

Audit & Beyond

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Making the most of technology to push audit improvement

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Can controls testing help when navigating a pathway to efficient, ISA-compliant journals testing?

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Embracing change

As we approach the end of summer, there is much for auditors to think about. With the implementation date for the new and revised quality management standards approaching and many auditors focusing on planning and preparing for the revised ISA 315 and the revised ISA (UK) 240, it's likely to be a busy period for auditors.

This year's Audit and Assurance Conference will focus on the theme of 'Change and Challenge', exploring the changes ahead for auditors and looking at how to deal with the biggest practical challenges facing audit firms today.

In this edition of *Audit & Beyond*, we reflect on the BEIS feedback statement, *Restoring Trust in Audit and Corporate Governance* (page 12). We also consider the tricky area of journals testing (page 6) and how auditors can ensure they meet the ISA requirements, and provide practical advice on how to manage a Quality Assurance Department (QAD) visit (page 14), including the approach QAD will be taking to ISQM 1 implementation.

There is much ahead for auditors to consider but, as always, we will keep you fully informed of developments and provide you with all the guidance and resources you need.

Emma Cross, Technical Manager, Audit and Assurance

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Faculty news & events

Stay on top of recent Audit and Assurance Faculty developments, as well as important events for your diary

FRC inspection results offer insights for all audit firms

Auditors' ongoing efforts to invest in their systems, people and capabilities have contributed to a steady improvement in audit quality at the largest audit firms over the past two years, according to findings in the Financial Reporting Council (FRC) *Audit Quality Inspection and Supervision Report* for Tier 1 firms, published in July 2022.

"We are pleased to note the general improvement in results for these – a selection of the largest, most complex audits. That improvement perhaps signposts continued voluntary improvements to the core audit made by the profession ahead of audit and corporate governance reform legislation and regulation," says Alex Russell, the faculty's Head of Audit and Assurance Strategy.

"The profession will continue to strive for further and continuous improvement in audit quality," he adds. For some firms, the findings in this report may play a

contributing role. Although the FRC's inspection and supervision report focuses on the largest firms, it offers information and insights that all audit firms may find useful.

Appendix 1 includes common inspection findings, with examples of areas where firms could have done better. Key findings are listed for: estimates (including provisions), impairment, revenue, ethics and journals. Areas of focus during recent inspections were the impacts of COVID-19, climate risks and fraud risks, and there are examples of good practices and key findings.

Appendix 3 focuses on what makes a good audit, with examples of good practice across the audit process in risk assessment and planning, execution, and completion and reporting. This may be a rich source of practical audit quality improvement tips for firms.

The report is available on the FRC website at tinyurl.com/AB-FRCAudQual



Auditing with inflation on the rise

Rising inflation presents challenges to auditors and the entities they audit. To assist auditors to understand the impacts, the faculty outlines some of the key areas of the audit that may be affected in an ICAEW Insights article at tinyurl.com/AB-InsInflation

The article covers planning, fraud, employee considerations, other cost factors, impairment, revenue, defined benefit pension scheme obligations, going concern, disclosures and written representations.

This is one of various ICAEW resources looking at the impact of inflation on people, businesses, accountancy and the wider economy. For expert guidance, opinion, data and analysis from ICAEW and its members, visit tinyurl.com/AB-GenInflation

FRC updates guidance on public sector auditors

The Financial Reporting Council has recently published revised guidance for Recognised Supervisory Bodies (RSBs) on the approval of Key Audit Partners (KAPs) for local audit.

An auditor must be registered as a KAP to sign the audit opinions of an English NHS

trust (apart from NHS foundation trusts), local authority or other local government body within the scope of the Local Audit and Accountability Act 2014. ICAEW is currently the only RSB for local audit in England.

Learn more from ICAEW Insights at tinyurl.com/AB-KAPGuid

Quality management: 100 days to implementation

In preparation for new quality management standards that come into force from 15 December 2022, audit firms are adopting a proactive approach to quality management (QM). The faculty is making resources available to assist firms. The 'Quality management in audit firms' hub introduces the new QM standards and covers matters such as:

- ISQM 1 implementation;
- quality risk assessments;
- QM and resources obtained from service providers;
- the 'people factor' in your tailored approach to QM;
- QM benefits for smaller firms; and

Audit and Assurance Conference 2022

'Change and Challenge' will be the theme of this year's faculty conference, taking place on 12 October 2022, 1-5pm at Chartered Accountants' Hall, One Moorgate Place, London.

The conference will explore the changes ahead for auditors and feature a panel discussion on how to address the big challenges faced by firms today.

Attendees can look forward to a host of panellists and presenters, and there will be opportunities to network and engage with other firms and professionals.

To learn more and book your place, visit tinyurl.com/AB-AuditConf

Reporting on charities

The Charity Commission for England and Wales wants to see ICAEW audit firms do better at meeting their duty to report matters of material significance, including modified audit opinions for charities. An ICAEW article looking at the importance of these reports and how firms may improve their reporting is at tinyurl.com/AB-CharityReq

Technical updates

The latest news on developments in audit and assurance, financial reporting and ethics is available on the ICAEW website. Find recent actions and outputs by the Financial Reporting Council, International Auditing and Assurance Standards Board and other standard setters and regulators at tinyurl.com/AB-TechNews

- conducting root cause analysis (RCA).

"We've worked extensively with faculty volunteers to create practical resources to support members on their quality management journey and more resources are in the pipeline," says Louise Sharp, Senior Technical Manager, Audit and Assurance.

Look out for our Insights article providing information, tips and an essential resources list on ISQM implementation for small practices, and an updated version of the faculty guidance on root cause analysis.

Visit the resource hub at tinyurl.com/AB-QMhub

Registered for audit in Ireland?

Firms registered for audit in Ireland with Chartered Accountants Ireland (CAI) are reminded that CAI has issued new stand-alone Audit Regulations for Ireland. The Audit Regulations Ireland replace the Audit Regulations and Guidance (effective 1 January 2020) and the addendum effective 22 December 2021.

The new Audit Regulations Ireland include new continuing professional development obligations for responsible individuals and a new requirement for practice continuity (alternate) arrangements for sole practice/sole practitioner audit firms.

