

FRC Brief - 2020

Audit Quality Inspection and Improvement Strategies for PWC LLP (audit quality)

The Financial Reporting Council's Audit Quality Inspection (AQR) reveals that PWC LLP is focusing on continuous improvement of audit quality. The review which encapsulates FTSE and FTSE audits is not necessarily representative of the entire audit portfolio performance. Recently, inconsistencies in achieving the audit quality were observed. To ameliorate this, the areas driving audit quality will be identified and adequate measures shall be implemented to achieve them. Significant changes to be introduced include proactive supervision of large audit firms, improving the transparency of audit quality assessments, and from 2022, an operational separation of audit practices from the rest of the firm operations will be in effect. This move is to ensure that the audit practices are mainly focused on achieving high audit quality. PWC's Programme to Enhance Audit Quality (PEAQ), initiated during the summer of 2019, reflects its efforts to improve audit quality.

Audit Quality Evaluation and Improvement Initiatives (governance)

The discussed content focuses on an independent review of audit practices, instigated by the Financial Reporting Council (FRC). Key areas under scrutiny include leadership, governance, risk management, values, and behaviors of audit firms. The FRC works towards promoting high standards in corporate governance, reporting and audit, and enforcing implementation. The aspect of classifying audits as high-risk based on varying factors such as sector, geography, financial difficulties, estimation uncertainties or identified weaknesses in governance or internal control was highlighted. Audit firms are seen as taking active steps towards enhancing audit quality through a set of planned initiatives, including the separation of audit and risk assurance services. They are also participating in regular review exercises and ensuring effective governance for maintaining a tight focus on audit quality. Overseeing further steps to ensure audit teams apply higher levels of challenge and skepticism, particularly on high risk audits has also been emphasized. Good practice has been observed in their active monitoring and governance of audit quality transformation plans involving independent non-executives. Lastly, the introduction of an independent review of the audit practice, creation of an audit quality board with an independent chair, and setting clear quality goals are tangible measures for improving audit quality, suggesting a proactive approach to challenges and concerns.

Audit Quality Inspection Findings and Recommendations (going concern)

Mandatory audit training on the ISA (UK) 'going concern' was conducted, and its reiteration will be a part of future training, specifically focusing on the revised standard made effective this year. The primary areas of concern in the audit findings for several firms this year include the audit of inventory, group oversight, going concern, and investment property valuations. Special attention was focused on areas like going concern, viability statement, other information in the annual report, longer-term contracts, asset impairment, and fraud risk assessment. Key findings, each from separate audits, mentioned inadequate audit procedures and insufficient review procedures in crucial audit areas like revenue, going concern, and disclosure

requirements. Inspecting a greater number of audits proportionately in the upcoming cycle has been planned. Short-term cash-flow forecast growth assumptions need to be more rigorously challenged during impairment reviews and going concern assessments. It is crucial to develop a tailored mandatory going concern checklist, increase the use of specialists, and improve reporting on fraud risks, going concern, and internal controls to enhance transparency. Enhanced tools and guidance should be made available to all auditors for better audit quality.

Securities Fraud Litigation Trends and Regulations (fraud)

The document discusses the evolving patterns of securities fraud cases and the regulatory measures put in place to address them. It mentions several safeguards, like heightened pleading requirements in fraud actions, instituted by the Private Securities Litigation Reform Act. Moreover, fraudulent practices related to cryptocurrency offerings, derivatives manipulation, and fiduciary duty breaches are also highlighted.

The document acknowledges a decrease in the delay between an alleged fraud's revelation and the filing of a related claim. Factors affecting settlements include the size of the case, market capitalization of the issuer, and types of involved securities, among others. The plaintiff's case's potential merit also plays a notable role in determining settlements.

Moreover, the text goes on to highlight the role of the Securities and Exchange Commission (SEC) in identifying cases of corporate fraud, with specific details on the requirements for securities fraud actions.

Toward the end, an evaluation of the need for additional protection against securities fraud for senior citizens and retirement plans is introduced. This entails studying the effects of abusive or unnecessary securities fraud litigation on these demographics and providing Congress with recommended protections based on the findings.

