevalent.

WHY WAS IT UPDATED?

Since the original TECH 01/06 AAF was published in 2006, times have moved on; industries have evolved and environments have become more

Since TECH 01/06 AAF was published in 2006, industries have evolved and environments have become more complex

complex. This led the faculty to consider whether the technical release was still fit for purpose. While the answer to this question was yes, changes were required to ensure the guidance reflected current activities performed by service organisations and also to refresh the control objectives within the technical release.

With more of these engagements now being done in practice, the faculty also had greater insight into the needs and roles and responsibilities of those conducting the assurance engagements, as well as the service organisations and the end user. This created an opportunity to improve the guidance and templates, providing greater clarity on how these engagements are done and, therefore, greater consistency in how these engagements are conducted.

HOW WAS IT DONE?

To help update the guidance, the faculty formed a working group of volunteers from member firms who specialise in these types of engagements. The group included Kirsten Barker, Director, third-party assurance at PwC and Rafik Ishani, Director, audit and risk advisory at Deloitte, who outline some of the key changes opposite (see box, right). Also, they have offered more in-depth insights in a recording of a recent faculty webinar (see left for more information). To ensure the views of all our stakeholders were captured, the faculty also carried out a public consultation in the second half of 2019. During this process, over 200 comments were received, all which were considered as the guidance was finalised.

The new technical release will be effective for reporting periods beginning on or after 1 July 2020 and early adoption is permitted. ●

Alison Dundjerovic,
Director, technical strategy talent, Financial Reporting Faculty

EXPERT INSIGHTS ON KEY CHANGES

A number of key changes have been incorporated within the new technical release. They include the following.

Better alignment with other standards and guidance

Many of the revisions to the guidance were made to better align the technical release with International Standard on Assurance Engagements (ISAE) 3402 *Assurance Reports on Controls at a Service Organization*.

While the original purpose of ISAE 3402 had been to converge existing standards in this area, including TECH 01/06 AAF, this was not fully achieved. With a view to addressing this issue, and improving comparability in reporting, the working group changed the terminology in the new technical release to be consistent, where possible, with ISAE 3402.

More detail and guidance has been added to TECH 01/20 AAF on concepts within the guidance for ISAE 3402 and SOC 1 reports (System and Organization Controls Reports). This includes dealing with sub-service organisations, subsequent events (the time between the end of the reporting period and the report signing date) and areas of the report not covered by the Service Auditor's Report.

Dealing with exceptions and modifying opinions

More explanation about the different types of opinion, issued by the assurance provider, have been added to the main body of the guidance. For example, there is more clarification about what constitutes a minor and major exception, and the types of qualified and non-qualified opinions. This also includes coverage of where a control objective, or part of a control objective, has not been required to operate in the reporting period.

The purpose of these changes is to ensure that assurance providers adopt a more consistent approach when forming their opinion. Updated and expanded examples of such opinion modifications have been included in the appendices to facilitate this.

There is also increased guidance on actions to be taken by the management of the service organisation.

Changes to control objectives

While the technical release continues to specify control objectives, some of these control objectives have been refined and reworded to reflect current risks faced by service organisations. In some cases, this has led to a reduction in the number of specified control objectives, in other areas this has led to the inclusion of new control objectives. There are now specified control objectives in two new areas (fiduciary management and property investment administration) and the removal of separate control objectives for hedge fund management.

We also added supplementary control objectives, which gives service organisations the flexibility to bring in additional control objectives, if relevant, without creating the need to call them out if not applicable.

The most notable changes made were to the control objectives related to IT as these were required to bring them up to date, with a focus on data integrity.

The footnotes have also been expanded to provide more clarity to the user on what aspects of technology have been included, and assured, in the controls report.

Additional guidance over the use of sub-service organisations

The working group noted that a key challenge for all service organisations was around the use of sub-service organisations, where the service organisation outsources some of its services to another service organisation. Further guidance has been added to help service organisations identify what a sub-service organisation is, how best to present them and how to deal with them from a controls reporting perspective.