Learn more at tinyurl.com/AB-CAIAuditReg

Auditors and independent examiners will find an ICAEW article offering guidance on their duty to report any matters of material significance to UK charity regulators. It sets out what should be considered a matter of material significance and the expectations of UK charity regulators (at tinyurl.com/AB-CharMoms).

EVENTS

Faculty webinars

Recent additions to the library of faculty webinar recordings include:

- a panel discussion among interviewees who contributed to the faculty's latest publication *Sharpening the focus on corporate fraud - an audit firm perspective*;
- a presentation on assessing and responding to fraud risk factors in a financial statement audit - with practical tips for small and medium-sized firms; and
- key reminders for firms on the Financial Reporting Council's 2019 Revised Ethical Standard, including ethical issues around remote working, role and mindset, professional behaviour in and out of work, and application of the objective, reasonable and informed third-party test.

Recordings are also available on topics ranging from climate risk in the statutory audit to a series on implementing the revised ISA 540. Visit icaew.com/aafwebinars

Climate webinars

Auditors who are closely monitoring developments around climate disclosures and reporting may want to watch a recorded Financial Reporting Faculty webinar (available to all ICAEW members) on the standards recently proposed by the International Sustainability Standards Board. Visit tinyurl.com/AB-ISSBStandards

Faculty members are also reminded that 'Climate risk in the statutory audit' is the subject of a recorded faculty webinar. It features insights from an auditor and from the Financial Reporting Council, and offers practical hints and tips for improving auditing in this area. Visit tinyurl.com/AB-ClimRiskAud



Audit is shaped by the International Standards on Auditing (ISAs). We all know that risk assessment is a fundamental part of an ISA-driven audit approach. When that thorny audit issue of journals testing comes around, however, often risk assessment takes second place to the ‘this is how we always test journals’ approach.

Perhaps you always test the 10 largest journals, those around the year end, and those posted by the Finance Director (FD) on a Saturday. Perhaps there are times when this may be appropriate, but it definitely isn’t always the appropriate thing to do.

This is the first of two articles on journals testing. In it, we will look at the part controls testing plays in journals testing, as we try to navigate a pathway to a more efficient, ISA-compliant approach.

Understanding the entity

Journal entries get more than 40 mentions in the auditing standard on identifying and assessing the risks of material misstatement (ISA 315), with the

main emphasis on understanding the controls in place over journal entries. As we know, journals are mainly used for recording non-recurring, unusual transactions or adjustments.

It’s a good idea to try and segregate the journals into these categories if possible.

Reviewing the audit trail for ‘routine’ transactions being posted as journals is a good starting point. For example, if a business is not using the sales ledger module in its accounting system, but instead is posting all its sales via journals, this should be flagged as a risk in the sales audit work and focus applied there, but then those journals could be excluded from any other generic journals testing. What may be unusual for one business is not necessarily unusual for another.

Of course, in this scenario you should also be reviewing the systems notes and the system design and implementation to ensure the business is following the processes you have recorded.

Non-recurring entries will be those one-offs that the accounting system just does not have a routine for. A new operating lease agreement, share capital issue and fixed asset revaluation are all items where a journal will most likely be deployed. Again, these types of transaction will hopefully have already been flagged as part of the risk assessment elsewhere and so these journals will be subject to scrutiny in other audit sections.

The adjustments are, in the main, going to be corrections to the month-end and year-end adjustments. There may well be some automation

Controls and compliance

The path to an efficient and ISA-compliant approach to journals testing can be hard to find. **Andrew Paul** considers the role of ‘controls testing’



involved and this may bring along its own set of risk considerations.

Having understood why journals are being posted, we must then move on to understand the controls in place over those journal entries. In most journal systems, there are two main elements to understand: who can post journals and who reviews and/or authorises them. The controls around these elements should be strong and eminently testable.

There is also the issue of whether the journals can be changed once they are posted. I recall a conversation with a client who had changed accounting systems and was bemoaning the fact that he could no longer “just go in and change the figures in a journal entry”. He may not have been happy about this, but I was very relieved.

So, what sort of tests of the operating effectiveness of controls could we undertake? Some examples of reasonably straightforward tests which could give good-quality evidence include:

- testing logins to see who has the journal entry screen available;
- testing the ability to change journals;
- testing that journals have been approved/reviewed in a timely manner and by the appropriate person;
- testing that all journals are accompanied by reasonable and appropriate supporting commentary and/or documentation; and
- testing that automated/recurring journals have been reviewed prior to deployment.

As always, these points all need to be considered in the context of the entity you are auditing. The better you know your client, the more able you will be to apply judgement and scepticism to identify unusual journals.

For less complex entities, there may be no controls over the segregation of duties and so a more substantive approach might be needed (and we will explore this route in the next article on journals testing). Where there is some oversight by the board, however, there may still be a control that can be tested and relied upon by the auditor.

Management override of controls

Journals are possibly the most vulnerable area for management override of controls. It may be quite difficult to change the pricing in the sales module or bypass the inventory controls in the warehouse, but having the authority to post a journal and manipulate the financial statements is potentially much easier.

This is why the fraud standard ISA 240 mandates procedures in this area. The specific requirements in paragraph 33 include the following:

- 1 making inquiries of individuals about inappropriate or unusual activity relating to processing journals (ISA (UK) 240 notes that these should be individuals with different levels of responsibility);
- 2 selecting journal entries made at the end of the reporting period (and ISA (UK) 240 goes further by including post-closing entries); and

- 3 considering the need to test journal entries throughout the period.

Let's look at these individually...

- 1 Making inquiries could be seen as part of the ‘understanding the entity’ requirement, but this would be incorrect. The inquiries must not just be high-level ‘in principle’ discussions with management, but practical inquiries of all the key people involved in the process. What actually happens? Does the FD ask the finance assistant to let them post a quick entry using their login? Does the financial controller just sign off any journals in a hurry without really checking? This needs to be a robust discussion with everyone involved to see what happens in real life – and then the risk is assessed, based on the findings.
- 2 Selecting the cut-off journals for testing is of course something where we all know there could be issues, but it is astonishing how often auditors miss this. We must ensure that year-end adjustments are appropriate. The additional requirement in ISA (UK) 240 to look at post-closing entries is also very sensible, as history has shown a number of fraudulent entries that have been reversed in the post-closure period. Auditors must be sure to look for unusual entries in the post-balance sheet period as well.
- 3 The final point is the vaguest, with the word ‘consider’ implying there is a choice of whether to do this testing or not. While grammatically that is correct, in reality an audit file with only cut-off journals being tested is unlikely to pass a quality review, unless there is some solid explanation as to why no entries were tested.

