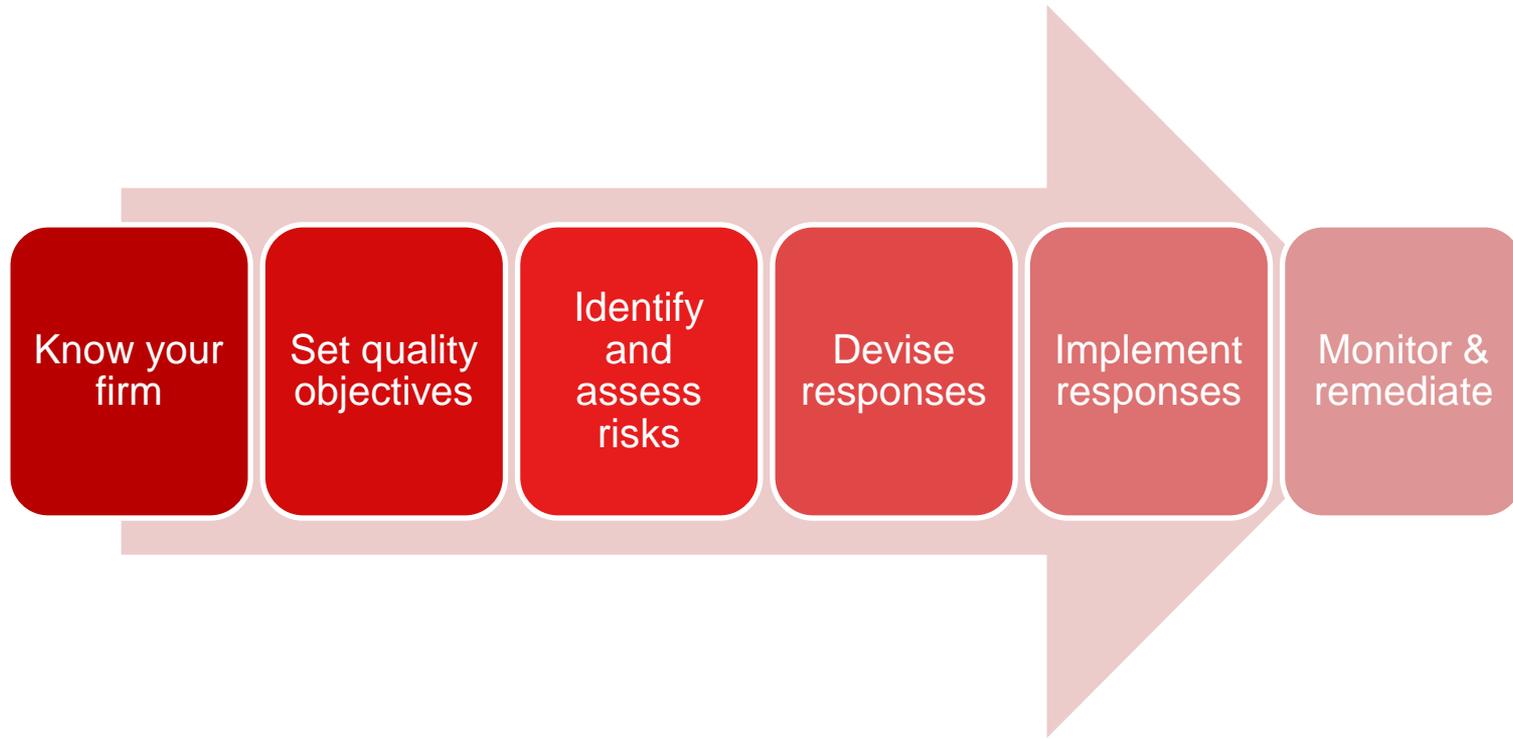


ISQM – How to Effectively Manage Audit Quality

John Selwood



ISQM 1 Implementation – 15 December 2022



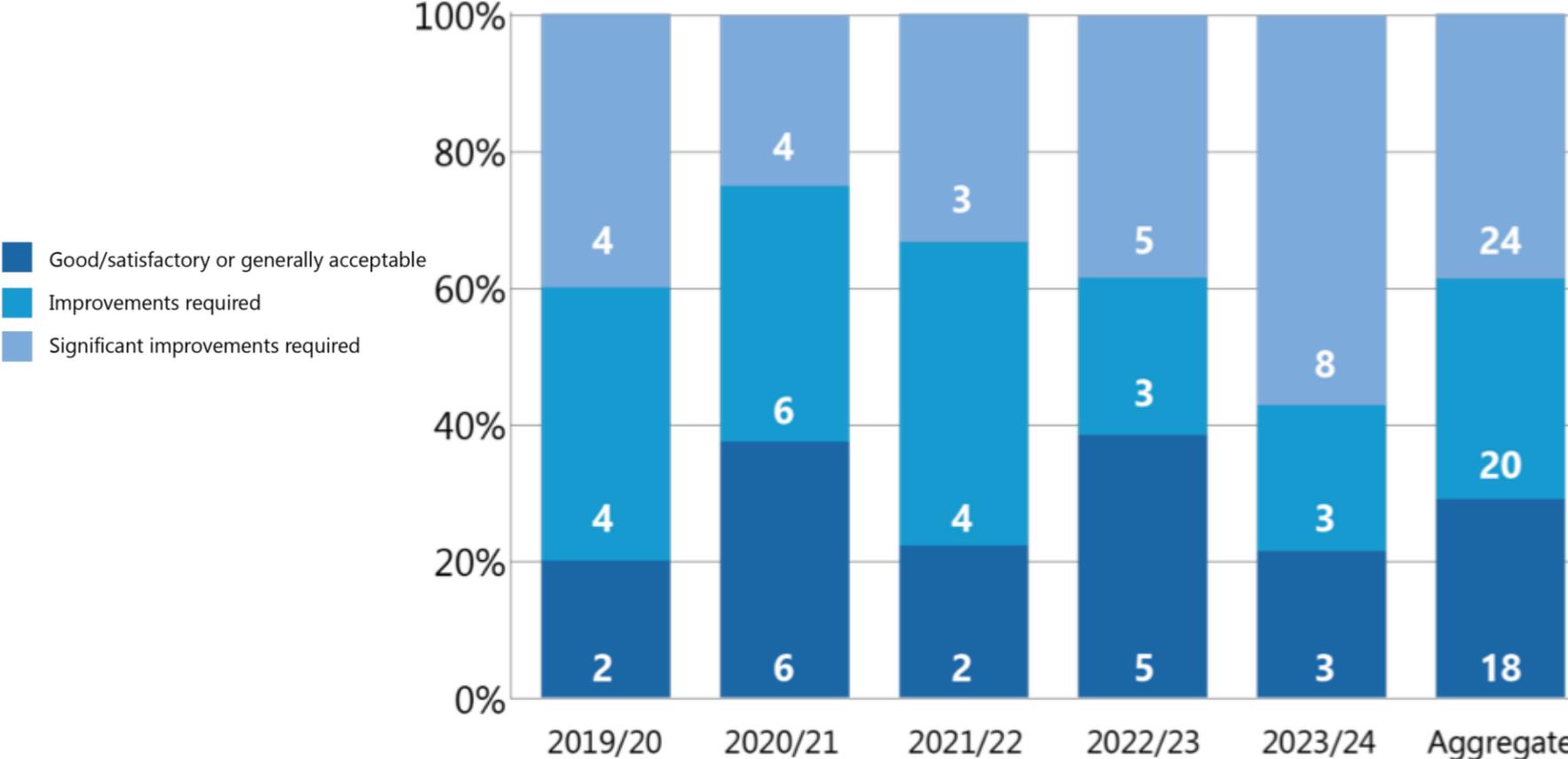
Why is QM important? – QAD feedback

2023/34

- 71% of 761 audits reviewed were either good or generally acceptable, which is the same figure as in 2022/2023.
- 8% of audit files were rated as 'requiring significant improvements' with the balance requiring improvements



Why is QM important? – FRC feedback



Highlights

ISQM (UK)
1 • Previously International
Standard on Quality Control 1

Brief refresher

ISQM (UK)
• Engagement quality reviews

Not so long ago, the only way you knew that your motor vehicle needed a repair was when it broke down or when your motor vehicle went