

FRC Brief - 2012

Annual Report on Audit Quality Inspections (audit quality)

The report discusses significant findings from audit quality inspections and lists actions needed to enhance overall audit quality. Firms are anticipated to share these reports with audited entities' directors. The selection of entities included in the report was based on judgment, taking into account their significance to audit quality. Private reports encompass findings related to improving audit quality and recommendations on whether to continue the firm's audit registration. If significant concerns are identified during inspections, those are addressed to the respective authority. The inspection is oriented towards identifying areas for improvement and agree on action plans with firms. The inspections cover compliance with relevant standards and major firms' audit quality procedures. One of the report's main objectives is to monitor and enhance the quality of auditing through input to several consultations. Changes enhancing overall audit quality and safeguarding auditor independence are recommended based on firms' interpretation/application of audit and ethical standards. Separate funding arranges inspections outside the conventional scope. The report, approved by the Professional Oversight Board, emphasizes the need for firms to focus on significant matters arising from the inspections to continually improve audit quality.

Updated Group Audit Standards and Their Impact on Auditing Procedures (auditing standards)

Changes in group audit standards, designed to align overall performance with best practices, have introduced specific requirements in conducting group audits. This includes detailed audit procedures and increased involvement of the group auditor in auditing significant components. Concerns have also surfaced about insufficient justification for the scope and materiality of business component audit procedures along with clarity regarding the objectives and outcomes of visits to component auditors and the adequacy of review of their work by the group audit team.

These auditing standards, applying equally to business components audited within the UK or overseas, necessitate setting the materiality level for business components within a group lower than that for the entire group audit. A requirement is also issued for auditors to determine both overall and performance materiality levels. Notably, third-party derived audit evidence is deemed more reliable, hence audit teams are expected to obtain such confirmations for cash and investment assets.

Engagement Quality Control Review (EQCR) is demanded by auditing standards for all listed companies' audits, with compliance under review by monitoring firms' adherence to the regulation frameworks for auditing. This includes auditing standards, ethical standards, and quality control standards for auditors, as issued by the FRC's Auditing Practices Board and other audit regulations established by relevant professional bodies.

Improper Practices in Audits concerning 'Going Concern' (going concern)

The analysis reveals interest in issues related to audit deficiencies regarding the 'going concern' basis for accounts preparation. Two such instances were highlighted where audits fell short,

and in one case, the entity stopped operating. Issues include inadequate work on financial forecasts underpinning the going concern assessment, insufficient disclosures on uncertainties relating to going concern and inadequate substantiation of parental support for going concern objectives. One case noted the audit team overlooked the relevance of ongoing banking facilities negotiations. Given the tough economic conditions and recent significant business failures, auditing the 'going concern' merits constant focus. Other areas outlined for review include group audit considerations, asset valuation and impairment, revenue recognition, related parties, and auditing committee reporting quality.

Overview of Audit Quality Policies and Ethical Considerations in Major Firms (ethics)

The review focuses on various aspects of corporate governance within major firms, including the organizational tone, transparency reports, ethics, performance evaluation, human resources, and risk assessment. These firms are also required to establish a code of ethics, like it is required in Mexico. The reliability of the audit quality is confirmed through frequent consultations with partners specializing in ethics, although it is noted that the recording of these consultations can be improved for transparency. The essence of these policies is to monitor and maintain audit quality and to ensure that ethical considerations are taken into account, particularly when potential conflicts of interest occur like with the provision of non-audit services.

Enhancing Auditor Independence and Audit Quality (auditor independence)

The key focus for improving both auditor independence and audit quality involves identifying and assessing potential threats, implementing effective safeguards, and robust reporting to audit committees. There is a particular emphasis on the need for auditors to report non-audit service threats in a timely way to audit committees, so as to manage risks effectively. Further, detailed information should be available to ensure evaluation of the maintenance of auditor independence. Auditors should also prioritize the audit of impairments in their efforts to boost audit quality. They should focus on acquiring the impairment assessments and sensitivity calculations from the audited entities and then apply the appropriate audit procedures. A significant aspect of this process involves contributing to the standard-setting process by recommending updates to auditing and ethical standards based on real-life application and interpretation.

Navigating Audit Quality Amid Economic Challenges (environment)

In the current economic climate, firms are experiencing increased demand for tenders and heightened pressure, impacting audit quality. The scrutiny has been less rigorous than the situation warrants, particularly concerning key assumptions. Given the tough economy and notable business failures, audits regarding going concern will continue to be integral. Firms are advised to concentrate their audit procedures on the risks tied to revenue recognition, considering the economic situation and the financial strain on entities being audited. The economic environment dictates firms to cut costs, which might influence the setting of audit materiality levels.

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