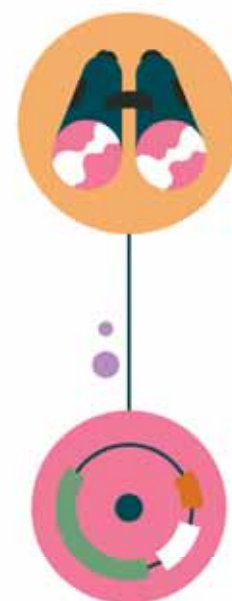
The amount you do, of course, comes back to risk assessment and too much can be as bad as too little, so we’ll consider this further in the second article in this series.

Again, if you are auditing a less complex entity you might feel that there is less risk and therefore less testing required. While this scalability is certainly true of the testing throughout the period, the inquiries and cut-off work will always be required regardless of size.

Is controls testing an option?

Overall, for all audits there is clearly the potential for controls testing in the area of journals. As well as giving audit assurance (or raising concerns) it can provide valuable feedback to those charged with governance and might even have the added advantage of reducing your substantive sample sizes depending on your audit methodology. It is certainly worth thinking about.

Andrew Paul, Audit Software and Technical Manager, Baker Tilly International





Making the most of your tech - and data

Audit firms of all shapes and sizes are using technology to support continuous improvements in audit quality and efficiency, and provide new insights

Audit firms and their audits rely on the application of a growing range of technologies and tech-enabled software and services across both audit-specific and non-audit specific areas.

These range from old favourites, such as software tools to automate aspects of audit engagement and practice management, to myriad tech tools that auditors now rely on to facilitate remote and hybrid working, as well as a host of increasingly smart tools to help auditors get the most from the data they have access to.

When the Financial Reporting

Council (FRC) published its latest *Audit Quality Inspection and Supervision Report* (for seven 'Tier 1' firms) in July 2022 (at tinyurl.com/AB-AQInspect), tech was one of the areas (along with methodology, culture and resourcing) where it found ongoing investment and improvement to improve audit quality. "All firms are continuing to invest in technology such as new audit systems and data analytical tools, and some are looking to the future of audit and developing AI tools," it says.

Smaller audit firms may not be developing their own artificial intelligence (AI) tools, but access

to AI-enabled tools is no longer the preserve of those with the deepest pockets and most extensive resources. Multiple software developers and service providers now offer access to products and services that utilise AI techniques such as machine learning (ML) and neural networks (a type of ‘deep learning’ ML that uses interconnected nodes or neurons in a structure that resembles the human brain).

Smart thinking

Software and services are getting smarter, and so are the ways audit firms (and clients) use them. The audit data analytics specialists Inflo and MindBridge both utilise ML to make processes smarter and faster for auditors, and firms are adapting to make the most of such tools. The 17-partner firm Beever and Struthers has created a team of master’s graduates with data analytics expertise to support its approach to this.

The team has assisted with data ingestion processes and initial analysis and insight. John Toon, Senior Audit Manager and Tech Strategy Lead at Beever and Struthers, says a clear strategy for data analytics use in a specific area of audit is also helpful. “We’ve managed to make better use of analytics around the management override of transactions in financial statements and around journals testing in particular.”

Connect and collaborate

Application programming interfaces (APIs) and the connectivity they enable between separate software and services (and initiatives such as ‘open banking’) also make it easier for auditors to get more from available data. The benefits for Beever and Struthers are shared by Toon in a recent *ICAEW Insights* article (at [tinyurl.com/AB-TechChal](https://www.icaew.com/AB-TechChal)). They include being able to more easily access and combine client data from multiple software products and data repositories.

“We use Circuit for accessing open banking data for our clients. It’s very powerful to have that information available without having to go through the process of a bank confirmation,” says Toon. Beever and Struthers recently started to combine client bank account information (accessed

‘As more processes get automated and more systems can easily access, analyse and exchange data, more possibilities will emerge’

via Circuit) with general ledger data from Inflo. This means teams are spending far less time tracing bits of information through the bank.

This sort of connectivity between systems may create all sorts of opportunities for Beever and Struthers and other audit firms. “We could conceivably get to a point where you will be verifying transactions as they happen in the general ledger, against the bank transactions, almost in real time,” says Toon. As more processes get automated and more systems can easily access, analyse and exchange data, more possibilities will emerge.

Working smarter

As auditors sharpen their focus on fraud (see our recent report on this at [tinyurl.com/AB-FraudFoc](https://www.icaew.com/AB-FraudFoc)), they have increasingly smart tools at their disposal to assist with the identification and investigation of irregularities. Document authenticity tools, for example, can automate analysis of a document’s structure to detect anomalies and identify miniscule ‘micro-misalignments’ that may have been altered or backdated (even by a graphics editing system).



Firms aren’t only working to get the most from software, data and functionality they have access to through relatively recent innovations and investments. Attention is also falling on software tools that auditors (and other accountants) have been using for decades, such as spreadsheets. “Firms have been asking us for practical information on how to do more analysis using spreadsheets,” says Alex Russell, Head of Audit and Assurance Strategy in the Audit and Assurance Faculty – hence the recent *Audit & Beyond* articles.

There are various reasons for this. It’s not just because firms want to get as much as possible from their Microsoft (MS) 365 licensing agreements, although that is an understandable motivation. Software applications are in a constant state of evolution and what MS tools make possible – and how easily – is changing, in ways that can also make it easier for auditors to get more value from MS Excel, other MS applications and the data these tools can be used to access and process.

Take the data ingestion and analysis capabilities of MS Excel, for example. “Power Query tools were an optional add-in when they were first introduced in Microsoft Excel in 2010, but went on to become a built-in option and are now the default method for linking Excel to all sources of external data,” says Excel expert Simon Hurst, who recently shared Power Query tips for auditors in *Audit & Beyond* (at [tinyurl.com/AB-PowerQuery](https://www.icaew.com/AB-PowerQuery)).

