



KRESTON

Knowing you.

Quality Bulletin

AUGUST 2020





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Chair's welcome

Welcome to this third edition of the Kreston International Quality Bulletin. The world has certainly changed dramatically since the previous edition in November 2019.

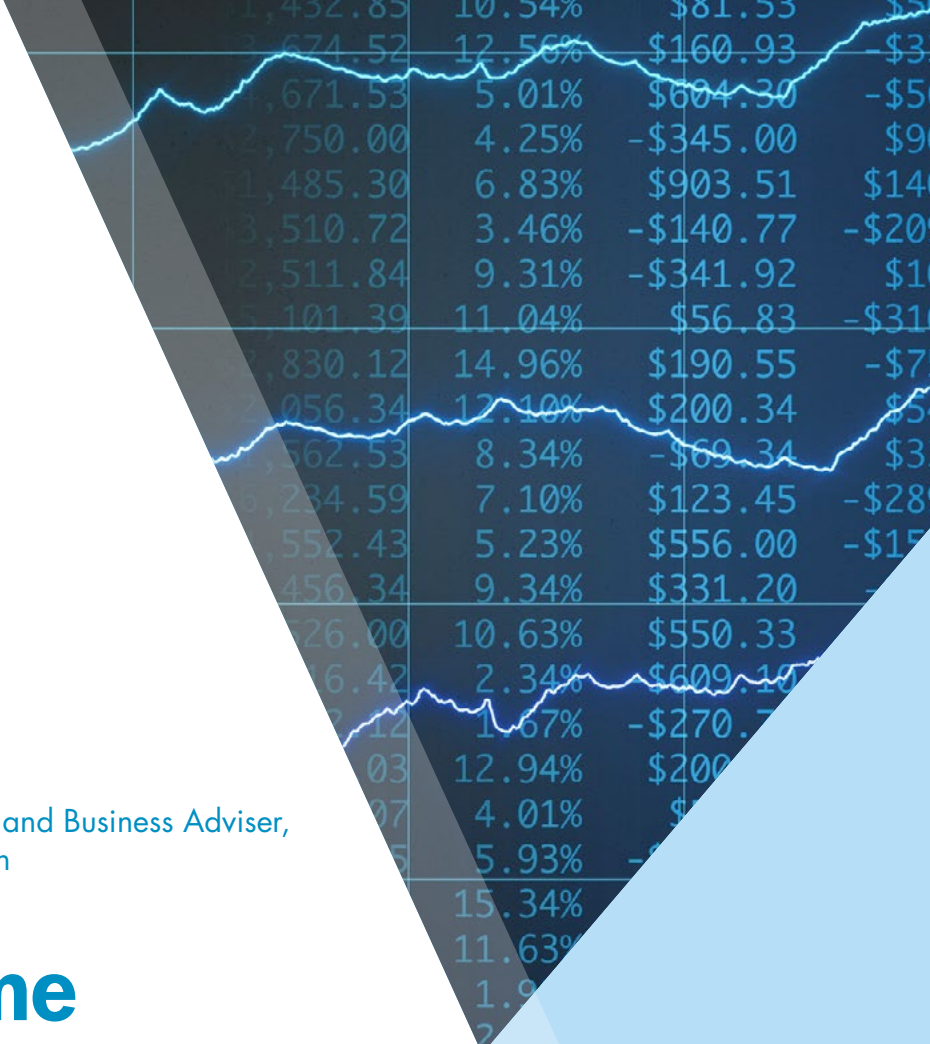
It has been impressive to see the efforts being made by Kreston member firms to maintain their own business while supporting the many clients they serve. Throughout these difficult times, I know that firms have had the quality of their work at the forefront of their mind as they have helped their clients to complete audits, access funding and plan for their business's future.

In many cases, the ability of firms to support their clients and complete work has been facilitated by the early adoption of remote working technology and tools. Firms have been able to access their clients' accounting records and request additional documentation while maintaining safety and working remotely. This is made possible by the readiness of clients to make available records in an electronic format in a secure environment.

It is likely that the changes initiated in response to COVID-19 will carry on into the future, and that firms and clients will continue to invest in technology that enables remote working. However, I think we are all looking forward to the time when we can meet in person as part of this process, as this is really invaluable in ensuring the deep understanding of a business that enables the provision of an effective and efficient audit service.