in for service. As motor vehicles developed, so did various onboard monitoring mechanisms. These were placed into motor vehicles resulting in various lights that could appear on the vehicle's dashboard. By having a more effective monitoring mechanism in place when various lights appeared, the driver would know if the issues were serious or not, can the motor vehicle be driven any further, or can the matter wait.

Monitoring and remediation



Feedback from FRC



Feedback from QAD



Sum up

Brief refresher

New Standards - 2022

ISQM (UK)
1

- *Previously International Standard on Quality Control 1*

ISQM (UK)
2

- *Engagement quality reviews*

ISA (UK)
220

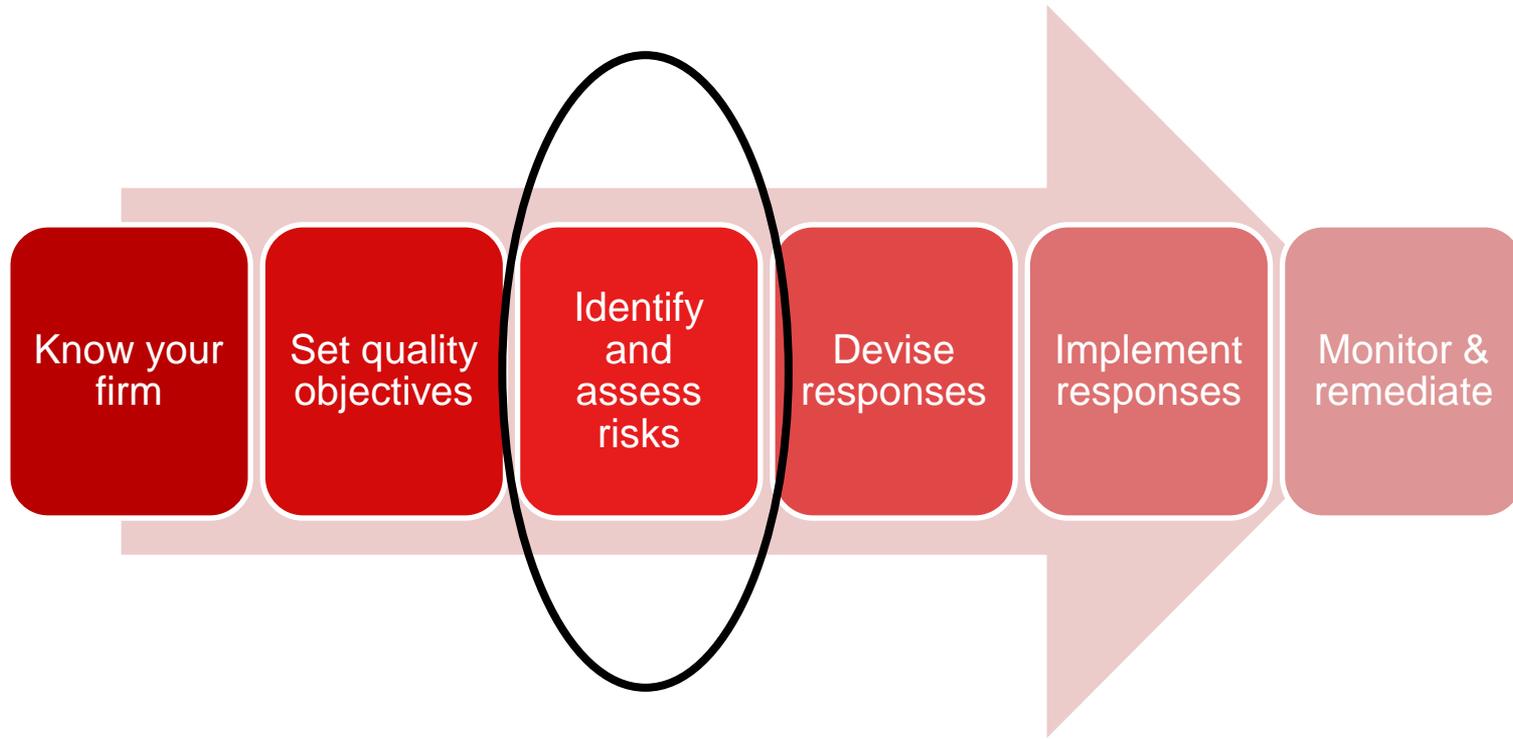
- *Previously Quality Control for an Audit of Financial Statements*