As well as using Power Query for data processing and mash-ups, auditors can use MS Power BI for more advanced analytics and to visualise the results. Power BI can be used to create personalised and interactive dashboards and give insights into reports and analyses. The strong integration between MS 365 applications can also make MS Power Automate and MS SharePoint a powerful combination for firms to apply in various aspects of audit and other service lines.

MS Power Automate and MS SharePoint (which is bundled with some versions of Office 365, but not all) can be used together to build workflows that streamline processes, improve efficiency and have a positive ‘knock-on’ effect on audit quality. Power Automate can automatically

update a template based on source files, so a user can point at files stored locally or on SharePoint and, with zero coding, set up a workflow.

“There’s a democratisation process going on,” says Ian Pay, Head of Data Analytics and Tech, ICAEW. “Everyone has access to tools that can be used to do some pretty powerful stuff. You still have data specialists to do the very complex tasks, but that accessibility reaches down right across the spectrum now.”

This is an area where ICAEW has, for some years, been taking steps to support auditors and other members of the accountancy profession with practical resources.

Whether your firm wants to focus on strengthening people’s spreadsheet expertise or equipping them with the skills to make better use of specialist audit data analytics tools, ICAEW can help.

- The Excel Community offers articles, Excel hints and tips, webinars and an extensive 19-part introduction to financial modelling (at tinyurl.com/AB-ExcelCom);
- The Data Analytics Community assists finance professionals to

‘Whether your firm wants to strengthen people’s spreadsheet expertise or equip them with the skills to make better use of audit data analytics tools, ICAEW can help’

develop advanced data analytics and visualisation skills – with articles, events, a newsletter and other resources (at tinyurl.com/AB-DataCom); and

- ICAEW’s Data Analytics Certificate programme (developed with Kaplan Financial) offers the profession two distinct learning pathways. The first is for analysts and the second is aimed at management (at tinyurl.com/AB-DataCert).

The auditor’s increased use of third-party tech is not, of course, without some risks. This is reflected in requirements in the new international

quality management standards. You may want to review the faculty guidance regarding this issue (see box, below) at tinyurl.com/AB-ThirdPartyTech

For many firms, tech is also part of the process of designing, implementing and operating a system of quality management (SoQM) under ISQM 1. “I decided to have a piece of software because otherwise it can get messy,” says Rachel Davis, Managing Director of Just Audit, a firm she launched to do just that.

In an ICAEW Insights article (at tinyurl.com/AB-TechTrain), Davis outlines the role of tech and training in Just Audit’s preparations for the new QM standards. But it’s vital to remember that ISQM 1 requires each firm to tailor its approach to QM.

Tech platforms may help to make the process of designing an SoQM less daunting for some firms, while other firms may prefer to design their own SoQM – and the responsibility for design, implementation and operation rests with the firm alone. As is often the case with tech use by auditors, it helps, but it’s no replacement for professional judgement.



The quality of software and services

Given the extent to which audit firms now depend on external providers of software and tech-enabled services, it is perhaps unsurprising that this is on the radar of standard-setters such as the FRC and the International Auditing and Assurance Standards Board. As each firm works to implement the new International Standards on Quality Management (ISQMs), it will need to consider its use of these and other third-party providers.

One of the key concepts underlying ISQM 1 is that a firm is solely responsible for the design, implementation and operation of its own system of quality management (SoQM) – even where it obtains resources (such as manuals, software tools, training, methodology and so on) from service providers. Given the extensive use of external service providers, these new QM requirements are important.

As well as supplying, implementing and maintaining the software and services mentioned above, there are many other kinds of tech-enabled third-party software, tools and services that firms may be utilising. Each firm will need to consider whether such resources are appropriate for use within its SoQM or the performance of engagements. The faculty has produced a guide that will be of assistance: *ISQM 1: Use of resources obtained from service providers*.

This guide outlines the requirements of ISQM 1 and the types of information that may help audit firms be in a position to identify and assess quality risks in relation to the quality objectives in ISQM 1 and their use of resources from service providers. It walks member firms through the information they might need for four types of resources: methodologies; training provision; software; and audit quality support services such as file review/technical consultations. Learn more at tinyurl.com/AB-ServProv

For firms carrying out United States (US) foreign school loan audits, the US Department of Education (DoE) requires them to comply with US Government Auditing Standards. However, where firms might not be able to fully comply with these requirements, this article discusses an alternative approach that firms may be able to consider.

In March 2020, the US DoE issued an updated Foreign School Audit Guide, which superseded its September 2002 version. The guide applies to financial statement audits and compliance attestation engagements of foreign schools that take part in the US DoE's William D Ford Federal Direct Loan Program. It is effective for years ending on or after 31 December 2020. The programme offers direct loans to US citizens and foreign institutions, including UK universities, can also apply to participate in the programme.

Included within the guide is a template independent accountant's report for 'standard compliance attestation engagements', which includes a statement that the engagement has been carried out in compliance with 'the standards applicable to attestation engagements contained in Government Auditing Standards'. We are aware, however, that firms may find it difficult, or be unable, to comply with these standards.

Firms may wish to consider instead applying International Standard on Assurance Engagements (ISAE) (UK) 3000 (July 2020) *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*.

This UK version of the international standard was adopted by the Financial Reporting Council (FRC) in 2020 (see panel) and is mandatory for engagements designated as 'public interest assurance engagements' by the FRC and voluntary for other assurance engagements, unless the FRC has issued a subject-matter-specific assurance standard relevant to the engagement.

Firms are advised to liaise with the engaging university and the US DoE to discuss their reporting requirements and whether this alternative option would be acceptable. Where this is possible, firms could report under ISAE (UK) 3000 and submit an accountant's report without reference to US Government Auditing Standards and specific requirements such as external peer reviews, as this is not necessitated by ISAE (UK) 3000.

Firms can find further information on the 2020 US DoE guide (in pdf format) at tinyurl.com/AB-ForeignSchool

ISAE (UK) 3000 resources

ISAE (UK) 3000 is available on the FRC website in the section on 'Other Standards and Guidance' (at tinyurl.com/AB-OtherStandards).