Kirsten Barker
Director, third-party assurance, PwC

Rafik Ishani
Director, audit and risk advisory, Deloitte

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ROOM TO IMPROVE

A summary of which areas of weakness are most common when reviewing audit files

Hundreds of audits are reviewed by ICAEW's quality assurance team (QAD) during audit monitoring visits every year and most of them are found to be satisfactory or acceptable. There is always room for improvement, however, and this article offers a brief reminder of areas where issues were most commonly found during 2019 (see tinyurl.com/AB-WorkRegAud) and the auditing standards (ISAs) they relate to.

Audit Evidence (ISA 500) and *Audit Documentation* (ISA 230) combine to account for around 90% of the issues found by QAD. The most common significant areas of weakness on audit files relate to audit evidence, in particular: revenue testing, fixed assets, stock and work in progress, and other areas of professional judgement such as goodwill and other intangibles.

Issues with documentation are less common than issues with audit evidence, but not uncommon. They tend to arise when firms have not recorded important aspects of their audit work on key assertions in material areas, or key areas of judgement. QAD also sometimes finds that key working papers have not been attached to electronic files, or that electronic files are not archived on a timely basis.

Issues around identifying and assessing risk (ISA 315) are found less frequently. However, there are instances when QAD reviewers cannot see how well the auditor understands the client's business and activities or see that the required design and implementation testing has been done. Also, sometimes reviewers identify apparently significant risks that have not been identified as such by the firm.

Audit Sampling (ISA 530) should reflect the materiality and risk of the relevant balance or class of transactions. Samples are sometimes taken from a restricted population, for example overdue trade debtors, with no testing of the – possibly lower risk, but very material – trade debtors within credit terms at the year end. Firms sometimes reduce sample sizes for controls reliance or substantive analytical procedures without carrying out the appropriate testing to justify it.

The auditor's responsibility relating to fraud (ISA 240) is another area in which firms have opportunities to improve. There is sometimes no evidence of discussion about fraud with management or consideration within the engagement team discussion. QAD also raises points around testing of journals to address the risk of management override. Sometimes audit teams incorrectly rebut the risk of management override.

The risk of fraud in revenue recognition is also sometimes rebutted without a strong enough justification.

Going Concern (ISA 570) may not be a risk for many profitable and financially sound businesses, but it

There are instances when QAD reviewers cannot see how well the auditor understands the client's business

can be a challenging area due to the judgement and inherent uncertainties involved. Firms do not always give this area enough attention, with either inadequate testing or showing insufficient scepticism, or with documentation failing to demonstrate the challenge that may have taken place.

Many of these challenges and shortcomings are found in audits of group financial statements. In addition, however, QAD sees problems around communications between the group engagement team and the component auditors (tinyurl.com/AB-Feb20Edition).

Of less concern, but still worth a look, are issues around: *Audit Considerations Relating to an Entity Using a Service Organisation* (ISA 402); *Related Parties* (ISA 550); and *Written Representations* (ISA 580). ●

Related articles, technical releases, webinars and other faculty resources to assist auditors are at tinyurl.com/AB-Faculty

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DIGGING DEEP

Focusing on culture and behaviour may help auditors to identify fraudulent financial reporting, says **Michelle Cardwell**

Debate on the future of audit has focused on a number of themes including what, if anything, auditors can do to detect and prevent fraud. In his review into the scope of audit in the UK, Sir Donald Brydon proposes that auditors do more on fraud, including training in fraud awareness and forensic accounting. These recommendations raise a host of issues, as fraudulent financial reporting is complex and its detection can be very difficult.

Auditors have a duty to look for material errors in the financial statements, including material errors caused by fraud, whether from theft of assets or intentional under or overstatements of financial statements. Identifying fraudulent financial reporting however, presents unique challenges to the auditor.

Fraud can start innocently enough – an optimistic, but justifiable accounting position that over time is stretched as pressure builds to continue to meet targets. The dividing line of when this position crosses into fraud can be difficult to pinpoint. Complicating matters further, perpetrators often know how to use estimates and other accounting judgements to justify their positions. They may even produce detailed and complex evidence to deceive others.

Acknowledging that these factors make it difficult for auditors, ICAEW's recent Future of Audit thought leadership essay on *Fraudulent financial reporting: fresh thinking* (see tinyurl.com/AB-FraudFT) explores how auditors could improve how they find fraud by using their privileged exposure to organisational culture and behaviour.

