

FRC Brief - 2022

Inspection and Supervision Report on Audit Quality: Mazars LLP (audit quality)

The Financial Reporting Council (FRC) conducted an audit quality inspection and supervision for Mazars LLP. The FRC's aim is to ensure high audit quality and judge the firms' operations that enhance audit quality and support market resilience via its supervision and oversight activities. The report from this review is part of seven firms' reports and includes the firm's internal quality monitoring details. Mazars LLP was found to need urgent addressing of firm-wide and audit inspection findings. To rectify these findings, it's essential to update the audit quality plan and ensure the pace of growth doesn't overcome the pace of remediation. The evaluation of individual audits showed four out of eight requiring minor improvements. Key areas requiring attention included revenue auditing, provision for expected credit losses, and quality control procedures. In response, Mazars has increased central resources, aligned the audit quality plan with the firm's strategy, and developed its culture strategy.

Enhancing Governance and Quality in Audit Practices (governance)

The overall themes discussed focus on the enhancement of audit quality through improved governance and proactive communication. Different mechanisms, such as the monthly updates of the action plan within the Audit Quality Program (AQP), are being transmitted to the audit executive and shared periodically with the firm's UK executive and public interest committee. The critical role of audit practices in fostering improvements in governance, controls, processes, and capability of finance personnel, primarily in companies within high-risk sectors or with less mature management functions is recognized. Responding to the governmental changes for 'restoring trust in audit and corporate governance', an integrative approach is being established by consolidating existing measures into a single quality plan. Concurrently, firms are being encouraged to ensure high-quality audits, regardless of the identified risks related to management or the entity's financial reporting systems. Legislative action is being taken to enable the audit, reporting and governance authority (ARGA) to hold those responsible accountable for improved standards of reporting and governance. The measures are also backed by robust audit governance boards, which are responsible for overseeing the AQP and monitoring the ongoing corporate governance activities.

Analysis of Audit Quality: Focus on Going Concern and Viability Assessments (going concern)

The 'Inspection and Supervision Report' identified an area for improvement not found in previous years: insufficient challenging of management judgements regarding going concern assessments. This especially pertains to audits of forecasts and management's assumptions. It was noted that auditors did not sufficiently review management's going concern cash flow forecasts in a case where a material uncertainty was included in the audit report. The Financial Reporting Council (FRC) has highlighted both areas of good and poor practice related to going concern assessments. The firm is focusing on increasing consistency through methodologies such as a 'going concern non-negotiables' framework.

The document praised the firm's good practice in areas such as going concern assumptions and recommended urgent improvements in skepticism and challenging of management's forecasts

in key areas. It was found that the evaluation of intangible assets and going concern and viability assessments had weaknesses and that the firm needs to urgently address these recurring issues. The report also credited instances of good practice in the assessment of going concern.

The firm has made efforts to mitigate risk posed to audit quality and failure through targeted actions in four areas: audit of revenue, detecting material fraud, going concern and viability, and challenge of management. The firm saw a reduction in the number of findings related to going concern due to new procedures, pointing to areas of progress. Simultaneously, the report showed areas of reliance without proper evaluation, highlighting the need for continued improvement.

Enhancing Audit Quality through Focus Areas and Risk Management (fraud)

The management plan outlines the upcoming focus areas for audit practice, concentrating largely on revenue auditing, management challenge, fraud response, and going concern consistency. The team used forensic specialists in their fraud risk assessments contributing to improved audit strategies. Significant efforts have been put into addressing four areas perceived as the most significant threats to audit quality and corporate stability. Encouraging results were observed with a notable increase in findings concerning revenue, challenge, and fraud, along with a decrease in findings associated with going concerns. An enhanced approach to fraud risk assessment was piloted with considerable success. Measures were taken to assess the impact of COVID-19 on fraud risk, positively influencing the designed audit procedures. The execution of audits necessitates a customised plan based on individual facts and circumstances. Progress was noted against previous findings; however, challenges remain around the testing of journal entries on several audits. The endeavour to identify potentially inappropriate journals and fraud risks involved extensive enquiries of the client's staff.