Firms are reminded that after ISAE (UK) 3000 was adopted by the FRC, ICAEW created resources to support firms with its application.

A Q&A is available outlining:

- the scope of the UK standard; and
- what's different about it by comparison with ISAE 3000 (Revised), issued by the International Auditing and Assurance Standards Board (available on the IAASB website at tinyurl.com/AB-IAASBCompare).

To view the Q&A, visit tinyurl.com/AB-ISAEQandA

A broad range of assurance-related resources is available from the Audit and Assurance Faculty at tinyurl.com/AB-AuditAssur

These resources include practical guidance for practitioners and their clients on how assurance engagements are planned, undertaken and reported (under ISAE 3000). See tinyurl.com/AB-AssurProcess

Overcoming compliance challenges

Firms that may not be able to fully comply with US government guidance on foreign school loan audits may wish to consider applying ISAE (UK) 3000



Routes to making meaningful progress

Alex Russell and **Amy-Joy Butler** consider some of the UK government's proposals for improving the quality of audit and corporate governance – and the profession's reactions

As part of the wider shake-up of corporate governance and audit reform, two measures that interact with each other and have the potential to drive improvements in corporate reporting and audit quality are the UK government's proposals for companies to write a Resilience Statement and to publish a triennial Audit and Assurance Policy (AAP). ICAEW is urging companies to get ahead of the new requirements and for audit committees and auditors to engage now with the steps required. This article outlines where we are, how we got here and what the profession is doing to progress the proposals.

On 31 May 2022, the UK government unveiled its plans for corporate reporting and audit, following the 2021 consultation on its White Paper on *Restoring Trust in Audit and Corporate Governance* (at [tinyurl.com/AB-AuditTrust](https://www.tinyurl.com/AB-AuditTrust)).

Initial reactions to that Feedback Statement were somewhat muted, with disappointment expressed at the lack of progress towards a more robust internal controls regime in the UK. There is a high degree of uncertainty around which measures will be progressed and a vague timeline. However, the profession is focused on progressing those proposals that can be kicked off without legislation or new regulation, while continuing to put pressure on further reform.

A policy for progress

In 2021, ICAEW's Audit and Assurance Faculty published *Developing a Meaningful Audit and Assurance Policy*, which is helping to inform the debate. An updated version is set to be published shortly. In the first edition of our report, we examined the challenges companies may have to overcome when creating an AAP and made nine recommendations to help a policy meet its full potential. We urged companies to get ahead of the new requirements and encouraged audit committees and auditors to engage with the steps required in preparing for the AAP. Following the government's Feedback Statement, this rings true more than ever, and some companies are already producing AAPs.

Public Interest Entities (PIEs) will be required to publish their AAP every three years – and more companies may find they are in this category. Forthcoming legislation is expected to classify companies with more than 750 staff and an annual

turnover of more than £750m as PIEs. These companies will also need to publish annual implementation reports on how their assurance procedures work in practice.

A recent ICAEW Insights article considers some fundamental steps for getting the AAP right (at [tinyurl.com/AB-AAPPolicy](https://www.tinyurl.com/AB-AAPPolicy)). In this, Jayne Kerr, PwC Director, Audit Public Policy, notes the importance of mindset. "The AAP is more than a compliance exercise. It is a really important way for directors to take a fresh look at the type of financial and non-financial information they're issuing, how they reach a comfort level with it and how internal and external stakeholders can rely upon it," she says.

Government proposals

Possible AAP requirements set out by the government include:

- setting out whether and how the company has sought independent assurance on all or part of the Resilience Statement, or over its internal controls framework;
- describing the internal auditing and assurance process;
- describing the company's policy in relation to the tendering of external audit services;
- stating whether any independent assurance proposed within it will be 'limited' or 'reasonable' assurance, or whether an alternative form of engagement or review will be undertaken;
- stating whether any independent assurance beyond the statutory audit will be carried out according to a recognised professional standard; and
- more generally, focusing on how companies are ensuring the integrity of their annual statutory and voluntary disclosures beyond the financial statements, demonstrating that these disclosures are underpinned by robust and reliable internal processes.

Guidance on the AAP is expected to come from the Financial Reporting Council. The government noted in its Feedback Statement that for PIEs that are required to produce an audit committee report, the AAP itself and the annual implementation report on the AAP should be published within the same section of the annual report as the audit committee report.

For other companies that are PIEs by virtue of the new size threshold, which will not be required to have an audit committee, it has not yet been decided whether the AAP should be in the strategic report or somewhere else in the annual report.

Closing expectation gaps

As ICAEW's AAP publication notes: "The expectation gap between the confidence and assurance that the statutory audit currently delivers, and the understanding of shareholders and other users as to what is assured has been at

the heart of a number of recent reports, including the Brydon Report.” The AAP might offer the profession the opportunity to dispel some misunderstandings if used to its full potential. The AAP “offers the means to describe the role the external auditor plays, both through the statutory audit and other assurance activities”.

The AAP also has the potential to underpin progress in audit committees’ and investors’ understanding of limited and reasonable assurance and encourage them to focus on the need for assurance in areas such as cyber security and environmental, social and governance reporting. Importantly, the government sees the AAP as a vehicle for setting out which parts of the Resilience Statement have been subject to assurance.

Risk and resilience issues

The new Resilience Statement will subsume the existing Going Concern and Viability Statements. The statement needs to include how the company is addressing risks or resilience issues, including threats to business continuity, supply chain and cyber security.

The new legislation will include the requirement for at least one reverse stress test – according to the nature, size and complexity of each business – to be chosen by the company and outlined within the statement. ICAEW issued guidance on reverse stress testing for entities and auditors with the pandemic in mind, but the information it contains remains relevant, for entities and auditors (at tinyurl.com/AB-StressTest).

A recent ICAEW Insights article considers the government proposals to introduce a Resilience Statement for PIEs, and shares some of the profession’s responses to this. “The Resilience Statement is certainly providing a framework that should provide investors with greater insight and information,” says Mark Kennedy, Partner, Audit and Assurance, Mazars. “In doing so, it will drive a greater focus among boards and auditors on a more holistic expression of the position of a particular company.”

