

ACCA audit monitoring reviews – quarterly update

Continuing in our quarterly series of findings from our monitoring reviews, we are building on the common issues shared previously, to consider the root causes of such issues.

ROOT CAUSE ANALYSIS

Following an audit monitoring review, where deficiencies are found in the firm's audit work, ACCA requires the firm to produce an action plan which sets out how the firm intends to improve its procedures and remedy the deficiencies found. A firm's completed action plan is a significant factor in ACCA's risk assessment of the firm and determination of next steps, including the timing of the firm's next monitoring review.

It is therefore important that the action plan demonstrates that the deficiency, its root cause and how to prevent recurrence, has been understood and is sufficiently detailed to enable ACCA staff to assess the likely effectiveness of the planned improvements.

Root cause analysis ("RCA") is a process for identifying the causes of problems or events in order to prevent them from recurring. It is based on the idea that effective management requires more than putting out fires for problems that develop, but finding a way to prevent them, i.e. tracing a problem to its origin and finding countermeasures for a long-term solution.

RCA techniques are well embedded in many industries with guidance being offered on various websites as to how to conduct RCA. Techniques such as "fishbone" and "five whys" are commonly used to consider a number of possible causes of a problem rather than just the ones that are most obvious and helps in categorising the potential causes of a problem in order to identify the root causes, for example the "five why" technique is designed to determine the root cause of issues by repeating the question "why?".

Ultimately, it is the responsibility of the audit principal to ensure that the audit opinion is properly supported, as required by ISQM 1.28 and ISA 220. Therefore the audit principal needs to ensure that they monitor the effectiveness of actions taken to address the identified root causes and to ensure that the deficiencies do not recur in future.

Following a review of the action plan, ACCA will summarise in the closing letter the main three root causes that have been identified within the action plan. It is important that a firm monitors how effective the implementation of the action plan is in addressing the root causes identified as ACCA may request evidence of implementation of the action plan.

COMMONALITY

The most common root causes identified by firms on audits mainly completed pre-COVID (December 2020) and more recently (June 2023) are identified below.

There is considerable crossover between the most common root causes between the two periods, meaning that many of the issues previously identified still remain.

December 2020

- 1 Lack of technical knowledge
- 2 Overfamiliarity with the assignment
- 3 Lack of training
- 4 Inadequate engagement partner review
- 5 Lack of application of professional scepticism
- 6 Time pressure
- 7 Inexperienced staff
- 8 Lack of resource.

June 2023

- 1 Overfamiliarity with the assignment
- 2 Lack of technical knowledge
- 3 Lack of training
- 4 Lack of capacity
- 5 Inadequate engagement partner review
- 6 Lack of application of professional scepticism
- 7 Lack of guidance and supervision by seniors
- 8 Inexperienced staff.

EXAMPLES

Below are examples of the most common root causes and associated actions identified by firms following recent audit monitoring reviews performed by the Senior Compliance Officers. Whilst these are actual examples, please be aware that they were deemed appropriate for the specific issue(s) raised at the corresponding monitoring review and therefore they should not be considered a one size fits all response. Firms are still required to consider their own root causes which will be assessed by the Senior Compliance Officer against the specific findings of their review.

EXAMPLES	AUDIT ISSUE	ACTION PLAN RESPONSE	
Overfamiliarity with assignment	Example 1	<p>Firm A had not adequately evaluated whether the overall presentation of the financial statements was in accordance with the applicable financial reporting framework, as required by ISA 330. In the audit files examined there were some instances of non-compliance with the reportable framework. For example, there appeared to be no accounting policy note on significant judgements and estimates and on going concern.</p>	<p>The firm had audited this entity for several years, and had become somewhat complacent in their financial statements review process.. They advised that the action they would take to address the root cause would be to start with rotating senior members of the audit team on audit assignments. It would also enhance its quality control monitoring procedures by engaging suitably qualified individuals to carry out engagement inspections in the form of hot and cold file reviews.</p> <p>The firm advised that the specific audit procedures to be implemented to address the deficiency would be to evaluate whether the overall presentation of the financial statement is in accordance with the applicable financial reporting framework and complete a disclosure checklist to ensure it does not miss out on any key accounting policies on judgement and estimates on going concern and other relevant disclosures.</p>
	Example 2	<p>Firm B had not confirmed their understanding of the client's systems and controls by way of a walkthrough test or other means when considering their understanding of the entity – including accounting systems and internal controls as required by ISA 315.</p>	<p>The same member of staff at the firm had been working on this engagement for several years and had been responsible for completing the audit planning procedures. Whilst they were familiar with the client's processes, this was not documented appropriately on the audit file.</p> <p>The firm advised they would ensure that a different member of the audit team carries out the walkthrough test each year, to ensure that the record of the firm's systems is clear and accurate.</p> <p>The specific procedures to address the deficiency would include: 1) assess the control environment, 2) entity's risk assessment process, 3) control activities and 4) monitoring of controls. By carrying out these procedures, they would sufficiently document their understanding of the entity.</p>
Lack of technical knowledge	Example 3	<p>Firm C had not recorded audit procedures to verify the validity and completeness of the interest charge, for example with reference to reperformance of interest calculations and obtaining confirmations in writing from the parties concerned. This entity was part of a group audit. The working papers appear to include only accounting schedules without explanation of how these provided audit evidence.</p>	<p>The member of staff completing the audit work lacked the technical knowledge to complete suitable audit procedures for this area of the audit file. The firm advised that the action they would take to address the root cause would be to ensure staff are fully trained in all relevant areas and consider whether the firm has the capacity for group audits.</p> <p>The specific procedures to address the deficiency would include the firm reviewing with staff the work required in material areas and ensures that the audit programme is suitably tailored to reflect the audit procedures needing to be completed to ensure adequate documentation on file.</p>
	Example 4	<p>When accounting for leases, Firm D had not recorded how it had assessed whether the accounting treatment adopted by the entity for leases complied with the requirements of Section 20 of FRS 102.</p>	<p>The member of staff completing the audit work was not aware of the requirements of Section 20 of FRS 102, and therefore has not assessed the accounting treatment adequately. The firm advised that they would ensure staff attended specific training course to go through the requirements of updated auditing standards, and the engagement partner would look to allocate more time to review the audit file in depth, and review notes will be included in the file to evidence this.</p> <p>The specific procedures to address the deficiency would include introducing a working paper to record the terms of the leases and also the accounting treatment to ensure that it is in compliance with Section 20 of FRS 102.</p>