The Role of Ethics, Anti-Fraud Measures and Resource Allocation in AI Governance and Finance Management (ethics)

People are primarily interested in ethical Artificial Intelligence (AI) practices, anti-fraud measures, and effective resource allocation as observed in the European insurance sector and the financial management systems. Key areas of attention fall under ethics, AI governance, risk and HR management. This includes the focus on promoting ethical environments that support business objectives.

There's recognition that simplified budget structures and sufficient resource allocation to finance regulatory bodies like ESMA is crucial for them to effectively carry out tasks, especially in areas of sustainable and digital finance. The effectiveness of governance structures, especially in preventive and managerial aspects of conflicts of interest, is also a matter of concern. Moreover, ESMA is also lauded for their gender balance at management and staff levels, indicating a keen interest in diversity and bias mitigation. Additionally, people appreciate the efforts made in raising awareness about conflicts of interest and ethics. This includes the existence of stringent ethical standards and measures to prevent misuse of information by key personnel.

Lastly, the need to improve guidelines relating to ethics and independent decision-making were explicitly mentioned, with a focus on better consideration of various stakeholders' perspectives.

Enhancing Audit Quality through Technological Integration and Investment (technology)

The text outlines considerable interest in boosting audit quality with increased focus on technology. Investments are made to expand the technology risk assurance team for digital auditing. Introducing controls-based audits, data analytics capabilities, and strengthening technology risk assurance are emphasized. The current demand for audit services induces an operational priority for resourcing, further catalyzed by the pandemic. Technology is understood to be key in improving audit quality, ensuring consistency, and monitoring engagement. Investments are planned to further leverage technology for audit transformation. A proposed 'audit sandbox' explores innovative audit policies and quality improvements through technology. The firm identifies audit culture, technology, and audit quality indicators as priority focus areas for the upcoming year. Included within the continuous investment plans is the development of AI tools for auditing. Technologically-centered strategies include investments in self-service support solutions and task-specific digital training. The ultimate goal is high-quality audit and meeting international auditing standard requirements through team synergy, manual task automation, and enriched audit evidence analysis.

Audit Quality Analysis and Implementation of Ethical Standards (ethical requirement)

The document primarily focuses on the principles of good auditing with special emphasis on implementation of relevant ethical requirements while also discussing various aspects like audit execution, engagement performance, application of audit methodology, resource utilization, internal quality monitoring, and potential remediation measures. The content also noted the revisions made in the Financial Reporting Council's (FRC's) Ethical Standards for Auditors and detailed on the firms' policies and procedures to prevent and detect ethical breaches, particularly in Public Interest Entity (PIE) audits. It also outlined the importance for firms to consider their competency, capability and the entity's integrity when undertaking engagements. Feedback suggested a need for strengthening companies' policies pertaining to compliance with stringent ethical requirements. Implications of not accurately identifying an entity as a PIE were also discussed, indicating potential risks including ethical breaches and unidentified deficiencies in the financial statements.

Analysis of Audit Processes, Culture and Quality Amidst COVID Environment (environment)

Audit teams are expected to maintain a comprehensive understanding of procedures including IT and manual control environment while performing adequate substantive testing. The role of audit culture and quality in enhancing company resilience and reputation is essential. The recent key inspection findings highlighted changes in the audit timetable and team structure challenges as a result of COVID-induced business environment volatility. The importance of nurturing an environment that supports continuous improvement, drives trust and serves the public interest remains paramount. A shift in our audit culture to a 'high challenge, high support' has begun and we continue to respond to inspection findings through our Audit Quality Plan (AQP). The Financial Reporting Council (FRC) defines high-quality audits as those providing high-level assurance and complying with auditing regulations and standards. Firms must also provide technical support and robust monitoring to enhance audit quality. The Human resource department plays a critical role in creating an environment for the delivery of high-quality audits including initiatives that encourage open communication and speaking up when issues arise. Additionally, our audit strategy incorporates a response to the impact of climate change on businesses along with a broader focus on environmental, social and governance factors.