It has been widely acknowledged that disclosures under the Viability Statement often lacked specificity and sufficient detail to assure investors and other stakeholders that a company could deal with any potential business shocks.

In its 2021 response to BEIS, ICAEW said: “To effect real change, it is important that the proposals for a Resilience Statement do not simply result in a different type of boilerplate reporting. To ensure meaningful improvements to the quality of reporting, the Audit, Reporting and Governance Authority (ARGA) must emphasise directors’ accountability for the quality of this statement and ensure it is not seen simply as an extended Viability Statement.”

The jury is still out on whether the Resilience Statement will restore trust among investors. As Kennedy observes: “The quality of reporting

derives not just from the framework, but also on the extent to which professional reporters really engage with the unique nature of a company.”

To this end, the proposals for the Resilience Statement are designed with some degree of flexibility and tailoring to the entity in mind. Instead of mandating a common set of risks, companies may be expected to “report on matters that they consider a material challenge to resilience over the short and medium term, together with an explanation of how they have arrived at this judgement of materiality”.

Kennedy goes on to say: “It is unavoidably forward-looking – it is in essence forecasting, which ‘usually tells us more of the forecaster than of the future’, as Warren Buffet famously said.”

Clarity and balance

It is expected that the government will publish a draft bill on the proposed reforms late in 2022. Once the detail is clearer, it is hoped that new legislation will be published in 2023, giving enough time for all stakeholders to get to grips with the new regime.

As this agenda moves forward, ICAEW and others within the profession will need to take a keen interest and apply pressure to ensure that what comes through is not asymmetrical, focusing unduly on auditors, for example, rather than other areas of the corporate reporting ecosystem.

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When QAD comes to call

Knowing more about when and what to expect from a QAD audit monitoring visit can help your firm to be adequately prepared for coming changes

Audit firms regulated by ICAEW are subject to monitoring by the Quality Assurance Department (QAD). Why and when your firm is selected for an audit monitoring visit by QAD depends on a number of factors. They include the size and complexity of your firm, its regulatory history and whether any UK entities the firm audits are within scope of the Audit Quality Review (AQR) team of the Financial Reporting Council (FRC).

The FRC monitors the audits of public interest entities, such as banks, listed companies and insurance providers, and procedures relating to these engagements, together with certain other 'retained audits'. QAD is responsible for monitoring all other audit work in ICAEW-registered firms, from the Big Four to small practitioners, including firms registered under the Crown Dependencies' recognised auditor oversight regime.

When, why and what

ICAEW is required by law to conduct monitoring visits to all firms registered for audit. All firms will be familiar with the six-year visit cycle, but also need to

be aware that they may be selected for monitoring visits more frequently. The six-year cycle means that QAD must review the audit work of every ICAEW-registered audit firm at least every six years. A visit can, however, occur at any time – a six-year gap between reviews is not an automatic default. As required by statute, ICAEW uses a risk-based approach to select companies for visits and some firms will receive more monitoring visits than others.

Larger firms, in particular, will already be used to more frequent monitoring visits, with some visited by QAD every one-to-two years. In response to changes in the audit market, the growth of challenger firms and some more complex audits moving away from the largest audit firms, ICAEW is increasing its activities to monitor the audits undertaken across firms registered for audit with ICAEW.

This means that more firms may be selected for accelerated monitoring visits. QAD will also be contacting some firms between monitoring visits about particular audit clients, or groups of audit clients. The extra contact points may take the form of

a meeting and/or review of completed audit files and will be in addition to standard audit monitoring visits.

New International Standards on Quality Management (ISQMs) will also be reflected in QAD's approach to audit quality monitoring in future. The shift from quality control to quality management is not insignificant and from January 2023, QAD audit monitoring visits will include review of the firm's ISQM 1 implementation. Also, early in 2023, QAD will contact selected audit firms for a survey on ISQM 1 implementation (see panel).

These changes in the nature and scope of ICAEW's audit and risk monitoring will support firms to develop their audit practices and maintain high standards.

Support resources

In many ways, preparing for and managing your firms audit quality monitoring review by QAD will, nonetheless, be 'business as usual'. To assist, there are plenty of ICAEW resources available offering insights and tips to help your firm to be ready for what's coming before, during and after a visit. You may want to start

your journey with one of the following.

'Quality assurance monitoring of ICAEW audit firms' offers information and links to various related resources (at tinyurl.com/AB-WorkInAudit).

The hub page includes:

- explanations of ICAEW's regulatory role (as a recognised supervisory body) and FRC oversight of ICAEW audit monitoring work;
- links to the annual overview of QAD audit monitoring activities and reports;
- information on the visit process for QAD audit monitoring reviews, covering matters such as the scope, review of audit files and concluding and reporting on visits; along with a link to the document *Your audit monitoring visit review* (at tinyurl.com/AB-YourVisit). This document provides practical pointers on aspects of the audit monitoring visit, such as:
 - information you will need to have available for the start of your QAD visit;
 - what to expect from the opening meeting and review;
 - what to expect if yours is a larger, multi-partner firm;
 - QAD monitoring visits to firms with at least one audit that's 'retained' by the FRC and subject to monitoring visits by its Audit Quality Review team;
 - the closing record that follows a QAD review;
 - your firm's response to QAD review findings; and
 - possible outcomes.

'Audit monitoring FAQs' deals with questions that are often asked about processes around the review process, onsite review and other related matters. How does ICAEW decide on the number of audit files to review? What is ICAEW's view about keeping queries from partner and manager reviews on the audit file? I am a small firm, why are you visiting me for two days? Find answers to these and other questions at tinyurl.com/AB-AuditQuestions

'Managing an ICAEW audit monitoring visit' is a faculty webinar recorded during December 2020. At just under an hour long, it offers firms of all shapes and sizes a wealth of insights and practical details from its two presenters, an experienced auditor and a seasoned QAD reviewer. A recording is available on demand at tinyurl.com/AB-ManageAuditVisit

QAD MONITORING OF ISQM 1

From January 2023, QAD audit monitoring visits will include review of the firm's ISQM 1 implementation. ISQM 1 and the system of quality management (SoQM) represent a significant shift away from the reactive quality control requirements of ISQC 1 that firms are familiar with, to a more proactive approach to quality management.