EXAMPLES	AUDIT ISSUE	ACTION PLAN RESPONSE
Lack of training	<p>Example 5</p> <p>When considering applicable laws and regulations as required by ISA 250, Firm E had not adequately recorded audit procedures it may have performed to show how the audited entity was complying with the key requirements of the specific laws and regulations, to ensure that it had assessed the risk of material misstatement, for example with reference to review of management and board minutes, legal and professional fees etc.</p>	<p>The firm explained that this was due to a lack of training by the staff involved in the job and an element of over familiarity.</p> <p>They would address this within the training to be undertaken by their training provider. The firm advised they would be revisiting the KYC procedures, to ensure that there is a full record of the laws and regulations that are central to the operations of their client. Procedures undertaken would include discussion with management, review of correspondence and minutes and any internal or external inspection, and appropriate documentation of these considerations on the audit file.</p>
	<p>Example 6</p> <p>Firm F had not documented the factors considered in order to determine sample sizes, and in some cases not documented their justification for capping the sample sizes calculated, as required by ISA 530 audit sampling.</p>	<p>The firm put this down to a lack of training. To address this, the firm has identified an article focusing on the calculation of sample sizes and will require all audit staff to read it. The firm will ensure that all staff are aware that it should be applied to all audits going forward</p> <p>They advised that going forward all factors would be considered and reasons for capping must be documented. They explained that the work not being documented on the audit file was an oversight by the partner, and in future they would adopt a mindset to document everything that is done.</p>
Lack of capacity	<p>Example 7</p> <p>When inspecting the audit files of Firm G, a group entity, there appeared to be no record of review notes raised by the audit principal to clearly show that he had taken responsibility for the direction and supervision of the members of the engagement team and the review of their work as required by ISA 220.16 and 220.17.</p>	<p>The firm advised they did not have sufficient experienced audit staff of the right level and will consider whether it has the capacity to continue to act for clients such as group entities, where a lack of capacity may be apparent.</p> <p>The firm would look to provide specific training for partners and audit staff, and ensure that audit files going forward would clearly evidence the direction, supervision and performance of the audit engagement by the audit partner.</p>
Lack of adequate engagement partner review at planning, execution and completion	<p>Example 8</p> <p>Firm H had not adequately documented matters which were important in providing audit evidence to support the audit opinion and show that it had carried out the audit in accordance with ISAs. The working papers mainly comprised accounting schedules which contained little indication of any audit work.</p> <p>The firm had not recorded on its working papers the objectives, nature, timing and extent of the audit procedures it may have performed, the conclusions drawn from any audit evidence obtained, and any significant professional judgements made in reaching those conclusions.</p>	<p>The firm's partner in charge of the audit advised he was stretched with his workload, and therefore was unable to perform an adequate review at planning, execution and completion. They advised the action they would take to address the root cause would be to ensure there is sufficient staff resource at the right level to perform the audit, and ensure adequate review procedures at each stage. Partners within the firm would also need to consider their existing portfolios and their individual capacity to ensure appropriate supervision of each engagement</p> <p>The firm would also look to provide practical training for audit staff and partner on specific matters and ensure standard working paper templates and the audit programme are updated and tailored appropriately.</p>
	<p>Example 9</p> <p>Firm I had not accumulated the misstatements identified during the audit to determine whether these were material, as required by ISA 450.</p>	<p>The partner advised that they had not reviewed or signed off the schedule of misstatements during the audit, and therefore this was not included within the working papers.</p> <p>Going forward, the firm has stated that it will ensure all misstatements identified during the audit are recorded on a suitable working paper and reviewed and properly assessed as part of the audit. Specific procedures to be implemented would also include enhanced supervision and review of this area to ensure this section is fully completed.</p>