New Standards - 2022

Key changes from ISQC 1

- A more proactive and **tailored** approach to managing quality which is focused on achieving quality objectives by identifying risks to those objectives and developing responses to those risks.
- Enhanced requirements to address the firm's governance and leadership, including increased leadership responsibilities.
- Expanded requirements which aim to modernise the standard and reflect factors which affect the firm's environment, including requirements to address technology, networks and the user of **external service providers**.
- New requirements that address information and communication, including communication with external parties.
- Enhanced requirements for **monitoring and remediation** to promote more proactive monitoring of the system of quality management as a whole and effective and timely remediation of deficiencies.

New Standards – Feedback from firms



Risk assessment



1. Understand conditions, events, circumstances that may adversely affect the achievement of quality objectives



2. Identify related risks – and related quality objectives

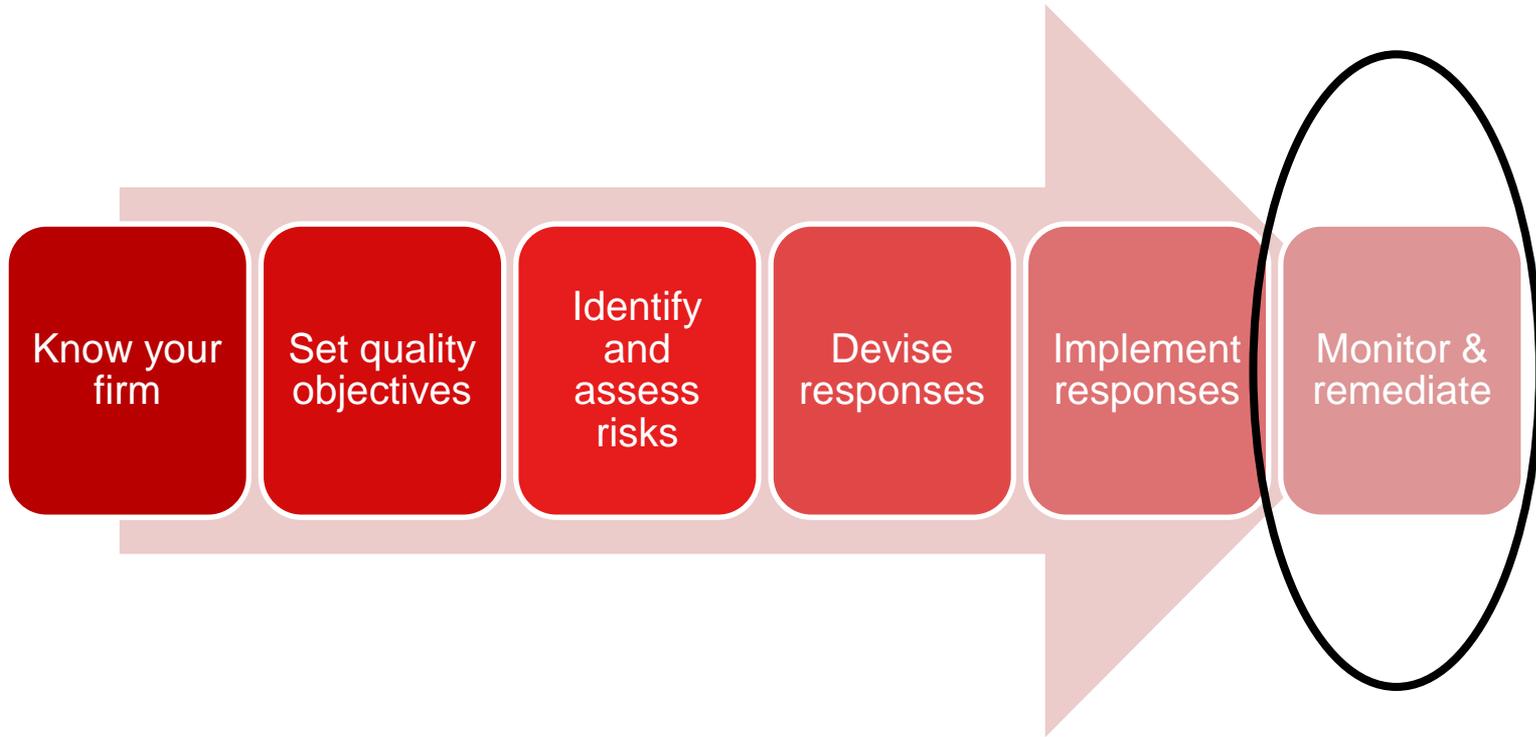


3. Assess risks



4. Design and implement responses to address the risks in a manner that is based on and responsive to the risk

New Standards – Feedback from me!



