

### **Firm's action plan to improve the standard of audit work**

#### **INTRODUCTION**

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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. Your completed action plan is a significant factor in ACCA's risk assessment of your firm and determination of next steps, including the timing of your firm's next monitoring review.

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

- identify the root causes for each deficiency
- explain how your firm is addressing the root causes and set out specific audit procedures your firm will perform to rectify each deficiency and the
- implementation date of the proposed actions.

It is also important that you monitor how effectively you implement your action plan, as ACCA may request a progress report or require other information from your firm in advance of the next monitoring review. In particular, if at your next audit monitoring review, it appears that failure to implement your action plan effectively has resulted in significant deficiencies in audit work, your and your firm's audit registration is likely to be at serious risk of withdrawal.

#### **RESPONSE ON OVERALL PROCEDURES AND QUALITY MANAGEMENT**

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The firm's response on International Standard on Quality Management (ISQM) 1 will depend on the weaknesses identified in the report. The response should therefore explain as appropriate:

- a the procedure introduced where none existed previously
- b the improvements made to existing procedures
- c communication of the firm's procedures to staff involved in the audit work
- d how procedures are being applied and monitored to ensure that they are effective.

## GENERAL GUIDANCE ON ROOT CAUSE ANALYSIS (RCA)

The firm will be required to identify the root causes of all of the deficiencies reported to the firm and explain the measures it is going to put in place to address those root causes. 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, ie tracing a problem to its origin and finding countermeasures for a long-term solution.

RCA technique such as “five whys” is commonly used to consider a number of possible causes of a problem rather than just the ones that are most obvious and helps in categorizing the potential causes of a problem in order to identify the root causes, for example by repeating the question “why”.

## GENERAL GUIDANCE ON RESPONSES TO SPECIFIC AUDIT PROCEDURES ON DEFICIENCIES

The action plan must also describe the specific audit procedures that your firm will perform in relation to a deficiency. The audit procedure should be as detailed as possible and specifically written in response to the matters included in the detailed findings. The firm should avoid brief or generalised responses as these will likely be considered inadequate by the Monitoring Department and may result in the firm being asked to provide further information.

Examples of inadequate responses include:

“We will implement the recommendations made in the report”

“We will ensure that in future we carry out and record the necessary work in this area”

“We will carry out “hot/cold” review of audit files”.

The response should explain in what way the firm’s approach will change to ensure that the procedures it carries out provide sufficient appropriate evidence in relation to the audit assertion being tested, taking into account root cause analysis.

### EXAMPLES

Examples of root causes, which are for illustrative purposes only and not intended to be exhaustive, include the following:

#### Knowledge/skills of individuals

- Lack of industry experience
- Lack of technical knowledge
- Lack of training.

#### Behaviours of individuals

- A mind set to cut corners to keep in budgets
- Lack of application of professional skepticism
- Unwilling or unable to supervise, complacency, etc.

#### Supervision by partners and senior team members

- Lack of guidance and supervision by seniors
- Lack of adequate engagement partner review at planning, execution and completion
- Significant matters being left to resolve at the end of the audit process.

#### Resources issues

- Lack of capacity
- Inexperienced staff

- Lack of time available and partners/staff heavy workload
- Lack of continuity of staff
- Lack of investment in infrastructure (people, processes and technology) supporting quality auditing.

#### Quality Control Procedures/Independence matters

- Inadequate quality controls procedures, for example, no policy on monitoring
- Inadequate staff appraisal, for example, lack focus on improvement in audit quality
- Overfamiliarity with assignment
- Focus on non-audit services.

#### Client matters

- Fee pressures
- Tight reporting deadlines (unrealistic)
- Delays in providing audit information
- Poor quality of audit information.

Below are two examples of how the firm may consider using the “five whys” technique to identify root causes. There are no specific rules about how long to continue to search for the root causes. Without repeatedly asking why, one possible solution for both examples would have been to replace the team member; however, the deficiency may nevertheless recur. Therefore, the number “five” is not the point, rather it is to keep asking the questions until the ultimate root causes are identified. The firm then needs to explain how it is going to address those root causes. Where there are multiple root causes, the firm should ensure that it has countermeasures for all root causes. It is worth noting that where lack of documentation has been assessed as the primary cause of deficiencies on the audit files, this may be a reason or symptom, but not necessarily the root cause of the problem. Failure to assess the underlying root cause in respect of each deficiency may result in the action plan being assessed as inadequate.