CULTURE AND BEHAVIOUR

While auditors are experts in financial reporting, their work also involves interacting with many different and sometimes difficult personalities. They observe how people respond to challenge and gain first-hand experience of the culture of a company. This knowledge and experience builds a strong foundation for understanding the human behaviours that lead to fraudulent financial reporting.

The new publication explores how auditors can be curious and go deeper to get under the skin of an organisation. It provides practical questions that auditors can ask to better understand the organisation's culture when planning the audit, as well as during the audit.

Planning could include reviewing past behaviours and management styles in the organisation, as well as considering whether key employees are facing pressures or might be particularly motivated to manipulate results.

The essay also explores ways auditors can play a part in preventing fraud, through promoting a culture that acknowledges and corrects mistakes, supporting whistleblowing and having the courage to speak up when something is wrong.

MOVING FORWARD

As the debate continues, reducing fraudulent financial reporting will be a key priority for policymakers. While this publication focuses narrowly on behavioural and cultural insights that auditors could use to detect and prevent fraud, other areas for improvement in the statutory audit will be worth considering as well.

Investors may also value the development of additional, optional assurance methodologies targeted at fraud detection. Using these new types of assurance to supplement the statutory audit is explored in another of ICAEW's recent publications, *User-driven assurance: fresh thinking* (see tinyurl.com/AB-userDA).

ICAEW RESOURCES

ICAEW has been working to ensure that the ongoing debates and independent reviews around reforming the audit market are well informed and auditors are kept up to date on progress, and related resources. They can be found on a hub at tinyurl.com/AB-InqIA.

More essays in the faculty's Future of Audit series will follow on going concern and viability, and internal controls. Auditors may also find ICAEW's publication *Scepticism: the practitioners' take* (see tinyurl.com/AB-sceptTPT) useful when considering how to incorporate behavioural and cultural reviews into audit methodologies. ●

Michelle Cardwell
Technical Manager, audit, assurance and financial reporting

OIVIND HOVLAND / IKON IMAGES

JOHN SELWOOD'S AUDIT CLINIC

Answers to questions on 2019 revisions to ISAs (UK) affecting all audits and all auditor's reports

During 2019 the Financial Reporting Council (FRC) enhanced and revised a number of International Standards on Auditing (UK) (ISAs (UK)) and they are effective for audits of financial statements for periods commencing on or after 15 December 2019 (see final question, far right column). Some of the resulting changes affect all audits, while some affect only audits of public interest entities (PIEs).

There is potential for confusion around some aspects of this, so this Q&A offers clarification on some of the new requirements in ISAs (UK) that affect the content and wording of all auditor's reports.

QUESTION

I recently read that there are new reporting requirements in the audit report that apply this year in relation to reporting on fraud. Don't these only apply to PIE audits?

No! They apply to all audits.

This results from a change to ISA (UK) 700 (Revised November 2019) (Updated January 2020) *Forming an opinion and reporting on financial statements*. When this ISA (UK) was published as an exposure draft these changes were not widely supported and it was suggested by many in the audit profession that the changes would be restricted to PIEs.

However, the final version of ISA (UK) 700 retains the scope proposed in the draft and the changes apply to all audits.

The key change to the audit report is the following requirement in ISA (UK) 700:

29-1. The auditor's report shall explain to what extent the audit was considered capable of detecting irregularities, including fraud.

It is worth mentioning, again, that this requirement previously applied only to PIE audits and now applies to all audits.

It is important to note that reporting relates not only to fraud but also includes laws and regulations.

Surely these changes will be reflected in software templates. Won't the computers do all the work for us?

Again, the answer is no! At the best of times, relying on software for such things is dangerous. However, in this instance it is also entirely inappropriate as the required wording is not boilerplate. It will need to be drafted for the circumstances of each specific audit.

Indeed, the application material on 'irregularities including fraud' in the latest version of ISA (UK) 700 explicitly spells this out in:

A39-2. The matters required to be set out in the auditor's report in accordance with paragraph 29-1 may be useful to users of the financial statements if they are explained in a manner that, for example:

- Enables a user to understand their significance in the context of the audit of financial statements as a whole. In determining those matters that are of significance, both quantitative and qualitative factors are relevant to such consideration.
- **Relates the matters directly to the specific circumstances of the entity**

The changes in the latest version of ISA (UK) 700 will apply for audits of financial statements for periods commencing on or after 15 December 2019

and are not therefore, generic or abstract matters expressed in standardised or boilerplate language.