ISQM 2 - Engagement Quality Reviews (EQRs)

Are
required
for:

- Audits of financial statements of listed entities;
- Audits or other engagements for which an engagement quality review is required by law or regulation; (Ref: Para. A133)
- Audits or other engagements for which the firm determines that an engagement quality review is an appropriate response to address one or more quality risk(s); (Ref: Para. A134-A137)
- Audits of financial statements of public interest entities;
- Public reporting engagements carried out in accordance with the Standards of Investment Reporting; and
- Engagements for which an engagement quality review is required by the FRC's *Providing Assurance on Client Assets to the Financial Conduct Authority* standard (Revised November 2019).

ISQM 2 - Engagement Quality Reviews (EQRs)

‘In some cases, the firm may determine that there are no audits or other engagements for which an engagement quality review or another form of engagement review is an appropriate response to address the quality risk(s)’

ISQM (UK) 1 para

Monitoring and remediation

Overview

The International Auditing and Assurance Standards Board uses the following analogy when explaining the monitoring and remediation process.

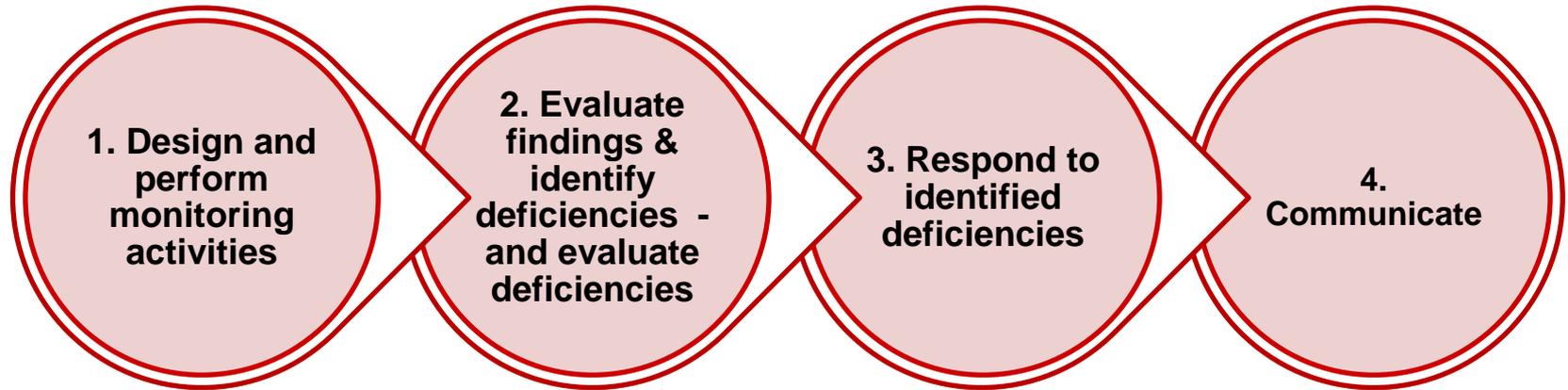
Not so long ago, the only way you know that your motor vehicle needed a repair was when it broke down or when your motor vehicle went in for service. As motor vehicles developed, so did various onboard monitoring mechanisms. These were placed into motor vehicles resulting in various lights that could appear on the vehicle's dashboard. By having a more effective monitoring mechanism in place when various lights appeared, the driver would know if the issues were serious or not, can the motor vehicle be driven any further, or can the matter wait until the next service. Similarly, with the same analogy, the same should be able to be applied to the firm's quality management system through its monitoring and remedial activities.

Objectives of monitoring and remediation

Objectives

- To monitor SoQM so that the firm has relevant, reliable and timely information concerning the design, implementation and operation of the SoQM
- To respond to identified deficiencies such that these deficiencies are corrected on a timely basis so that they do not reoccur