It is the responsibility of the audit principal to ensure that the audit opinion is properly supported, as required by ISQM1.28 and ISA 220. Hence the audit principal needs to ensure that he/she monitors the effectiveness of the actions taken to address the identified root causes, to ensure that the deficiencies do not recur in future.

## EXAMPLE 1

### Deficiency noted:

Not addressed recoverability of debtors’ balance at the year end

### Assessing Root Cause using “five whys”

- **1st why:** Why was recoverability of debtors’ balance not tested?

**Answer:** *Because we placed reliance on debtors’ circularization.*
- **2nd why:** Why was reliance placed on circularization when testing recoverability of trade debtors?

**Answer:** *Because we followed our standard audit approach.*
- **3rd why:** Why was the audit approach on debtors not adequately planned and designed to address recoverability of debtors?

**Answer:** *Because of a lack of sufficient time to review planned approach/ followed same approach as per previous year.*
- **4th why:** Why was there insufficient time/the previous year’s approach followed?

**Answer:** *Because of heavy workload and fee pressure/lack of understanding of audit objective from inadequate training and supervision.*
- **5th why:** Why was there heavy workload/inadequate training and supervision?

**Answer:** *Because of a lack of capacity.*

**Root Cause** Assessed deficiency arose due to “Lack of capacity” ie, not enough qualified staff to service all audit clients.

### Actions for the Root Cause may include:

To address a lack of capacity, for example:

Firm will ensure that there is sufficient staff resource at the right level assigned to each audit. It will review the numbers/ mix of its audit team. It may limit the number of audit clients it has [ie, carry out a review of its client acceptance and continuance procedures including a review of audit fee recovery rates, consider renegotiating fees, etc.] to improve staff/partner workload and time availability.

### Specific audit procedure for the deficiency of recoverability of debtors

The firm will provide practical audit training to staff on risk assessment and planned audit approach. It will update its standard working papers templates and procedures for testing recoverability of trade debtors, for example, instead of simply relying on circularization of debtors balances which primarily addresses “existence” assertion, the firm will trace trade debtors balances to subsequent settlement of invoices by customers with reference to post year end bank statements and remittance advices and summarise and evaluate the results of its tests to verify recoverability.

**Implementation date:** Immediate on all audits.

### How to populate the action plan template

Compliance with ISA 500- Audit evidence				
			Sections to be completed by the firm	
Audit Area	Deficiency	Firm’s comments	Root Cause	Action (and implementation date)
Trade debtors	Not addressed recoverability of debtors’ balance at the year end	Accepted	Lack of capacity	<p><b>Actions for the Root Cause:</b> The firm will ensure that there is sufficient staff resource at the right level assigned to each audit. The firm will review the numbers/mix of its audit team. It may limit the number of audit clients it has [i.e. carry out a review of its client acceptance and continuance procedures including a review of audit fee recovery rates, consider renegotiating fees, etc.] to improve staff/partner workload and time availability.</p> <p><b>Specific audit procedure for the deficiency:</b> The firm will provide practical audit training to staff on risk assessment and planned audit approach. It will update its standard working papers templates and procedures for testing recoverability of trade debtors, for example, instead of simply relying on circularization of debtors balances which primarily addresses the “existence” assertion, it will trace trade debtors balances to subsequent settlement of invoices by customers with reference to post year end bank statements and remittance advices and summarise and evaluate the results of its tests to verify recoverability.</p> <p><b>Implementation date:</b> Immediate on all audits.</p>

## EXAMPLE 2

### Deficiency noted:

Where the entity had a net liability position which appeared to cast doubt about the entity's solvency, the firm had not obtained sufficient assurance concerning the continuance of the entity. The audit work was limited to written representation from the management.

### Assessing Root Cause using "five whys"

- **1st why:** Why did the audit team rely on written management representation only?

**Answer:** *Because the firm did not adequately plan its audit approach.*

- **2nd why:** Why was the audit approach not adequately planned?

**Answer:** *Because the firm had not identified this as a significant audit risk area.*

- **3rd why:** Why did the audit team not highlight going concern as a significant risk area?

**Answer:** *Because the engagement partner has been acting for this client for many years and knows the client well so did not consider this a significant risk area. Moreover, the client has been operating with a net liability for the past two years and the bank has renewed its facilities every year.*

**Root Cause** Assessed deficiency arose due to lack of professional skepticism or overfamiliarity with the assignment by the engagement partner.