Analysis of Audit Methodology and Compliance with Auditing Standards (auditing standards)

The audit methodology of the company and the guidance taught to auditors is a major part of its quality control system. It ensures that audits are conducted uniformly and comply with the auditing standards. In one audit, the audit team failed to communicate its involvement and the extent of its oversight in a component audit. They also failed to provide rationale on why the audit team for the UK component did not follow auditing standards. In four other audits, the EQCR partner did not provide proof of conversation with the key audit partner about significant components or explain why this was unnecessary. Whenever there are missing bank confirmations, auditing standards dictate the completion of alternative procedures to collect noteworthy and dependable audit evidence.

Insights on Corporate Audit Quality and Improvement Measures (internal controls)

People are interested in the aspects of well-managed companies that boost the quality of audits, such as clear reporting and efficient internal controls. Progress has been noted in crucial areas from previous years, like group audits and testing of internal controls. However, there's been an upsurge in findings concerning journal entry testing. Notably, audit findings frequently correlate with flaws in a company's internal controls or the quality of information given to auditors.

Enhancing Auditor Independence and Audit Quality in FRC-reviewed Firms (auditor independence)

The emphasis in the latest revisions by the Financial Reporting Council (FRC) on reports concerning Mazars LLP, Deloitte LLP, KPMG LLP, PricewaterhouseCoopers LLP, Grant Thornton UK LLP, and Ernst & Young LLP was to increase both the reality and perception of auditor independence. This is essential for auditors to make objective judgments about audited entities and for stakeholders to trust the audit results. The changes also targeted enhancing the firm's procedures over independence assessments. The FRC further revised ethical standards for auditors to ensure compliance and to augment the perception of auditor independence.

Audit Quality Enhancement and Investment in Data Analytics (data analytics)

The company has doubled the size of the central audit support team and hired or promoted new audit partners. Focused specialization has been applied to strategic markets which include financial services, public sector, and private businesses. Specialized staff have been added for complex engagements such as IT, property valuations, and auditing. Steps to boost audit quality include the introduction of technical assessments for responsible individuals and the kick off a culture-based 'no compromise' project. New audit quality indicators have been developed to track team wellbeing and productivity. The company has also made advancements in their audit methodology related to IFRS and their approach to expected credit losses, auditing of fair value and revenue management. Going forward, further investments and reviews are planned to improve onboarding, cultural integration, software deployment and client acceptance processes. The growth pace of the audit service line in the next year will also be moderated to focus more on quality enhancement. With the wide use of data analytics in the

audit process, good practices like a high standard of fraud risk assessment and rigorous management challenge are noticeable. The company has also been monitored by the ICAEW for audit quality. In the coming periods, more sophisticated audit techniques will be adopted, with emphasis on controls based testing and data analytics.

Assessing and Managing Climate Change Risks in Auditing (climate change)

The audits have increasingly incorporated in-depth climate risk assessments, focusing on the impact of climate change on accounting practices, financial statement disclosures, and more broadly, business operations. These entail the involvement of specialists and comprehensive methods to evaluate not only the direct financial implications but also the effects upon the useful lifespan of assets. The audits include supplementary risk assessment procedures and strengthened methodologies to appropriately respond to climate change impacts. There's a particular emphasis on environmental, social, and governance (ESG) factors as key to the audit quality strategy. Additionally, the audits have addressed the combined impact of climate change and the potential for fraud, heightening the complexity and depth of the risk assessments.

Improvement in Root Cause Analysis Process Through Audit Quality Indicators (interviews)

The RCA team is in the process of identifying potential causal factors of audits by evaluating self-assessments completed by audit team members, analyzing key measurements, and conducting in-depth interviews. The firm is incorporating audit quality indicators into the RCA process to provide input for investigation and to validate findings. Efforts aiming to refine the RCA process include considering additional audit quality indicators for information analysis and implementing deeper questioning in interviews. This structured approach has led to more effective interviews, comprehensive analysis, and accurate identification of causal factors.

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