Objectives of monitoring and remediation



Problem areas in practice

Overview

Evaluate and update SoQM

Use a broad range of monitoring tools – not just cold file reviews

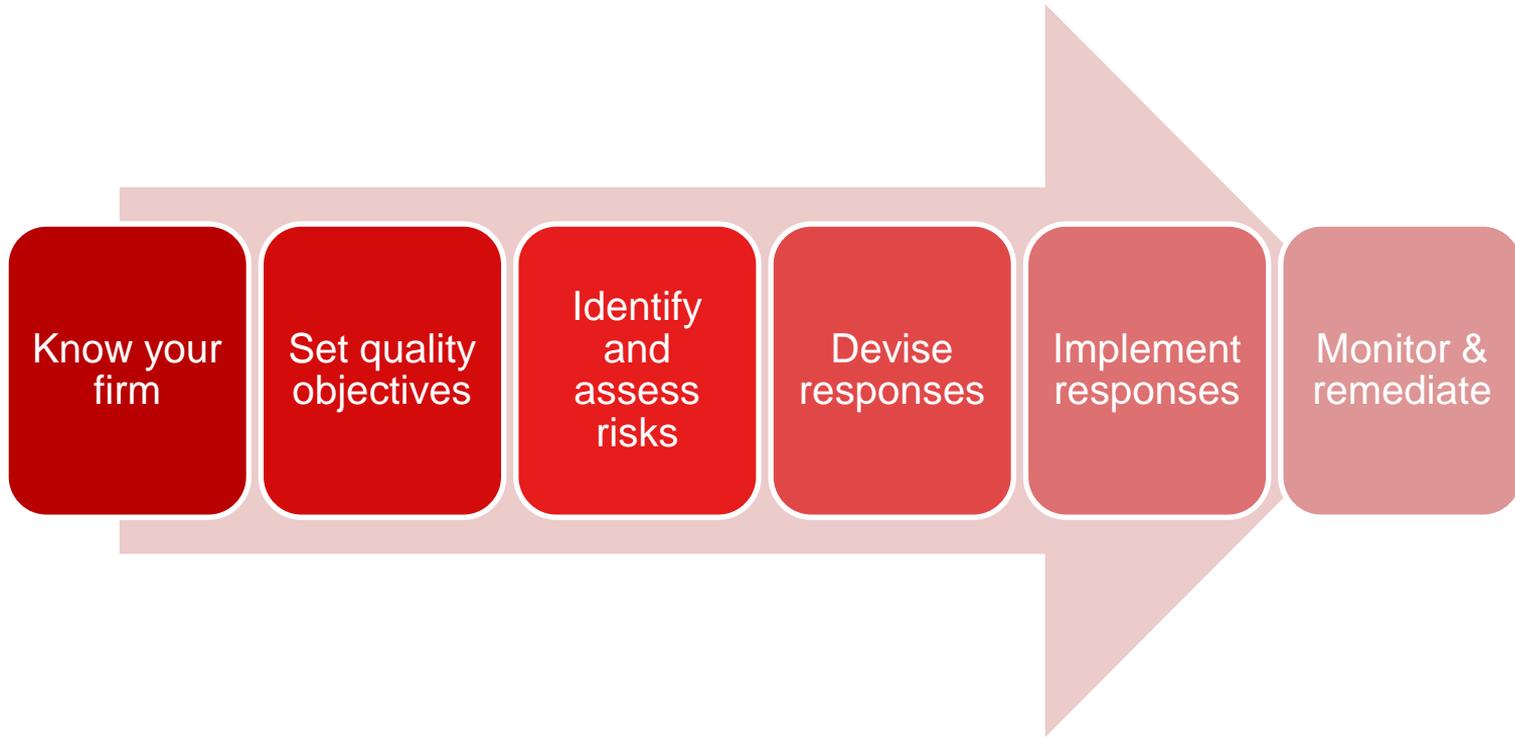
Evaluate findings

RCA - have you found the real cause?

Tackle big issues on an appropriate time line

Remediation!

Evaluate and Update SoQM



Cold file reviews

Audit Regulations provides guidance on basis for file selection

ICAEW visits should not replace CFRs

Consider results of previous monitoring activities

Review cycle would usefully consider managers as well as RIs

Is ½ a day enough?

Other work re ISQM compliance?

Familiarity risk re reviewer – benefits of rotation?

Root Cause Analysis

- Identify underlying cause behind review findings
- Prevent recurrence
- Address cause not symptom
- RCA does not have to be complicated – just ask ‘why?’
- Is often requested by regulators
- Can be used on positive review findings

Evaluating deficiencies

Considerations

Severe?

Pervasive?

Look at
deficiencies
in aggregate



Feedback from FRC

Useful publications



Thematic Review:

ISQM (UK) 1 Root Cause Analysis (RCA)

September 2024



Thematic Review:

ISQM (UK) 1 Network Resources & Service Providers

August 2024

Teir 1 firms – RCA scope

| RCA carried out 2022-2023 | Firm A | Firm B | Firm C | Firm D | Firm E | Firm F |
|---------------------------|----------------|--------|--------|--------|--------|--------|
| External adverse findings | ● | ● | ● | ● | ● | ● |
| External good practice | ● | ● | ● | ● | ● | ● |
| Internal adverse findings | ◐ ₁ | ● | ● | ● | ● | ● |
| Internal good practice | ◐ | ◐ | ◐ | ◐ | ● | ◐ |
| PYAs | ◐ | ◐ | ◐ | ◐ | ○ | ◐ |
| Thematic reviews | ● | ● | ○ | ● | ◐ | ● |

| Key | |
|-----|-----------------|
| ● | Full coverage |
| ◐ | Scoped coverage |
| ○ | No coverage |

Tier 2 & 3 firms – AQR Report



Dec 2024

**Tier 2
and Tier
3 firms**

Tier 2 firms

| Tier 2 (6) | Audit fee income (£m) | PIE audit fee income (£m) | FRC scope audits |
|-------------------------|-----------------------|---------------------------|------------------|
| Crowe U.K. LLP | 61.0 | 1.5 | 37 |
| Grant Thornton UK LLP | 192.5 | 6.3 | 31 |
| Johnston Carmichael LLP | 17.6 | 0.9 | 45 |
| MacIntyre Hudson LLP | 52.0 | 5.0 | 47 |
| PKF Littlejohn LLP | 39.7 | 5.5 | 90 |
| RSM UK Audit LLP | 141.0 | 6.0 | 26 |
| | 503.8 | 25.2 | 276 |

Tier 3 firms

| Tier 3 (21) | Audit fee income (£m) | PIE audit fee income (£m) | FRC scope audits |
|--|-----------------------|---------------------------|------------------|
| Anstey Bond LLP | 0.4 | 0.02 | 1 |
| Beever and Struthers | 8.6 | 1.23 | 17 |
| Begbies | 0.9 | | 1 |
| Bright Grahame Murray | 1.8 | 0.06 | 2 |
| Deloitte (NI) Ltd | 5.5 | | 4 |
| Gerald Edelman LLP | 5.5 | 0.26 | 4 |
| Grant Thornton (NI) LLP | 4.8 | 0.27 | 4 |
| Gravita Audit II Limited | 4.2 | 0.70 | 2 |
| Hazlewoods LLP | 6.8 | 0.10 | 3 |
| HaysMac LLP (formerly Haysmacintyre LLP) | 29.3 | 0.15 | 5 |
| Johnsons Financial Management Ltd | 2.0 | 0.23 | 3 |
| Kreston Reeves LLP | 12.7 | 0.16 | 8 |
| LB Group Ltd | 2.0 | 0.03 | 2 |
| Macalvins Ltd | 0.4 | 0.01 | 2 |
| Moore Kingston Smith LLP | 28.5 | 0.60 | 12 |
| Pointon Young Limited | 0.1 | 0.03 | 2 |
| Price Bailey LLP | 9.4 | 0.02 | 2 |
| Royce Peeling Green Limited | 1.2 | 0.29 | 9 |
| RPG Crouch Chapman LLP | 3.8 | 0.70 | 9 |
| Shipleys LLP | 5.5 | 0.17 | 15 |
| Zenith Audit Ltd | 0.6 | | 1 |
| | 134.0 | 5.03 | 108 |

FRC Report

Estimates
and
judgments
– ‘lack of
scepticism’

- **Expected credit loss (ECL) provisions** – Weaknesses in the audit procedures performed to test the methodology and data inputs used in ECL calculations,
- **Provisions for insurance liabilities** – Weaknesses in the testing of data used in the provision calculation and insufficient evaluation of the work carried out by the auditor’s expert over the valuation of the provision.
- **Impairment** - Weaknesses in the audit procedures to corroborate and challenge cash flow forecasts used in management’s impairment assessment of property, plant and equipment, goodwill and other intangible assets.