Although this is a time when there is so much to do in terms of maintaining business, it is also an opportunity to think about how services are provided and businesses are run with a view to making changes that will be to the long-term benefit of all parties. Kreston's Technology Newsletter helps member firms to access a wealth of information on the digital tools being used by firms to enhance their services.

I hope you are keeping well, and wish you all the best.





USA



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Four accounting topics everyone's talking about

It has been a challenging year for accountants and auditors. Significant changes that have been on the horizon for several years were finally incorporated into yearend financial reports. Then the pandemic swept across the globe.

Implementation of major accounting updates

In the US private companies were required for the first time to apply the new revenue recognition standard to their calendar year end Dec. 31, 2019 financial statements. Although the required effective date was subsequently delayed in the US by one additional year due to the pandemic, many companies continued to cope with the challenges of implementation in 2020 while having their audits performed. A second major standard, new lease accounting, was also required for US public companies and companies reporting under IFRS. In addition, most US public companies also had to cope with adoption of a new credit loss standard for their first quarterly reports in 2020.

Implementing these new standards has impacted the timing of recognition for revenues, certain expenses, and the amounts of assets and liabilities raising challenges in understanding the impacts on the results of business and potentially affecting compliance with debt covenants and other contracts. Accounting processes, internal controls and other reporting functions have all needed adjusting.

Impairment

The economic decline caused by the COVID-19 pandemic has raised many questions about the fair

▼ *For those organizations with material amounts of goodwill, indefinite lived intangibles, amortizable intangibles or fixed assets, the analysis should begin with evaluating if a triggering event has occurred that will require a detailed impairment analysis*

value of a variety of assets held in a broad range of industries and companies. For some businesses and industries this has been demonstrated by declines in public share prices.

This market movement, along with the impact on future cash flows, and the resulting effect on other fair value indicators will create many questions about what may constitute a triggering event for organizations to determine whether to test their assets for impairment purposes.

For those organizations with material amounts of goodwill, indefinite lived intangibles, amortizable intangibles or fixed assets, the analysis should begin with evaluating if a triggering event has occurred that will require a detailed impairment analysis.

The accounting guidance does not provide a bright line definition for what constitutes a triggering event, which is due to the significant differences in the nature of assets and the differences in what may affect their valuation. Rather, organizations should evaluate the facts and circumstances that may indicate an asset's fair value is less than its carrying value.



Four accounting topics everyone's talking about continued

Going Concern

The material uncertainties created by the pandemic and recent events may cast doubt about an organization's ability to continue operating as a going concern and will need to be considered for accounting purposes prior to issuing financial statements. However, given the time and speed of changes, entities will likely struggle to understand and evaluate the potential impacts on their financial reporting. In order to prepare an analysis of the ability to continue as a going concern, an entity needs to understand its operating environment at the date the financial statements are issued. The pandemic affects industries very differently. In some cases, an organization may have continued to operate and may have even seen an increase in customer demand, which is the case with online retailers, food delivery services, and agricultural products. Surges in demand, however, have come with their own potentially financially damaging consequences, namely supply and personnel shortages. The travel bans and stay-at-home orders have led to supply chain disruptions worldwide.

Government Grants

Unlike international accounting standards, US accounting standards do not provide authoritative guidance for the accounting for government grants by for-profit entities. As a result companies have to carefully consider the appropriate accounting guidance to apply to various government programs and incentives. The most significant US program is the paycheck protection program which provides for forgivable loans, however many other government programs that provide for direct grants also exist.

For most US companies when it comes to forgivable loans they choose to either account for it as a loan and recognized forgiveness income when it is formerly granted, or analogize to IAS 20. Other alternatives exist however, including analogy to guidance specific to not-for-profit entities which result in accounting an outcome that has some similarities to IAS 20, or to guidance on contingent gains, which results in accounting similar to the guidance for a loan.





UK



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Forum of Firms update

The Forum of Firms is an association of the leading audit networks; it includes the Big 4 firms, and Kreston International is proud to be a member. The key function of the Forum is to promote audit quality globally.

The Forum meets twice a year and the March meeting was, as you would expect, held virtually. A key element of meetings is the interaction between attendees and presenters. The technology was well managed and, by using the hand-raising and chat functions within Zoom, participants were still able to contribute fully to discussions.

The meeting included a session on the impact of COVID-19 on auditing and financial reporting. The notes from this are available to member firms, along with a webinar on the impact of COVID-19 for auditors (see the Kreston Training Brochure for details).