I have added the bold emphasis above to highlight the fact that boilerplate wording is not expected.

When do these changes apply?

As mentioned earlier in this Q&A, the changes in the latest version of ISA (UK) 700 will apply for audits of financial statements for periods commencing on or after 15 December 2019. In general, therefore, this revised standard will apply for December 2020 year-ends, but watch out for short periods such as the six months to 30 June 2020 – it could be easy to miss those.

What sort of things should I be including in the audit report?

The audit report could cover:

- the auditors' understanding of the regulatory framework and the significance of relevant laws and regulations;
- the assessed risks in laws and regulations, and fraud, particularly any area that might be susceptible to fraud; and
- the extent to which the audit is capable of detecting fraud.

Para 39-3 of the ISA offers more guidance, such as additional points which could potentially be included.

Are there any examples that I could use for inspiration?

Yes. These requirements have applied to PIEs since 2016, so you can look at the audit reports. It is probably best, however, to draw inspiration from the most recent examples of PIE audit reports, as the quality of this reporting has improved significantly since the requirements first applied.

Note, however, that you will almost certainly be looking at extended audit reports that include reporting on key audit matters (KAMs). Where laws and regulations, and fraud are mentioned in the KAMs the reporting elsewhere might be briefer than it would have been otherwise.

Are there any other changes to watch out for, relating to the wording of audit reports?

Yes. ISA (UK) 570 (Revised September 2019) *Going Concern* also applies for audits of financial statements for periods commencing on or after 15 December 2019.

It is a very good idea to ensure that you both read and understand the revised and updated ISAs (UK) and are familiar with the changes they introduce

As detailed in para 21-1 of the standard, where the auditor concludes that the going concern basis of accounting is appropriate, the auditor will report:

(a) Where the auditor concludes that no material uncertainty related to going concern has been identified, a statement that the auditor has not identified a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern for a period of at least 12 months from when the financial statements are authorised for issue;

(b) A conclusion that management's use of the going concern basis of accounting in the preparation of the entity's financial statements is appropriate.

There are additional specific new requirements that also apply for entities that are required or choose voluntarily to apply the UK Corporate Governance Code, for PIEs and other listed entities.

The faculty recently held a webinar updating members on how auditors' responsibilities on going concern are changing. A recording of this is available at icaew.com/aafwebinars

Can you suggest any other sources of information that may help me to understand these recent requirement changes?

As always, it is a very good idea to ensure that you both read and understand the revised and updated ISAs (UK) and are familiar with the changes they introduce; paying particular attention to the highlighted sections in the standards.

Current ISAs (UK) are on the FRC website at tinyurl.com/AB-FRCCurrentISAs

There are also some recent *Audit & Beyond* articles you may find helpful.

At tinyurl.com/AB-Feb20EthicAudit Mark Babington from the FRC explains how recent enhancements to UK ISAs will make the process of reporting clearer and more proportionate; while at tinyurl.com/AB-FRCBabington he explains why the FRC is encouraging auditors to do more work around going concern. ●

John Selwood is a member of the faculty's Practitioner Services Panel and a freelance lecturer and writer

HELICOPTER VIEW

A recent gathering of training providers offers insights into what's on the horizon for auditors, says **Louise Sharp**

Back in January, the faculty hosted its annual event for training providers and developers of audit software methodology to highlight future plans, discuss good practices and explore a range of topical challenges and issues in auditing and assurance. It covered significant ground, and in 2020 we can expect to see:

- a revised standard from the International Auditing and Assurance Standards Board (IAASB) on agreed-upon procedures engagements;
- ISA 540 (Revised) illustrative worked examples from the IAASB;
- another round of consultations on IAASB extended external reporting non-authoritative guidance (possibly being finalised later in the year);
- an IAASB exposure draft on ISA 600 (Revised) on group audits;
- a proposal on a way forward by the IAASB for audits of less complex entities;
- approval of final IAASB standards on quality management; and
- further UK audit reform consultations.