FRC Report – journal entry testing

Addresses
fraud risk from
management
override



Journal
entry
testing

FRC Report – journal entry testing

Journal; entry testing

- FRC found that in some cases, no testing had been performed over journal entries or any evidence of the audit team's response to the risk of management override of control

FRC Report – journal entry testing

Risk assessment

- The FRC identified key findings on four audits. These mostly related to cases where there were shortcomings in the audit evidence retained by the audit team to support risk assessment conclusions or to test the design and implementation of related controls. The FRC also identified other findings on four additional audits relating to weaknesses in audit teams' procedures to meet the requirements of ISA (UK) 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement*.

FRC Report – journal entry testing

Going concern

- The FRC identified key findings on three audits. These largely related to cases where audit teams had insufficiently corroborated and challenged the cash flow forecasts used in management's forecast and assumptions; or adequately assessed the impact of related sensitivities on the going concern model.

Feedback from QAD

QAD Report 2023/24



**AUDIT MONITORING REPORT
2023/24**



icaew.com/auditguidance

**PROFESSIONAL
STANDARDS
DEPARTMENT**

**QAD
Feedback** 90% of audit
firms have
implemented
ISQM 1

QAD Report 2023/24 - RCA

ICAEW
made the
following
initial
observations
on root
cause
analysis:

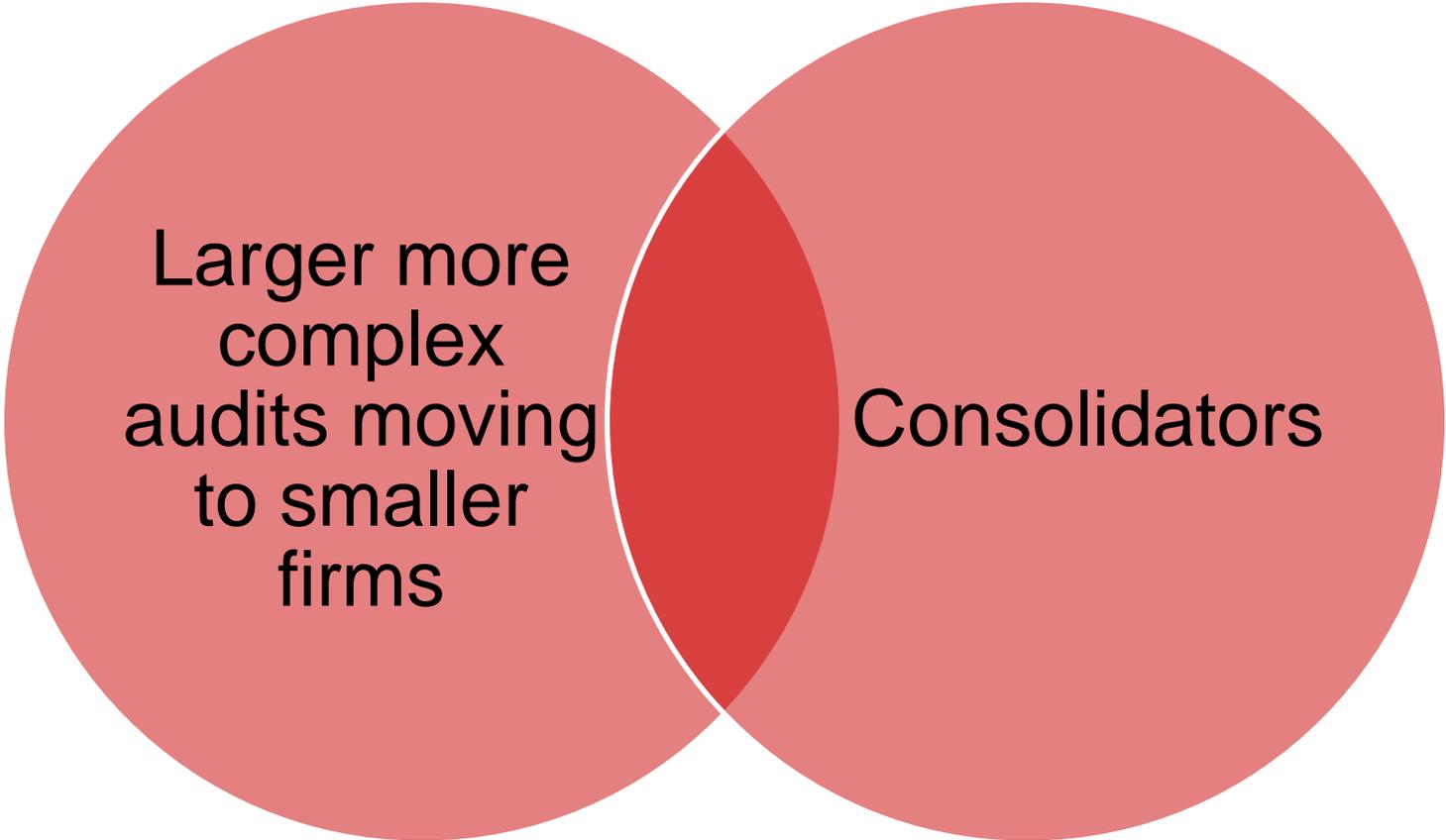
- 'Development of ability within the firm to conduct effective root cause analysis, facilitating open and constructive discussion on 'what went wrong' is likely to have wider benefits in strengthening a positive culture of accountability rather than blame.
- Training organisations will provide valuable support and independence and objectivity to the process, but the effectiveness of their work will be very reliant on those in the firm arranging interviews and meetings with relevant individuals and so this is more complex to outsource than routine reviews of completed engagements or provision of training courses.
- Whoever performs the root cause analysis, it must be a timely process to enable development of action plans and implementation of any changes within a reasonable timeframe.'