The new SoQM will ensure that your quality management procedures evolve with your audit firm and its clients, with key components of risk assessment, monitoring and evaluation.

Many of your firm's existing quality control policies and procedures will remain relevant within the new framework and originate in UK Audit Regulations (at tinyurl.com/AB-AudRegsGuide) that pre-date the original ISQC1 in 2005. However, firms should take this opportunity to reassess, refresh and update existing procedures.

Firms need to have designed and implemented their SoQM by 15 December 2022 and must perform an evaluation of the SoQM by 15 December 2023. Operating an SoQM is an iterative process; all firms will need a good starting point on 15 December 2022 and the SoQM will develop and improve over time.

QAD is working with the Audit and Assurance Faculty to support its implementation guidance for ISQM1. You can stay up to date on the latest developments and access resources by visiting the hub for 'Quality management in audit firms' (at tinyurl.com/AB-QMAuditHub), reviewing the technical guidance and best practice advice in the latest editions of 'Audit News' (at tinyurl.com/AB-AuditNewsEditions) and reading *Audit & Beyond*.

There is considerable interest from firms, keen to understand QAD's planned approach to monitoring compliance with the new requirements.

In early 2023, QAD will contact a sample of audit firms to ask for further information about their implementation of ISQM1, including details of their risk assessment and background supporting information about their audit clients and staff. Subsequently, insights and good practice from this survey will be shared for the benefit of all ICAEW audit firms. Depending on the results, similar surveys may be conducted in 2024 and 2025 expanding into evaluation and monitoring requirements.

The review of ISQM 1 implementation during audit monitoring visits (from January 2023) will provide an opportunity for the firms involved to discuss their SoQMs with a QAD reviewer. Firms can draw on their reviewer's experience to assist them in identifying potential areas where further development and improvements to the procedures are needed.



Question corner

This month **John Selwood** deals with some familiar questions that come around again and again

During a recent monitoring visit, my firm was criticised for entertaining our audit clients. I thought that the Ethical Standard only addressed the situation where the auditor received the hospitality. I have been in the profession for many years and in my experience my audit clients expect my firm to entertain them at nice restaurants.

During the pandemic, independence issues arising from hospitality dropped off the agenda for many audit firms, for obvious reasons. I have noticed that some people are now making up for lost time.

It seems that you have fallen into a common pitfall in not appreciating that the Financial Reporting Council's (FRC's) Revised Ethical Standard 2019 refers to hospitality accepted and received. The standard is now very clear that hospitality is a two-way street, for independence purposes, as you will see from the emphasis I have added in the extract below.

Policies adopted by audit firms on hospitality vary enormously. Some firms adopt financial thresholds that are positively puritanical. Even a cheeky Nando's would be borderline. Other firms are more permissive.

Deciding what hospitality is and isn't acceptable is very much down to a matter of professional judgement in applying the standard, which states (para 4.40): "A firm, its partners and any covered person, and persons closely associated with them, shall not **offer or accept*** pecuniary and non-pecuniary gifts or favours, including hospitality, from an entity relevant to the engagement, or any other entity related to that entity, unless an objective, reasonable and informed

third party* would consider the value thereof as trivial or inconsequential." (* Emphasis added for the purposes of this article.)

The 'third party' test is key here. I don't think that a third party would solely consider the financial value of the hospitality. Context would also be relevant. I think that they are more likely to consider a working lunch to be trivial than an evening event that is purely social.

Having said that, in my personal opinion, a third party is not likely to consider a swanky restaurant to be trivial. I recommend that you revise your hospitality policy to take this into account.

You may also want to refresh your memory by watching a recent faculty webinar on the FRC Ethical Standard (learn more later in this article and by visiting [icaew.com/aafwebinars](https://www.icaew.com/aafwebinars)).

It shares some lessons learned and offers some useful reminders for firms. Among other things, the webinar includes a section on application of the 'Objective, Reasonable and Informed Third Party test'.

You will find the Revised Ethical Standard 2019 on the FRC website along with the latest glossary of terms and other related documents (at tinyurl.com/AB-FRCEthicStandard).

'The standard is now very clear that hospitality is a two-way street, for independence purposes'

Can you clarify what sole practitioners should do when they have been auditing an entity for 10 years or more? Must I have an external review every year now?

What you are referring to here is commonly known as the '10-year rule', which applies for audits of entities that are not listed and are not public interest entities (PIEs). For PIEs and listed entities, the rules are different.

The Revised FRC Ethical Standard 2019 has a fair amount to say on all of this in Section 3, Long Association with Engagements and with Entities Relevant to Engagements. I'll briefly paraphrase.

Where an engagement partner has been in that role for 10 years, the familiarity threat has to be considered. This has to be communicated to management and safeguards must be applied.

The obvious issue here for sole practitioners is that second partner review is the most commonly used safeguard, under the so-called '10-year rule', and that option is, of course, not easily available for sole practitioners.

While an external file review would be an appropriate safeguard (and a properly robust one), it is not the only safeguard that could be applied. You might have sufficiently experienced senior managers in the firm that could perform a review. Also, you might decide to give up the audit, although many would consider this an extreme choice.

However, I accept that more often than not, there is nobody sufficiently senior and experienced in the firm to do this and an external review is the only option.

There will be circumstances in which the threats to independence are such that the external review must be performed every year, but equally, sometimes it might be sufficient for this review to be performed on a rotational basis, every two or three years. As always, professional judgement is needed.

To inform this judgement, you may want to give the relevant sections of the Revised Ethical Standard 2019 a read through. As I suggested in my response to the previous question, also watching the recent faculty webinar on the standard may prove to be a good use of your time.

Faculty webinar on Revised Ethical Standard 2019

The FRC's Revised Ethical Standard 2019 came into effect on 15 March 2020 and aimed to strengthen auditor independence, prevent conflicts of interest and improve audit quality.

The audit profession has had more than two years to digest, understand and apply the standard and there have been plenty of opportunities to learn lessons. This July 2022 faculty webinar draws on one firm's experience with applying the key changes introduced in the revisions, explores some of the requirements in more detail and highlights some of the more recent emerging issues for firms to consider.