AUDIT QUALITY ISSUES

Inspection grades have fallen short of Financial Reporting Council (FRC) targets in recent years. Key findings include the need for improvements on estimates and judgements. This covers corroboration and challenge for key assumptions, including those relating to going concern.

Other issues include group audits, file augmentation (the ability to edit after archiving dates), substantive analytical procedures, sample sizes and testing of IT controls. Where there is severely deficient documentation of key judgements and significant risks, these become audit evidence issues, and here the FRC wants to see meaningful resolution of audit shortcomings, not just undertakings to 'improve documentation'.

ICAEW's quality assurance team (QAD) also sees quality issues around audits of groups, and insufficient work on components overseas. Other issues include revenue testing and weak substantive analytical procedures, lack of challenge on going concern and service organisations not being identified or understood. Going forward, QAD will be looking for firms to explore and comment on root causes in terms of findings.

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ISA 315 (REVISED 2019) CHANGES

The revised standard is effective for periods beginning on or after 15 December 2021. It contains significantly more application material and more granular requirements. It has more than doubled in length, with six detailed and necessary appendices, compared to two previously. Seven new definitions have been added, many of them about IT and systems of internal controls.

Key changes include mandatory separate assessments of inherent and control risk, and a new 'spectrum of inherent risk' based on magnitude and likelihood. This spectrum is not linear. There are five inherent risk factors to be taken into account, and a new stand-back assessment.

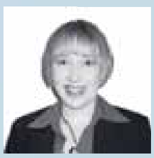
The FRC is also consulting on ISA (UK) 315 with no additional UK pluses proposed other than those in the existing standard.

GROUP AUDIT PLANS

We can expect to see an exposure draft of ISA 600 (Revised) shortly, focusing on a top-down, risk-based approach, driven by the group engagement team. The IAASB sees this as more than an exercise in centralisation: it will be about firms ensuring that they have the right people in the right places doing the right work.

ADDITIONAL REPORTING REQUIREMENTS

The additional reporting requirements introduced in ISA (UK) 570 (positive audit report wording for all audits) and ISA 700 (extension to non-public interest entity audits, of reporting on the extent to which the audit is capable of detecting irregularities and fraud) are likely to cause challenges for firms and software providers alike. Both of these additional reporting requirements are effective 15 December 2019 and will apply to short periods, so it is important that practitioners do not get caught out by simply relying on the report produced by software. ●



Louise Sharp,
Technical Manager, audit and assurance

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MEETING DISCLOSURE DEMANDS

Chris Skinner explores the shift in expectations around disclosure of capital allocation and dividend policy

Many investors are calling for companies to be more transparent in disclosing their capital allocation and dividend policies and practice. They see decisions around these matters as vital to the long-term success of the companies in which they invest and are seeking improved disclosure.

Some investors are additionally demanding that companies disclose an audited figure for their level of distributable reserves. Most recently, the Investment Association has called on all listed companies to disclose their distribution policies.

POLITICAL PRESSURE

The topic has moved into the political arena. The government, acknowledging that change is required, has stated that it will look at ways to strengthen the UK's capital maintenance framework. It has made it clear that it will legislate to require companies to disclose and explain their capital allocation decisions in their annual report and accounts if what it sees as 'sufficient progress' is not made through companies making voluntary disclosure.

S172 REPORTING

The new statutory requirement for all large companies to report how the directors have discharged their Companies Act 2006 s172 duties to promote the success of the company for the benefit of its members came into force for periods beginning on or after 1 January 2019.

The statement, required for all large companies, is to be included within a separately-identifiable section of the company's strategic report. To provide the statement, directors will need to have had regard to matters such as the need to consider the interest of the company's employees and the need to consider the likely consequences of any decisions made in the long term. Both of these are vital when making capital allocation and dividend policy decisions.

Compliance with this new legal requirement is expected to drive fuller disclosure around capital allocation and dividend policies. Indeed, the Financial Reporting Council (FRC)'s revised *Guidance on the Strategic Report* goes as far as to say that it expects that, for most companies, disclosure of capital allocation and dividend policy will form part of their s172 reporting.

While some companies are leading the way and are currently making disclosures voluntarily, compliance with s172 reporting will take disclosure a step further. Also, fundamentally, it will enable companies to demonstrate that they are addressing calls from investors.