QAD Report 2023/24 – Key observations

Factors contributing to lower audit quality compared to pre-pandemic levels:

- Changes in working remotely
- Significant staff shortages
- Less face to face time with the audited entity's staff because of continued remote working by those staff
- New and revised auditing requirements that add to workload

QAD Report 2023/24 – Know your audit firm



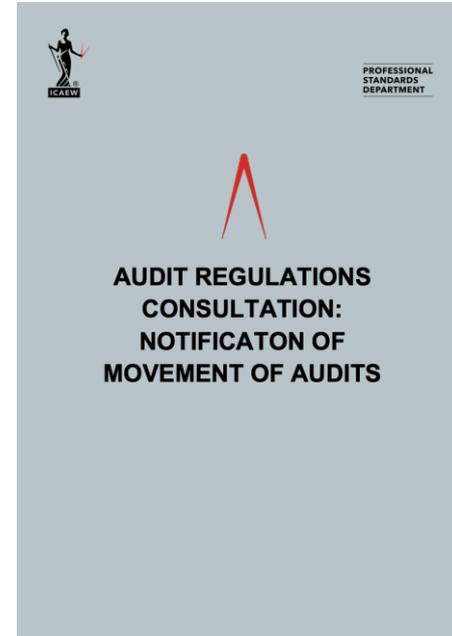
Larger more
complex
audits moving
to smaller
firms

Consolidators

Upcoming changes to Audit Regulation

Proposals

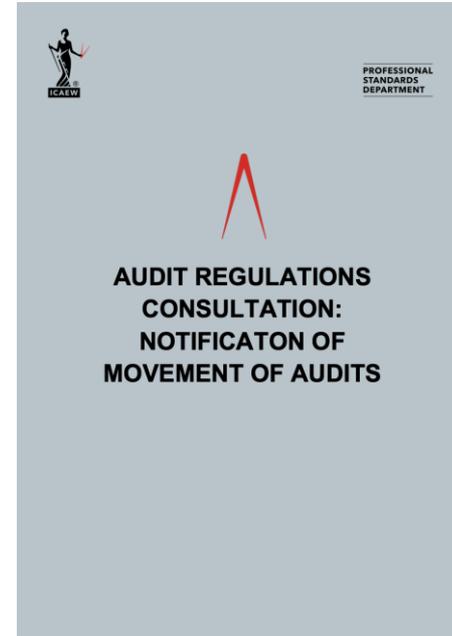
- Audit registered firms to notify ICAEW within 21 business days of being appointed as auditors to certain entities, and to entities where the audit fees are significantly higher than fees in the firm's existing audit portfolio
- 2025 implementation



Upcoming changes to Audit Regulation

Proposals

- Audit registered firms to notify ICAEW within 21 business days of being appointed as auditors to certain entities, and to entities where the audit fees are significantly higher than fees in the firm's existing audit portfolio
- 2025 implementation



Key challenges identified by QAD 2023/34

Estimates and judgements

- valuations
- provisions
- cashflow forecasts — going concern assessments

Focus on:

- models, assumptions and data used by management

Key challenges identified by QAD 2023/34

ICAEW says

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

Key challenges identified by QAD 2023/34

Letterbox audits

These are UK companies, with a limited UK presence with substantial overseas subsidiaries, that are often seen to have been audits previously undertaken by larger audit firms, now taken on by smaller firms

QAD – All firms should ask themselves



What types of stock do audit clients have? Are there significant audit risks to be addressed? Manufacturing clients with stocks at standard cost, clients with long-term contracts and those where stock management relies on perpetual inventory counting systems may all be considered 'specialist' in their own right. Members of the audit team will need particular knowledge and experience to conduct these audits to a good standard.

QAD – All firms should ask themselves

Stand back

Dangers of
sample size
cap

Substantive
AR?

Does the audit of revenue start with a clear understanding and critical assessment of the revenue recognition accounting policy? This should be a starting point for audit risk assessment and then the design of appropriate audit procedures. Typically, audit teams will accept the significant risk relating to fraud, but what exactly is this risk, and how is it addressed through the audit work performed? For some types of business, it may be difficult to conclude on sufficiency of audit evidence over revenue, whether you have a sample of 20 or 2,000 items, so audit plans may need to consider other audit techniques to gather evidence.

Key challenges identified by QAD 2023/34

CPD Hours

- Minimum number of hours
- Minimum number of **verifiable** hours

Accountants in practice

- Category 1
 - eg PIE audit partner
- Category 2
 - eg audit partner of large company
- Category 3

| CPD CATEGORY | MINIMUM NUMBER OF HOURS | MINIMUM NUMBER OF VERIFIABLE HOURS |
|--|---|------------------------------------|
| Practice | | |
| Category 1 | 40 | 30 |
| Category 2 | 30 | 20 |
| Category 3 | 20 | 10 |
| Working outside practice | | |
| Category 1 | 40 | 15 |
| Category 2 | 30 | 10 |
| Category 3 | 20 | 5 |
| Executives/trustees of charities working pro bono. | ICAEW's CPD course for charity trustees (coming soon) or training with similar learning outcomes. | |