The webinar covers:

- what we have learned, two years on, including application of the Objective, Reasonable and Informed Third Party test;
- horizon scanning - anticipated changes down the road;
- role and mindset;
- ethical issues around remote working; and
- non-financial conduct - professional behaviour in and out of work.

The webinar is available on demand at icaew.com/aafwebinars

'Thinking that investment manager reports are always third-party evidence is, unfortunately, a common mistake'



When auditing investments managed by investment managers, I have always used the annual report, from the managers, as a third-party confirmation. I am now being told that this is not good enough. I always thought that third-party confirmations were high-quality evidence. What am I missing?

For audit purposes, investment managers are often not third parties, they are service organisations. Thinking that investment manager reports are always third-party evidence is, unfortunately, a rather common mistake.

The audited entity often uses the investment manager as a service organisation, in that the investment manager maintains the only record of the assets held, income received, profits and losses on sale and revaluation gains and losses. Therefore, the entity has outsourced an element of its internal controls.

This means that the annual report provided to management by the investment managers is part of the audited entity's internal controls and cannot be relied upon as audit evidence. When the investment managers are treated as a service organisation, the auditors should:

- consider obtaining a 'Type 2' report, if there is one;
- obtain audit evidence to support the valuation of the investments; and
- obtain audit evidence to support the ownership and existence of investments.

If you aren't too sure what I mean by a 'Type 2' report, I can understand why – there are a number of contenders. Fortunately, I can point

you at some ICAEW resources that will be helpful.

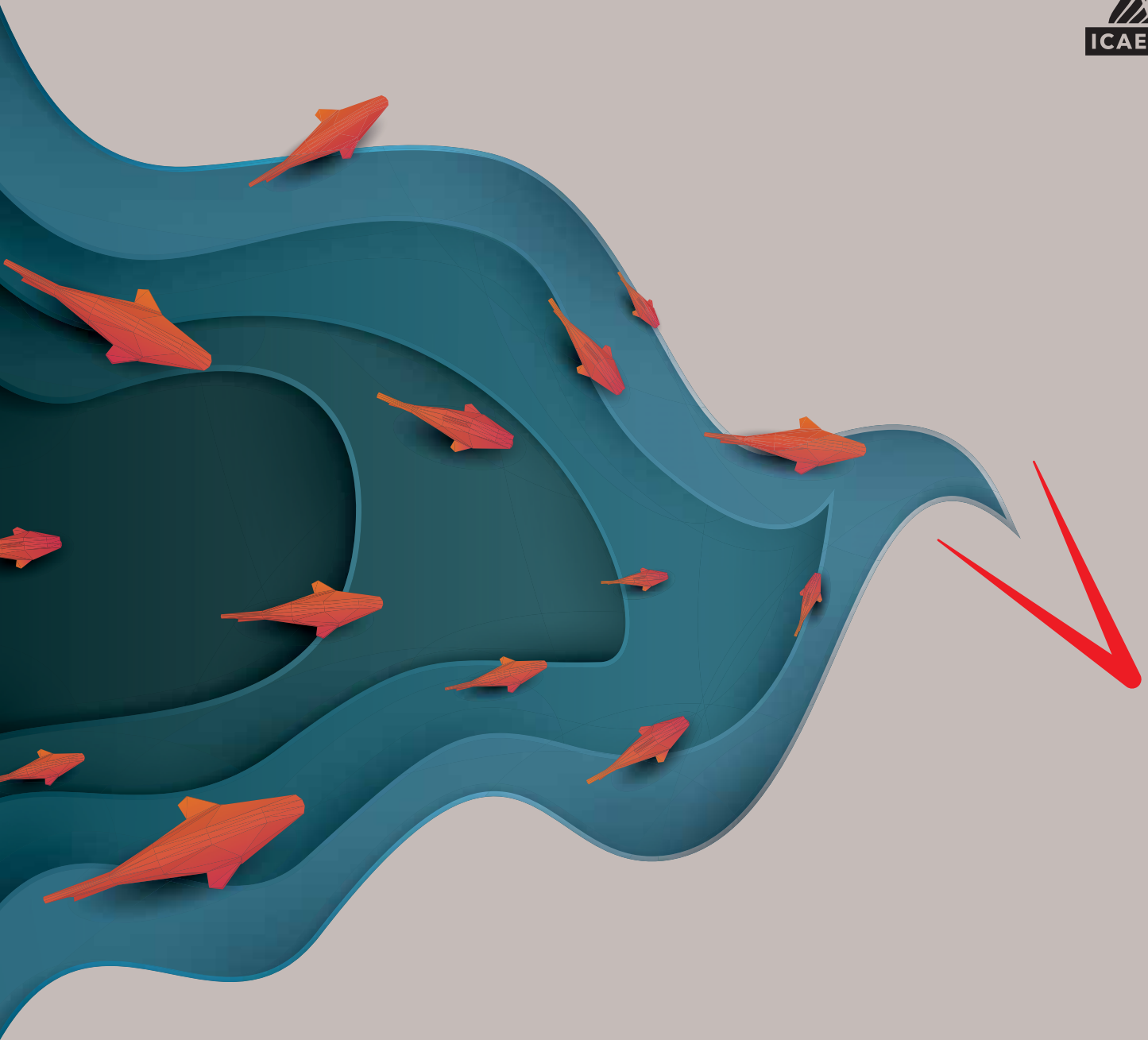
In 2020 the faculty published a Technical Release TECH 01/20 *Assurance reports on internal controls of service organisations made available to third parties* (at tinyurl.com/AB-AAFInternal).

It includes information on Type 1 and Type 2 reports, with explanations, examples and templates. This offers information you may find useful on comparable guidance and standards including ISAE 3402 and SSAE 18 SOC 1 and SSAE 18 SOC 2.

TECH 01/20 was published as a replacement for the Technical release AAF 01/06. TECH 01/20 features updated terminology that aligns with the terminology in ISAE 3402 and in SOC 1 and SOC 2.

You will find an *Audit & Beyond* article introducing TECH 01/20 at tinyurl.com/AB-TechIntro

John Selwood, freelance lecturer and writer



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

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