The main focus of the meeting was on the future. An in-depth session was held on the move from the quality control standard currently in place through ISQC 1 to a quality management approach with the introduction of ISQM 1 and ISQM 2.

Based on feedback from the exposure draft period, the International Auditing and Assurance Standards Board (IAASB) Task Force has worked on addressing the many matters raised by respondents. The final version of the standard is expected to be issued later this year.

A key element of the standard is its emphasis on leadership of the firm taking responsibility for the system of quality management. Although there are common risks and components of a quality management system across firms, the standard is designed to ensure that firms reflect on and identify

the specific risks they face and design appropriate responses. Kreston International will be working to produce support material for member firms to enable processes to be adopted in good time for the effective date (which has yet to be agreed).

The International Ethics Standards Board for Accountants led a session on the definition of 'public interest entities' and 'listed companies'. This is central for determining which entities are subject to more exacting requirements in the Ethics Code and in ISAs. It is complicated by differences in the definition applied in various countries, and the need to avoid a definition that includes too many low-risk entities. This work will continue over the next year.

The IAASB also covered proposals for the update to ISA 600, which deals with the audit of groups. This is a key standard for an international network such as Kreston, where access to reliable component auditors across the globe is vital.

The proposed standard introduces an enhanced risk-based approach to planning and performing a group audit. This approach is intended to focus the group engagement team's attention and work effort on identifying and assessing the risks of material misstatement of the group financial statements, and designing and performing further audit procedures to respond to those assessed risks. The proposed standard recognises that component auditors can be, and often are, involved in all phases of a group audit. In these circumstances, the proposed standard highlights the importance of the group engagement team's involvement in the component auditor's work.



Forum of Firms update continued

In addition, the proposed standard:

- Clarifies the scope and applicability of the standard
- Emphasises the importance of exercising professional scepticism throughout the group audit
- Clarifies and reinforces that all ISAs need to be applied in a group audit through establishing stronger linkages to the other ISAs, in particular to proposed ISA 220 (Revised), ISA 315 (Revised 2019) and ISA 330
- Reinforces the need for robust communication and interactions between the group engagement team, group engagement partner and component auditors
- Includes new guidance on testing common controls and controls related to centralised activities. This reflects the move by international businesses to use shared service centres to process accounting records
- Includes enhanced guidance on how to address restrictions on access to people and information
- Enhances special considerations in other areas of a group audit, including materiality and documentation.

The exposure draft of the proposed ISA 600 (Revised) is open for public comment until **2 October 2020** and can be found at www.iaasb.org.





INDIA



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Information complexity and the enduring value of checklists

Before a patient leaves the operating theatre, it is standard practice for hospital staff to count the instruments, sponge and needles that have been used. Compared with keeping the patient alive, this might sound a trivial activity; yet it prevents materials accidentally being left in the patient's body, leading to complications and even death. That's why this crucial routine is included on the World Health Organization's 'Surgical Safety checklist'.

Many years of experience in the audit domain have taught me the value of a checklist. With the continuous flow of information, getting the steps right can be hard, even if you know them. Given the increasing volume of information to be processed, the risk of routine mistakes creates difficulties across a broad range of professions (e.g. medical, legal, audit, investment).

Seeking a solution, US surgeon Dr Atul Gawande turned to the field of aviation. Back in 1935, the US Army Air Corps tested a new aircraft, the Boeing 299. Based on design features and capacity, it outperformed competitors; yet on its second evaluation flight, after a routine ascent, the aircraft stalled, turned on one wing and crashed in a fiery explosion, killing both test pilots and injuring observers. Boeing lost the contract and almost went bankrupt as a result.

An investigation revealed that the crash was due to pilot error: the new four-engine design added significant complexity to the operation of the plane (one newspaper described it as 'too much airplane for one man to fly'). Despite the experience of the senior pilots (one was Boeing's chief test pilot), a new locking mechanism on the elevator and rudder controls had not been released.

Clearly, rapid technological advances meant that flying a new aircraft had become too complicated to be left to the memory of any one person, however expert and experienced. A group of pilots created a checklist to prevent similar incidents in future. It lists the routine steps that all pilots must follow – simple checks such as ensuring that the brakes are released, the instruments are set, the door and windows are closed, the elevator controls are unlocked, and so on. Armed with this checklist, pilots went on to fly the Model 299 a total of 1.8 million miles without a single accident.

