

How to prepare for an audit quality review

For small- and medium-sized practices, there are ‘good’ and ‘not so good’ aspects to all audit quality review visits. This article highlights some tips to help you ensure your firm does not fall into the ‘not so good’ category.

BY JOHN MCCARTHY

Put simply, preparation is the key to a successful quality review visit from the Institute’s Professional Standards team. This preparation will involve having detailed knowledge of the audit issues around FRS 102, Ireland’s new accounting framework, the implementation of which has mostly been straightforward. Where transition adjustments are required, however, these are not always supported with appropriate audit evidence – especially regarding the independent verification of the fair values obtained.

Auditing standards require the auditor to display a sufficient degree of scepticism in her or his work, and an auditor cannot be said to have carried out an effective audit without conducting corroborative research and obtaining appropriate written representations. Furthermore, all auditors should prepare a comprehensive audit file to support her or his audit opinion.

Reference should also be made within the audit planning memorandum (APM) to connect specific significant risks in the audit with the actual tests carried out. For the audit of the financial statements of a supermarket, for example, it may be turnover and stock completeness. For an audit of the financial statements of a quarry, on the other hand, it might be

the restoration provision.

There should be a link between the audit assertion (completeness, cut-off or existence, for example) and the individual tests executed. The assertions being audited must be made clear and the outcome of each test properly documented (for example, whether the result is satisfactory or unsatisfactory). If it is the latter, the auditor must explain the nature of the further work carried out.

Analytical review (ISA (Ireland) 520 Analytical Procedures) documentation must contain appropriate explanatory text to show why the numbers have or have not changed year-on-year, taking into account matters such as consideration of different revenue lines, expectations based on activity and so on.

A mandatory requirement of ISA (Ireland) 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding of the Entity and its Environment is that audit files show clear evidence of testing journal entries. This highlights the potential for fraud to have been perpetrated using seemingly innocuous journals to cover them up. Some auditors are now using audit data analytics tools like Information Data Extraction and Analysis (IDEA) to isolate outliers, such as unusual journals, which merit further audit scrutiny.

Sample size selection often needs better explanation in the planning section of the audit file as well as more detail about the sampling method used (selected top 20 items, for example, then 10 random above performance materiality).

Quite often, too much testing is done on trade creditors. When a supplier statement is available, for example, it may be unnecessary to check post-year-end payments as well. On pre-payments, there is no need to recalculate every figure and no need to place a copy of the supporting invoice on file to support every figure, especially when they are below materiality.

With trade debtors’ verification to post-year-end cash receipts, audit files often neglect to show that the recorded remittances post-year-end actually relate to pre-year-end sales.

Top tips

Do not over-rely on financial statements presentation software; auditors must verify disclosures in accordance with Companies Act 2014 and FRS 102. Chartered Accountants Ireland has some very useful toolkits for checking financial statement disclosure references.

Note on the audit file any critical judgements or assessments made, as others reading the file may not come to the same conclusion. These notes

should be written clearly to justify the audit treatment adopted.

Do not answer 'Y', 'N' or 'N/A' to questions in an audit programme or checklist without some supporting corroborative evidence as to why this is the correct answer. Just because it was there last year does not necessarily mean it is correct this year (with or without a change in accounting standards).

In terms of related parties and beneficial owners, the audit team must be well briefed before the audit starts. If someone can influence the company – irrespective of whether they have entered into any transactions with the party or there is any required disclosure – the audit team must know about these people. For example, premises rented from a related-party landlord at a zero-rental charge is still a related-party 'transaction' and disclosable if the market rent that would have been charged by a third party would have been material.

Often, a free search on CRO will highlight other directorships previously unreported. Directors' spouses, parents, children and business interests can be incorrectly omitted from relevant financial statement disclosures. With the new requirement on Irish corporates from 15 November 2016 to keep a register of 'beneficial owners' for anti-money laundering legislative purposes, auditors will need to check that the ultimate beneficial owners – as disclosed on that register – correlate to those disclosed in the company's financial statements.

Going concern evidence is another frequent bugbear on audit files. If the company is planning to stop trading in the next year, it is not a going concern. It is therefore important to ascertain and document the future business plans of the directors and shareholders (for example, to inject more working capital or file for liquidation). It is not enough to say that there is a positive balance sheet. If the sole director/employee is contemplating retirement, then the business may not be a going concern and the financial statements need to reflect this (for example, prepared on a 'break-up' basis).

Always follow-up on bank enquiry

responses and obtain them before the audit is signed off.

Note the difference between 'immaterial errors' and 'trivial errors'. Immaterial errors need to be noted for consideration while trivial errors do not. Refer to Practice Note 26 (PN26) Guidance on Smaller Entity Audit Documentation for more information.

Where stock is material, the auditor is not absolved from stock-take attendance, even if there are expert stock-takers present. Expert stock-takers tend to be more prevalent in supermarket and pharmacy audits. Their presence is a useful addition to the audit evidence available to the external auditors, but the statutory auditor is still responsible for attending the stock-take (refer to PN25 Attendance at Stocktaking and ISA (Ireland) 501 Audit Evidence – Specific Considerations for Selected Items) and assessing the work of the expert stock-takers under ISA (Ireland) 620 Using the Work of an Auditor's Expert.

FRS 102 has lots of useful exemptions, which auditors should become well acquainted with: Section 35.10, which can only be used once on transition; Paragraph 1.8 for subsidiary company accounts; and Section 33.1a for related-party transactions in wholly owned groups.

Once Section 1A is triggered for 'small' companies, upon the signing into law of the delayed Companies (Accounting) Bill 2016, it will open up many other useful exemptions for certain 'small' entities, including the exemption from presenting the statement of cash flows.

FRS 101 also has some useful disclosure exemptions for Irish/UK subsidiary companies preparing IFRS financial statements, and already includes the exemption from presenting the statement of cash flows.

Lastly, audit report signatures must use the label 'Statutory Auditor' or 'Statutory Audit Firm', as the term 'Registered Auditor' no longer exists under company law.



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BE PREPARED

When preparing for an audit quality review visit, ask yourself the following questions. Has your firm:

- Carried out its whole firm annual compliance quality control review and documented the action plan arising?
- Carried out the required number of audit, clients' money and investment business cold file reviews (usually one file per partner) and documented the key action points?
- Communicated and documented the findings of these internal reviews to relevant audit staff and partners?
- Updated its professional indemnity cover?
- Ensured that annual independence, fit and proper and confidentiality declarations have been completed by all relevant partners and staff, including sole proprietors making the declarations to themselves?
- Put in place clients' money five-weekly bank reconciliations and bank letter of trust (for the clients' money bank accounts)?
- Filed up-to-date employment contracts with all staff and documented staff appraisals for all audit personnel?
- Checked that, where the firm has recently incorporated its audit service, it has made the necessary arrangements for student trainee contracts to be registered with the Institute's education department in the new entity's name?
- Got up-to-date CPD records for all relevant partners and updated CPD records for all other audit personnel?
- Written audit quality control procedures in place to deal with the 'International Standard on Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Engagements' (ISQC 1)?

If you have answered "no" to any of the above, or are unsure of the answer: do your homework. These are some of the many items examined during a review.