There are diverse views as to the nature and necessary details that the s172 statement should contain. The Financial Reporting Lab's research reports into dividend policy and practice provide practical guidance to assist company directors in determining what to include. Its recent report on sources and uses of cash provides further insight into what investors expect. To avoid repetition, companies may find it useful to provide disclosures elsewhere in the annual report with a cross reference to the s172 statement in the strategic report. So, while legally the s172 statement is required in the strategic report, disclosures regarding capital allocation and dividend policy may be made elsewhere.

There are diverse views as to the nature and necessary details that the s172 statement should contain

TANG YAU HOONG / IKON IMAGES

GOVERNANCE AND QUALITY

Some companies might consider that capital allocation and dividend policy are not principal decisions and may choose to make no disclosure in their s172 statement. However, in the light of investor pressure, calls from the Investment Association and the FRC's expectations regarding the new s172 reporting requirement, it is becoming increasingly difficult for companies to avoid making disclosures of dividend policy and capital allocation within their annual report and accounts.

A few commentators are pushing for more radical changes to the UK's capital maintenance framework such as a move to a solvency-based regime. These more fundamental changes will require careful consideration and will take time. But for now the change that investors are seeking, and which companies should embrace, is in the governance over capital maintenance decisions and in the quality of the disclosures supporting them. ●

Chris Skinner,
Senior Manager, Deloitte

FROM THE FACULTIES

Keep up to date with what is going on in our selection of other faculty magazines

ON HIGH ALERT
Business & Management

As the new strain of coronavirus, COVID-19, sweeps across the globe, it is testing even the most robust and rigorous business continuity plans. There have already been major disruptions to businesses across the world, but how do we keep it from getting worse?

The business world is no stranger to health emergency events – thanks to outbreaks of SARS, bird flu and MERS in recent years – and should therefore be adept at building contingency plans. But this new outbreak is on a different level, with the potential to devastate many enterprises.

The implications of the current epidemic are far-reaching. From potential price increases because of stock shortages through to a complete lack of product availability, the full impact of COVID-19 on supply chains may not become clear for many months.

Travel and hospitality were among the earliest sectors to be badly affected. The recent collapse of regional airline Flybe will be the first of many.

Jeremy Hammant, Senior Business Adviser at independent management and technology consultancy BearingPoint, provides a measure of what we could be facing. "The SARS outbreak had repercussions that lasted for as long as two years and the financial impact has been estimated at over $400bn of increased costs and lost revenue."

John Beattie, Principal Consultant at disaster recovery and business continuity specialists Sungard Availability Services, says: "Businesses should consider what can be done in the present to continue meeting customer commitments in the future. Potential gaps in services need to be planned for."

Good communication during a health emergency is crucial to business continuity. Having protections put in place ahead of the fact is far more effective than ad-hoc recovery efforts, the consequences of which can be devastating. Agility in the face of any crisis is essential.

PATIENCE PAYS
Corporate Financier

In September 2019 Siemens announced plans to acquire the entire share capital of Process Systems Enterprise (PSE). Reports put the deal in excess of £100m. Siemens stood out among a pool of potential buyers – it saw the value PSE would offer its diverse client base. Formal work on the takeover began in the summer of 2019 and a deal was announced before autumn.

PSE provides "advanced process modelling technology to the process industries". Its applications range from understanding and modelling how drugs react in the human body to improving the efficiency of an offshore oil platform.