### Actions for Root Causes may include:

To address lack of application of professional skepticism, for example:

- Firm will 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 (such as contradictory audit evidence and conditions that may indicate possible fraud), to avoid over generalization when drawing conclusion on audit observations and to not use inappropriate assumptions in determining the nature, timing and extent of audit procedures and in the evaluation of the results thereof.

- Firm will also update its standard audit working papers to incorporate procedures designed to address the application of professional skepticism, for example, requiring staff to obtain and document corroborative and contradictory audit evidence in support of management estimates and assumptions. The engagement partner will always review and sign off on these sections.

To address overfamiliarity with the assignment, the firm will introduce the following measures, for example:

- The firm will rotate senior members of the audit team on audit assignments.
- The firm will enhance the firm's quality control monitoring procedures by engaging suitably qualified individual to carry out engagement inspections (hot /cold file reviews).

### Specific Audit procedures for the deficiency relating to Going Concern

The firm will 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/her 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.
- Review management's assessment of going concern.
- 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.

**Implementation date:** Immediate on all audits

## How to populate the action plan template

Compliance with other ISAs			
		Sections to be completed by the firm	
Going Concern [ISA 570]	Firm's comments	Root Cause	Action (and implementation date)
Where the entity had a net liability position which appeared to cast doubt about the entity's solvency, the firm had not obtained sufficient assurance concerning the continuance of the entity. The audit work was limited to written representation from the management.	Accepted	Lack of application of professional skepticism	<p><b>Actions for the root cause:</b></p> <p>Firm will 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 (such as contradictory audit evidence and conditions that may indicate possible management bias), to avoid over generalization when drawing conclusion on audit observations and to not use inappropriate assumptions in determining the nature, timing and extent of audit procedures and in the evaluation of the results thereof.</p>
		Overfamiliarity with the assignment	<p>Firm will also update its standard audit working papers to incorporate procedures designed to address the application of professional skepticism, for example, requiring staff to obtain and document corroborative and contradictory audit evidence in support of management estimates and assumptions. The engagement partner will always review and sign off on these sections.</p> <p><b>Actions for the root cause:</b></p> <p>The firm will rotate senior members of the audit team on audit assignments. It will also enhance its quality control monitoring procedures by engaging suitably qualified individual to carry out engagement inspections (hot /cold file reviews).</p> <p><b>Specific audit procedure for the deficiency:</b></p> <p>The firm will 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/her 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; 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><b>Implementation date:</b> Immediate on all audits.</p>

### **Audit documentation (ISA 230)**

Having satisfied itself that its audit approach is appropriate to the assertion being tested, the firm will also need to consider whether it is recording its work adequately to meet the requirements of ISA 230, in particular paragraph 8. Working papers should set out:

#### **The objective:**

- The assertion being tested (eg, completeness, recoverability, ownership)

#### **The method:**

- The audit procedures performed, including details of accounting records or documents tested
- Sample size and method of selection

#### **The results:**

- Details of each item in the sample
- The results achieved on each item in the sample
- A summary of the results and evaluation of any errors

#### **The conclusion:**

- A clear record of the auditor's opinion on whether, based on the evidence obtained, the audit objective has been achieved.

The firm's response on documentation of its work in specific areas may therefore need to include details of how it will improve the recording of one or more aspects of its procedures.

### **Assistance from a training company**

Training companies provide various services which can be tailored to your requirements and which include:

- Undertaking a review of your current procedures and making recommendations for improvements
- Assistance with developing appropriate policies and procedures to ensure compliance with ISQM 1
- Training on the audit process or specific aspects or specialist areas
- Consultation on difficult or contentious areas
- 'Hot' or 'cold' file review services.

If considering external assistance, ACCA recommends that you contact at least two training companies to discuss your requirements and how the arrangements will work in practice, before making a choice. The company will be able to help you decide on which service(s) will best meet your needs, according to your circumstances. The firm's response should include details of any arrangements made with a training company. It is important to note that ACCA does not rely on the results of external reviews performed by a training company as a basis for continuing audit registration. Whilst a training company may assist you in bringing about improvements in audit quality, the responsibility for the standard of the audit work remains with the firm.

## **OTHER MATTERS**

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The firm may, if it wishes, provide copies of relevant documentation to demonstrate the improvements implemented subsequent to the monitoring review, but this is not mandatory. If further assistance is required, please email [PMAdmin@accaglobal.com](mailto:PMAdmin@accaglobal.com) and a member of the Compliance team will contact you.