Enhancing Non-Audit Service Control Environments Amid Economic Challenges (environment)

The primary focus is on improving the non-audit service control environments and approval processes, ensuring adherence to the FRC ethical standard and other regulatory compliance. Amendments have been introduced to the client record management system for automated authorization of the non-audit service delivery. Efforts are being intensified, especially in the current adversarial economic environment, to prioritize public interest obligations of an audit. Actions have been undertaken to assist engagement level teams, considering the circumstances under which these audits are conducted. Internal audit response is being scrutinized by our quality control teams for continued improvement in response to the external environment. In the COVID-19 situation, impairment challenges could intensify. Audits of companies with concerns regarding control environments or governance are difficult, pushing for more management and board intervention. A robust reporting process for identifying significant weaknesses in a company's financial reporting environment, inclusive of controls and governance, has been established. The importance of internal controls has escalated in recent years within the UK corporate reporting environment, and focus in this area will be sustained.

Audit Transformation Strategy and Enhanced Learning Programs (internal controls)

The primary focus is on substantive procedures on revenue and analytical review, with no reliance placed on internal controls. The ongoing audit transformation strategy involves experimenting with new reporting methods on fraud, going concern, and internal controls to

enhance transparency in audit reports. Enhanced learning programs have been implemented to address cognitive bias, identifying fraud, and internal control management. A new pilot approach has been introduced on reporting audit work regarding fraud risks, going concern and internal controls. Given the rising significance of internal controls within the UK corporate reporting environment, there will be a consistent focus on this area. Internal controls coaching and focused coaching on high-risk areas are integral to the coaching programs.

The Surge of Legal Filings Against Tech Firms (technology)

Legal filings against technology companies have increased notably, largely stemming from alleged accounting issues or not meeting earnings guidance. Most allegations were made against companies in the electronic technology and technology services sector. The most growth in filings was observed in the Ninth Circuit, encompassing Silicon Valley. Despite the number of filings against foreign firms in the health technology and services sector diminishing by half, the technology sector still faced the most accounting claims. Claims against companies failing to meet earnings guidance have also grown significantly since 2018. However, there was a decrease in the number of filings against technology and communication companies, as well as a decrease in filings against communication services/ telecommunications/ information technology firms. Looking at the bigger picture, the technology sector and consumer non-cyclical sectors represented the highest percentage of filings in the first half of the year.

Audit Quality Control and Compliance with Standards (auditing standards)

The audit review and quality standards were not fully complied with, as the Engagement Quality Control Reviewer (EQCR) did not discuss the review results with key auditors. Auditing standards call for an audit partner to maintain responsibility for the overall audit quality, however, lapses in procedure adherence and lack of communication indicate inconsistencies in quality control management. Additionally, administrative amendments to audit documentation, permitted during a brief period post-audit opinion signing, reflects procedural flexibility within the regulations. In terms of compliance with auditing standards, while significantly high levels are usually witnessed, lapses in adherence to internal requirements may still lead to unsatisfactory rating in internal reviews. The current audit methodology, LEAP, aligns better with auditing standards, focusing more on risk areas, compared to its predecessor, and is more in sync with methodologies used by prominent audit firms. Enhanced scrutiny and reinforcement of certain quality control procedures are recommended to guarantee true audit quality.

Audit Procedures and Improvement Measures in Financial Institutions (interviews)

The subject matter is about the methodologies and procedures that are employed in conducting robust and effective audits within finance organizations. Different tools and practices, such as interviews with various members of the organization, examination of firm policies and procedures, analysis of work papers, and fieldwork, are highlighted. Particular attention has been given to the engagements with the Spot FX traders, Spot FX salespersons, and other senior management in Australia and overseas. An important aspect is the focus on continuous improvements, with features such as focused group sessions, the incorporation of behavioral specialists, and a push for more comprehensive aqr category inspections, and the need for a broader range of engagement team interviews. Mention is also made of the auditing of select portions of work, to ensure thorough quality control checks and balances. On-site visits,

inspections, and document transparency have been considered essential elements of the audit process.

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