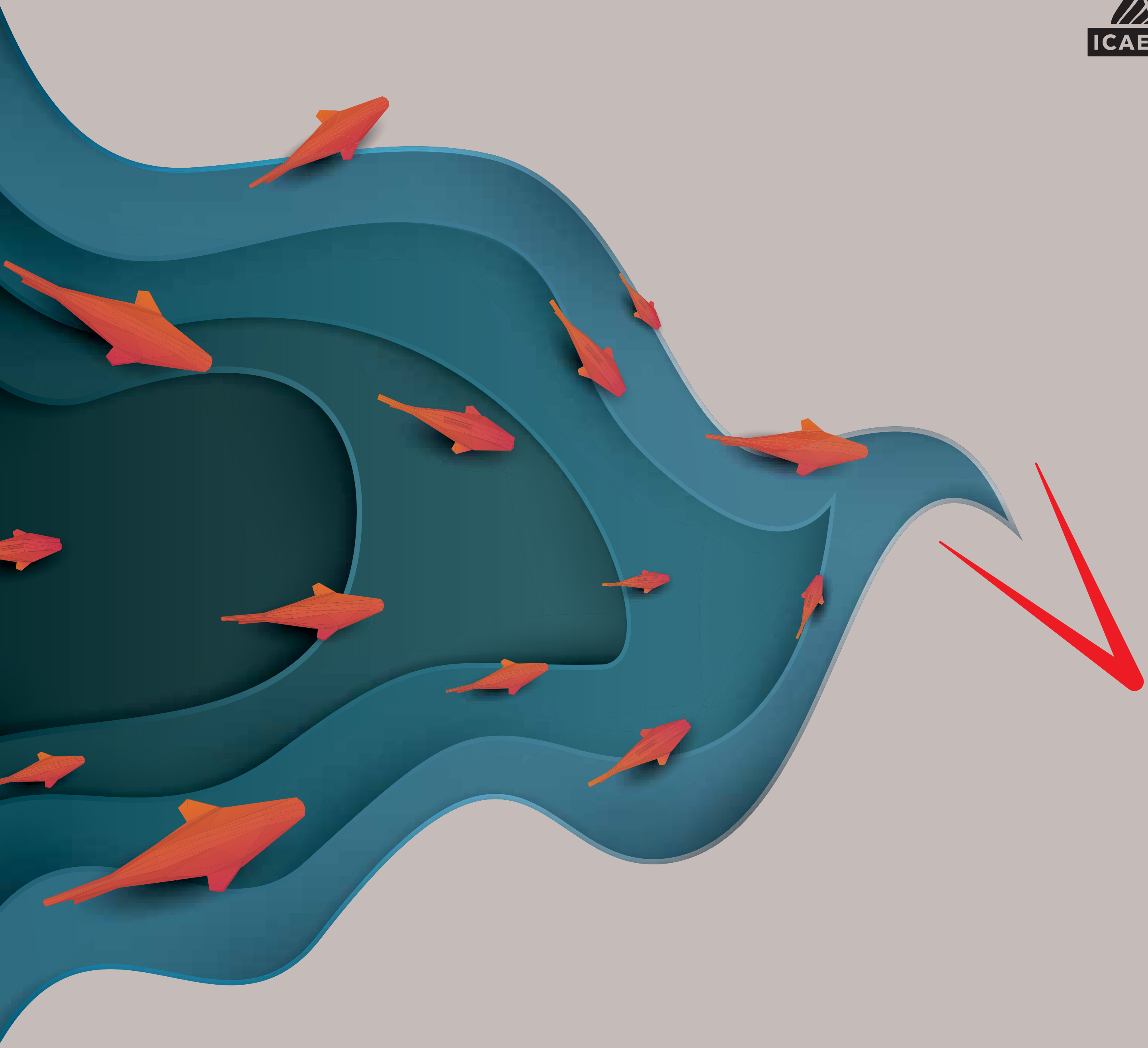
PSE's chairman started the search for external funding and was directed towards AlbionVC, which initially invested £1.5m through its venture capital trusts, with a further £0.5m in 2011. The sale generated a 10x return for AlbionVC.

SISTER ACT
Chartech

ICAEW admitted the world's first female chartered accountant, Mary Harris Smith, into its ranks in May 1920. A series of events, led by current ICAEW President Fiona Wilkinson, has been planned across the world for this centenary year, and a book celebrating ICAEW's pioneering female accountants has been published.

In this month's cover story, *Chartech* asked the following members from across the generations to share their views in this centenary year: Anzo Francis, Tech Faculty Board Member; Caroline Rivett, Director of digital, security and privacy in the life sciences at KPMG; Nic Granger, Chair of the Tech Faculty and CFO at the Oil & Gas Authority; ICAEW's Senior eCommunications Executive Lucy Alfred, and Digital Media Executive Birgit Lewinski; and Monique Malcolm-Hay, Senior Consultant at PwC and co-founder of New Gen Accountants.

ICAEW KNOW-HOW



What does climate change mean for your organisation?

What does it mean for your clients?
Are you professionally ready?

icaew.com/climatechange