Sum-up

Problem areas in practice

Overview

Evaluate and update SoQM

Use a broad range of monitoring tools – not just cold file reviews

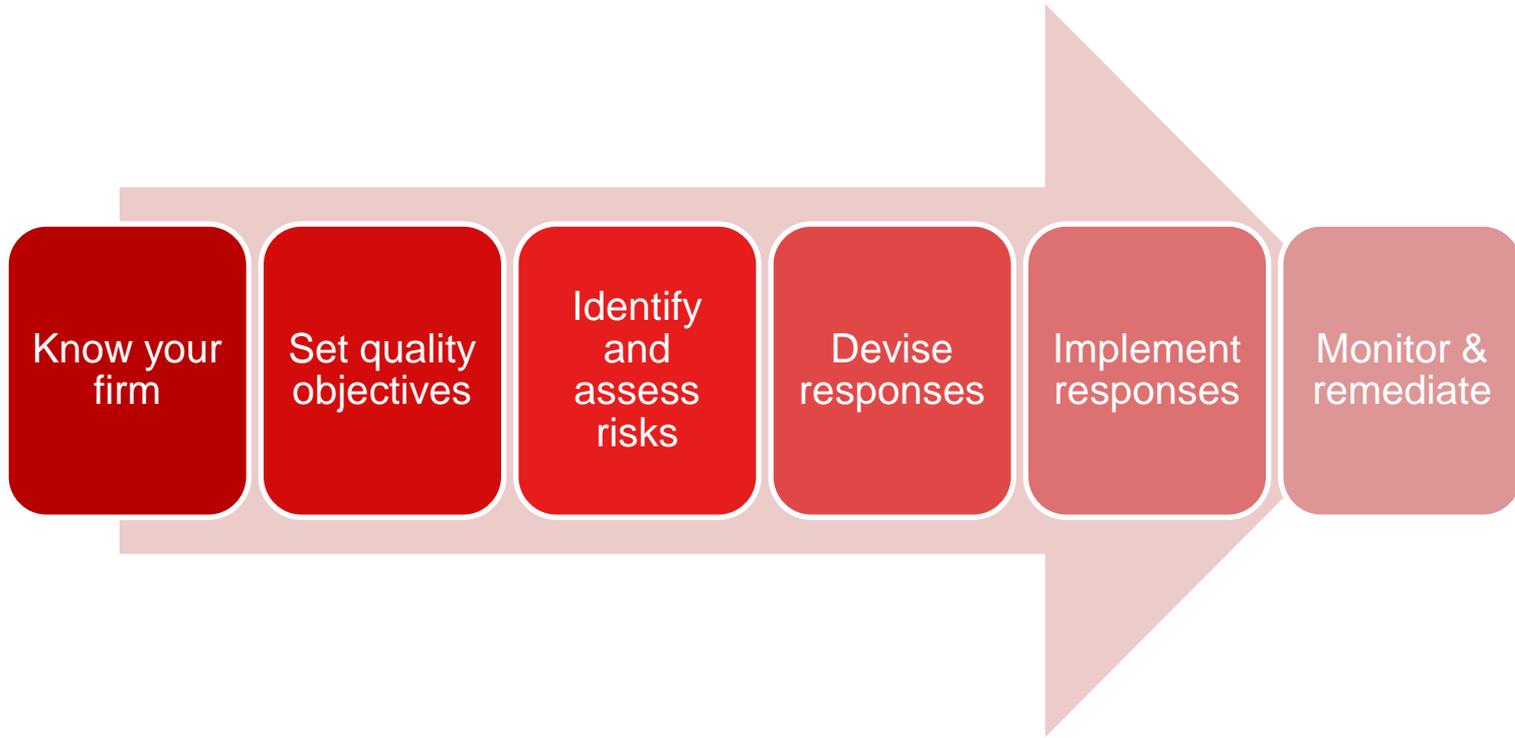
Evaluate findings

RCA - have you found the real cause?

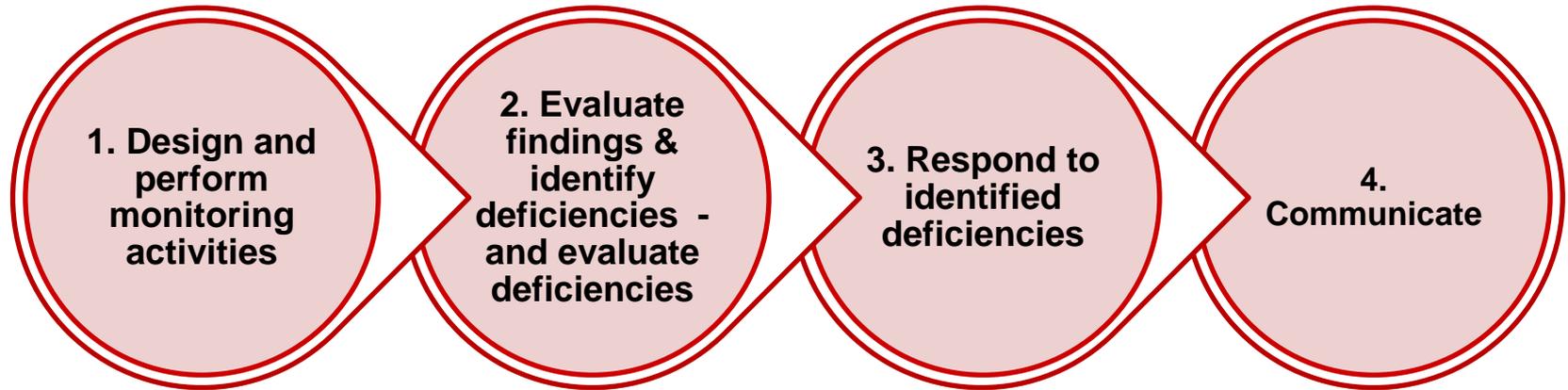
Tackle big issues on an appropriate time line

Remediation!

Evaluate and Update SoQM



Objectives of monitoring and remediation





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