EXAMPLES	AUDIT ISSUE	ACTION PLAN RESPONSE	
<p>Lack of application of professional scepticism</p>	<p>Example 10</p>	<p>There appeared to be insufficient professional scepticism and challenge of management by Firm J when assessing the appropriate of going concern. It had not considered a more robust audit approach to support the management's view that the entity is a going concern for at a least a year from the date the financial statements are approved, including obtaining up-to-date forecasts and obtaining and documenting corroborative and contradictory evidence with regards to management explanations and demonstrating scepticism and challenges of management.</p>	<p>The firm stated they would provide practical audit and personal skills training to all staff and partners on the need to always apply a questioning mind in significant audit areas requiring the application of professional judgments and critical assessment of audit evidence, such as going concern, to adopt a stand back approach and to not overlook unusual circumstances.</p> <p>The firm would also look to update its audit working templates on going concern to include procedures to address events or conditions that may cast significant doubt on the company's ability to continue as a going concern. The engagement partner will enhance his supervision and review of this area and the procedures to be performed may include: enquiry of management as to what information is available about the future and determine whether this has been appropriately considered as part of management's assessment and review management's assessment of going concern. In addition a robust review of up to date cash flows and forecasts [covering a period of at least 12 months from the date the financial statements are approved] including testing accuracy of data and validity of assumptions used by the management.</p>
	<p>Example 11</p>	<p>Firm K had not documented that it had carried out appropriate procedures to address the risk of fraud from management override of controls, for example by reviewing client journals during the year and around the year end date, as required by ISA 240.</p>	<p>The firm explained that the root cause was the lack of professional scepticism by audit staff to address the risks from management override of controls and lack of awareness of recording the assessment of fraud risks.</p> <p>The firm would look to document on file the enquiry to management on identifying and responding to the risks of fraud and evaluation of the response obtained. Documentation would also include reviews undertaken of any unusual entries and journals. The progress of this would be monitored during cold reviews undertaken by a training provider.</p>
<p>Lack of guidance and supervision by seniors</p>	<p>Example 12</p>	<p>Firm L had not considered obtaining cash flow projections and forecasts to support the management's view that the company would be a going concern for at least a year from the date the financial statements were approved, as required by ISA 570 Going concern.</p>	<p>The firm advised that existing junior staff had not always been guided on what evidence they would need to obtain to support the going concern assumption on existing audit engagements. The firm stated that they would look to ensure appropriate guidance and supervision is offered to junior staff.</p>
	<p>Example 13</p>	<p>Where Firm M had used sampling techniques, it had not recorded how it had calculated sample sizes and selected items for testing. In addition, where the working papers showed a sample size calculation, this was capped to a maximum number of items to be tested and was further reduced by risks factors.</p> <p>However, the firm had not recorded how it had ascertained the appropriateness of the risk factors, and why capping sample sizes is appropriate, considering that capping may prevent an objective assessment of the actual test results particularly in areas of significant risk and where key judgments are required.</p>	<p>With regards to specific procedures, the firm advised that they will consider in future written requests for cash flow projections and record the management response, and document their own consideration and judgement accordingly. The firm stated that where such forecasts were not available for some companies, the firm would consider and record the implications on going concern in these circumstances accordingly.</p>
<p>Inexperienced staff</p>	<p>Example 14</p>	<p>Firm N firm had not verified the completeness of income. There was no testing from underlying source documentation to invoices and the nominal ledger.</p>	<p>The firm explained that some audit procedures had been completed by inexperienced staff. They advised that they would update their engagement quality control procedures going forward, and for any audit trainees completing audit fieldwork, they will have an additional review of work on site by the audit senior to ensure appropriate work has been completed.</p>
	<p>Example 15</p>	<p>Firm O had not documented the work done to update its subsequent events review to cover the full period to the date of the audit report, as required be ISA 560 Subsequent events.</p>	<p>The firm put this down to lack of training and inexperienced staff. The partner will identify work carried out by less experienced staff and allow time for more detailed review. Where improvements to the work are needed, the partner will give informal training to the less experienced staff member. The firm also advised that in future, they would adopt a mindset to document everything that is done.</p>

Hopefully this reenforces the importance of appropriately identifying the root cause of any issues identified at an audit monitoring review or indeed in relation to any issues faced.

Next quarter we will be providing feedback obtained at our monitoring reviews on the implementation of ISQM.