In his book *The Checklist Manifesto* (2011), Dr Gawande writes:

In the current complex environment of technology, information experts are up against two main difficulties. The first is fallibility of human memory and attention, especially when it comes to mundane, routine matters that are easily overlooked under the strain of more pressing events. And second is that the people can lull themselves into skipping steps even when they remember them. In complex processes, after all, all certain steps don't always matter. The volume and complexity of what we know has exceeded our individual ability to deliver its benefits correctly, safely, or reliably. Knowledge has both saved us and burdened us.

So, what is the solution? The simple checklist. It can't tell us how to do things, and may not apply 100% to all situations; but it does provide essential guidance to minimise errors. We are all familiar with



Information complexity and the enduring value of checklists continued

simple briefs such as accounting standards checklists and auditing standards checklists, which ensure that nothing is overlooked during an audit.

As Dr Gawande notes, 'The knowledge exists but however supremely specialized and trained we may have become, steps are still missed. Mistakes are still made'. Checklists offer some protection against such failures. They remind us of essential steps, making them both explicit and verifiable. Dr Gawande has found that they can even help to establish create a more disciplined culture in which a higher standard of baseline performance is maintained.

In practice, there can be some resistance to using checklists, especially if these are unfamiliar or badly designed: Boeing's senior checklist manager, Dan Boorman, notes that a checklist that is lengthy, vague and imprecise is unlikely to be followed. Perhaps Dr Gawande is also right that 'We don't like checklists. ... It somehow feels beneath us to use a checklist, an embarrassment'. Have you ever experienced such feelings, or witnessed them in a team member? If so, just take a moment to consider what could have been avoided if the pilot's checklist had been implemented back in 1935.





UK



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Managing internal monitoring

Although the audit landscape has transformed dramatically in recent months, one thing remains unchanged: the importance of ensuring quality in the audit work done. These are challenging times for businesses and auditors, and there are potentially many uncertainties about the future that will need to be considered by companies.

Against this backdrop, it would be easy to downplay the importance of internal monitoring. However, as pressures on audit teams increase it is vital to safeguard quality. Limitations on travel and contact can make performing quality reviews more difficult, but there are steps that can be taken:

- If you have an electronic audit system, then file reviews should be possible. Where possible, the review should be done on a copy of the file, so that there is no trail of the review.
- Where paper files are used, it may be possible to have these delivered to the reviewer. Take care to transport them securely.
- Virtual meetings can be carried out when needed.

One of the challenges with remote reviews is ensuring focus on the review. It is easy to be distracted by client work demands. The use of external consultants can help, as can setting specific timescales for in-house reviews.

A growing trend among larger firms – and something that is being encouraged by regulators – is ‘in-flight reviews’, which examine certain aspects of files during the audit to check that policies and procedures are being followed. The reviews do not constitute an engagement quality control review, and will not have the same scope as a full cold review once the file is completed.

This type of review requires electronic files and access for appropriate individuals. The information reviewed will be limited to that relevant to key issues – identified, for example, in cold reviews and external quality reviews – concerning changes in standards or revised systems and processes. Some audit software systems can provide an overview of progress on all assignments so that files with risk indicators, such as delays in completion of certain elements of the file, can be targeted. In other cases, files can be selected based on risk and the need to cover partners and managers.

Areas that could be covered by this type of review include:

- Documentation of fraud discussions
- Partner review and approval of planning
- Timely and appropriate involvement of the Engagement Quality Control Reviewer
- Review of high-risk audit areas, such as intangible assets and financial instruments
- Assessment of the ‘going concern’ audit work.

It is crucial that internal monitoring is well planned, adequately resourced, and supported by the tone at the top of the firm. This will help ensure that reviews are completed, issues identified and appropriate action taken.





THE NETHERLANDS



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Audit quality framework in the Netherlands

In the Netherlands, companies are obliged to have their annual accounts audited once they satisfy at least two of the criteria for medium-sized entities for two consecutive years. A company is considered to be medium-sized if its annual balance sheet totals €6 million or more, has a turnover of at least €12 million, or employs ≥ 50 full-time staff. In addition to the statutory audit obligation, a company can voluntarily have its annual accounts audited or have one of its stakeholders, such as the company bank or subsidy provider, arrange to have the annual accounts audited by a registered accountant.

All auditors registered with the Royal Netherlands Institute of Chartered Accountants (NBA) may issue an audit report in the event of a non-statutory audit engagement. Issuing an audit report for a statutory audit is reserved for auditors and audit firms with a licence from the Netherlands Authority for the Financial Markets (AFM). If a company is listed as a Public Interest Entity, it can only be audited by an audit firm with this type of additional licence.

Audit firms with an AFM licence are subject to periodic reviews by the AFM, which means that they must undergo an in-depth review once every 4–6 years by the AFM regulator or an organisation that has been mandated by the AFM to conduct such a review. In the Netherlands, the NBA and the SRA (www.sra.nl) are official bodies entitled to exercise and evaluate this supervision on behalf of the AFM. The delegation of AFM supervision to other organisations is currently under discussion in the Netherlands, and there are ongoing developments and/or political decision-making processes to reserve the monopoly on supervision for the independent regulator AFM.

This supervision generally consists of an annual survey of an audit firm's internal quality system. Every audit firm must have guidelines and policies in place to ensure that its work is carried out in compliance with legal and professional requirements for the proper performance of an audit engagement, on the Dutch Standards on Auditing (almost fully comparable to the International Standards on Auditing).

An audit firm's quality system must include, among other things:

- Engagement Quality Assurance Review on audit files
- Internal file reviews
- Consultation
- Complaints mechanism
- Register of incidents and violation
- System of sanctions for non-compliance with the quality system.

As explained above, this policy must be assessed annually by the regulator and an in-depth review is performed once every 4–6 years, using audit files to assess whether the audit was carried out in accordance with the auditing standards and whether the audit team complied with the internal quality rules in the course of their work.

Based on this assessment, an accounting firm will receive a score either 'satisfactory' or 'unsatisfactory'. The first 'unsatisfactory' score will require the firm to draw up an improvement plan and undergo another review within 1 year. In the event that a reassessment



Audit quality framework in the Netherlands continued

once again results in an 'unsatisfactory' score, the regulator could ask the firm to draft yet another improvement plan; but if the firm fails to show sufficient improvement, it may be asked to surrender its licence – or, in extreme cases, the AFM can revoke the licence. In addition to confronting the audit firm with its problems, substandard performance can also have consequences for the auditor, such as a disciplinary complaint being filed with the audit firm. The Accountancy Division can only find individual accountants guilty and issue a warning or reprimand, or (temporarily) strike their name from the register. Incidentally, any person or organisation in the Netherlands may lodge a complaint against an individual accountant if they believe that the accountant has not carried out their work properly; this is therefore not a right reserved exclusively for professional bodies or regulators.

The system of compulsory licencing for statutory audits and their periodic supervision by the regulator for accounting firms on the one hand, and the system of (continuing) education and disciplinary review for individual accountants on the other, is designed to ensure that audits satisfy national and/or international requirements that we have all agreed with one another in advance.





UK



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Quality corner

This section looks at ways to enhance effectiveness of the components of a quality system. The areas covered are not just relevant to audit and assurance, but can also be good practice in other service lines.

Consultation

There are many situations where staff and partners need to make judgements regarding audit evidence or advice being given to clients. Although firms invest significantly in training and continuing professional development, this does not mean that individuals should shoulder the entire burden of taking complex and often finely balanced decisions. Consultation enables the effective sharing of experience and knowledge, which can lead to better decision making.

Creating an effective consultation culture requires a number of factors:

- **Leadership from the top** – senior partners and staff who actively consult in appropriate circumstances
- **Openness for consultation** – appropriate partners and subject-matter experts should be identified, and it should be easy for staff to contact them
- **Recognition as a positive attribute** – quality, recognition and reward systems should identify appropriate consultation as a desired and positive outcome
- **Support resources** – experts should have access to appropriate professional publications to ensure their knowledge is up-to-date.

Where consultation is undertaken, it is important that this is fully documented. The matter considered and the thought processes underlying the final judgement should be clearly recorded. In audit and

assurance engagements, it is important to remember that the final decision on judgements rests with the engagement partner.

As well as building a consultative culture, many firms will have required consultations that seek to maintain quality in complex areas. Issues that give rise to required consultations need to be determined by firms, but could include:

- Modification of the audit report
- Change in accounting policy by the company
- Prior period adjustments
- Change in the accounting framework
- Removal of a previous audit report modification
- Use of derivatives that may have a material impact on the financial statements.

Second partner review

An engagement quality control review (also known as a 'hot review' or second partner review) is always required for listed entities. There may be other situations or client types where, given the potential risk to the firm, a decision is taken to require a second partner review of the file.

Such requirements are set by the firm in response to the risks of the work being undertaken. Examples of sectors or clients where a second partner review might be useful include:

- High-risk sectors, such as casinos and gambling
- Sectors where there is external oversight, such as banking and some financial services



Quality corner continued

- Entities that either have or are looking to obtain significant levels of external loan finance
- Entities that are expected to list in the near future
- Entities that are looking to sell their business, and where the purchaser may consider the financial statements being audited (the auditor does not normally owe a duty of care to the potential investor, but care is needed)
- Entities with a level of public interest, such as significant national non-profits that raise substantial funds from the general public.

The purpose of the review is to provide a second pair of eyes to the assignment that is designed to support quality. The reviewer will look at areas such as client acceptance and independence; the assessment of risk in the planning stage; key audit judgements on higher-risk audit areas; and the effective conclusion of the audit, including communication with those charged with governance.

The review should be completed before the audit report is issued, and the second partner must confirm the audit can be issued. However, responsibility for the audit and the audit judgements remains with the audit partner.





UK



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ISA 600 – A reminder amid the coronavirus pandemic

While the global COVID-19 crisis has led to many challenges in complying with ISA 600, the requirements of that ISA have not changed. Here, we give a brief reminder of ISA 600 obligations and consider how auditors might go about fulfilling them during this time of great uncertainty.

The objectives of ISA 600 are:

- A. To determine whether to act as auditor of the group financial statements; and
- B. If acting as the auditor:
 - To communicate clearly with component auditors about the scope and timing of their work on financial information related to components and their findings
 - To obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In respect of objective (A), the COVID-19 lockdown creates a number of issues around accepting appointment of the group audit – including whether the auditor believes it is possible to obtain sufficient audit evidence from all jurisdictions within the group. Auditors will also need to consider whether sufficient audit evidence can be obtained regarding the opening balances – particularly in respect of the consolidation, a task that may not be easy given the potential difficulty in reviewing prior period working papers. This task may need to be undertaken remotely rather than in person, depending on social distancing rules and other restrictions. Auditors will

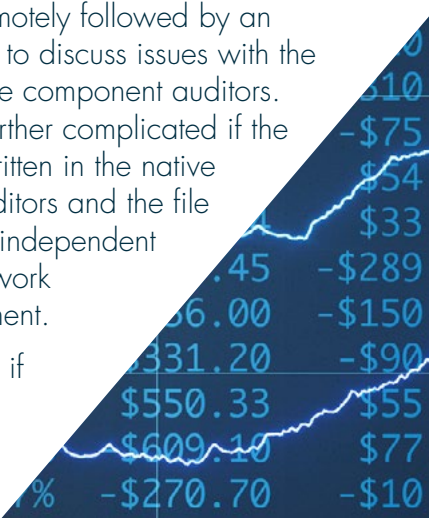
▼ *In this digital age, it may well be possible to review working papers remotely followed by an in-depth video/phone call to discuss issues with the senior team members of the component auditors*

need to think carefully about whether they, and proposed component auditors, have the ability to undertake a large proportion of the work that needs to be done remotely.

Objective (B) could give rise to more significant issues. This is especially relevant where sufficient audit evidence has previously been obtained via the onsite review of significant component auditor working papers, particularly when this involves travel overseas. Given the extensive worldwide travel restrictions in place, physically reviewing these files on site at the component auditor may prove impossible and auditors will need to consider very carefully how they are going to obtain a sufficient level of assurance over the components work.

In this digital age, it may well be possible to review working papers remotely followed by an in-depth video/phone call to discuss issues with the senior team members of the component auditors. This could, however, be further complicated if the working papers are not written in the native language of the group auditors and the file reviews previously utilised independent translators to interpret the work undertaken on the component.

Further complications arise if countries have imposed





About Kreston

Kreston International Limited is a global network of independent accounting firms.

A cohesive network of close to 200 firms in over 110 countries that is home to more than 23,000 dedicated professionals, Kreston gives you access to top-quality advice and exceptional service wherever in the world you happen to do business.

As new markets develop and technology evolves, your business operates on an increasingly global scale. And when you're branching out into the unknown, you can't beat a bit of local knowledge. Our members leverage their network of local contacts to shape international solutions that are right for you and your business.

All our members know their local regulations and customs inside out. Combine that with their solid reputation and enviable contact book and there's no doubt that we give your business the competitive edge.

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