



Knowing you.

Quality Bulletin

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Chair's welcome

Welcome to the November 2020 edition of the Kreston International Quality Bulletin.

A fundamental element of membership of an international accounting network is the ability to ensure that clients receive great advice wherever they are doing business. Kreston has always prided itself on the close connection between member firms and individual partners that delivers a high-quality personal service to clients. I am delighted that Kreston has now successfully launched an online platform that enables rapid access to the most appropriate support.

The new system does not replace the personal touch, but ensures that introductions can be monitored and tracked. The automated system enables the partner to quickly check on current status and follow up as needed. If you are a Kreston member, I would encourage you to visit the Kreston Kommunity, which in addition to the referral system contains lots of other information about Kreston International.

If you are a client or contact of a Kreston firm and have a professional service need overseas, do ask your Kreston contact to make an introduction.



UK



ANDREW COLLIER

Director of Quality and Professional Standards
Kreston International



Forum of Firms update

The Forum of Firms, an association of international audit networks, held its second meeting of the year in October. The virtual meeting covered a wide range of topics, summarised below, that are important to the profession and wider stakeholders.

International standards on quality management

The final versions of the Quality Management Standards have been approved by the IAASB. The standards need to be confirmed by the Public Interest Oversight Board before final release. The standards will need to be implemented by December 2022.

The standards mark a shift in emphasis from quality control, which required a range of activities to be undertaken, to a quality management approach. Under the quality management standards, firms will need to identify quality objectives and the risks to those objectives. Responses will then be developed to address the risk faced by the firm. The new standards are designed to be more responsive to the circumstances and risks of individual firms.

This approach is intended to ensure that audit quality is maintained and enhanced.

Ethical standards

Independence continues to be a significant focus in the debate on audit quality. Areas that generate discussion are the provision by audit firms of non-assurance services (NAS) and the impact of non-assurance fees on the audit fee. The International Ethics Standards Board for Accountants is undertaking projects in these areas.

The non-assurance services proposals are expected to include:

- A prohibition on providing NAS to an audit client that is a public interest entity (PIE) if a self-review threat to independence will be created
- Further tightening of the circumstances in which materiality may be considered in determining the permissibility of a NAS
- Strengthened provisions regarding auditor communication with those charged with governance (TCWG), including, for PIEs, a requirement for NAS pre-approval by TCWG
- Stricter requirements regarding the provision of some NAS, including certain tax and corporate finance advice
- Guidance to assist firms in evaluating the level of threats to independence when providing NAS to audit clients.

The fee proposals are expected to include:

- A prohibition on firms allowing the audit fee to be influenced by the provision of services other than audit to the audit client
- In the case of PIEs, a requirement to cease to act as auditor if fee dependency on the audit client continues beyond a specified period
- Communication of fee-related information to TCWG and to the public to assist their judgements about auditor independence
- Guidance on identifying, evaluating and addressing threats to independence in relation to other fee-related matters, including the proportion of fees for services other than audit to the audit fee.



Forum of Firms update continued

The revisions will further restrict the auditor’s ability to provide non-assurance services to audit clients, especially where the client is a PIE. The fee requirements would reinforce the separation of the provision of audit from other services. This separation is underway in the UK, where the Financial Reporting Council, has required the Big 4 firms to plan for the operational split of their audit arms by 2024.

Kreston International places the highest priority on ensuring firms meet the requirements of the IESBA Code of Ethics, and this will continue as changes to the code are implemented.

Audit of less complex entities

A great deal of the discussion around audit quality and standard setting centres on large listed and other public interest entities. However, the vast majority of audit reports, in terms of number, are issued for small and medium-sized entities. There are jurisdictions where there is no or little exemption from audit, and many entities are audited under the ISAs. The ISAs are designed to be flexible and scalable, but it has been decided that a fresh approach is needed to provide a global solution and prevent fragmentation caused by the development of local approaches.

The IAASB is developing a separate standard for the audit of less complex entities while continuing a broader approach with the ISAs where drafting principles guidelines address complexity, scalability and proportionality.

An early challenge will be the definition of a less complex entity where the new standard will be applicable.

An exposure draft of the proposed standard is expected in June 2021.

Extended external reporting

The traditional role of the auditor has been to provide an independent opinion on the financial statements. It is recognised that the future prospects of an entity are impacted by a wider range of factors than those presented in the financial statements. Stakeholders are increasingly looking at areas such as sustainability, corporate social responsibility and governance. As entities increase the scope of their external reporting, the demand for assurance on this information grows.

The IAASB is aiming to ensure consistent and appropriate application of ISAE 3000, which covers assurance engagements other than audits or reviews of historical financial information. The aim is to finalise the project by March 2021.

International Accounting Standards Board (IASB)

Goodwill and impairment continues to be a complex issue for both preparers and auditors of financial statements, and an area of much debate. The IASB project in this area has led to some preliminary views. There have been calls for the systematic amortisation of goodwill. However, the impairment-only model is expected to continue. Where changes could be seen is in the provision of relief from the annual impairment test and simplification of value in use.

The comment period for responses to the discussion paper closes on 31 December 2021.





UK



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Auditing related parties

Related parties are a hot topic in the world of audit, and fulfilling the requirements of ISA 550 can be tricky. Files must evidence the work performed and, importantly, the thought processes followed in reaching our conclusions. This article highlights some useful tips.

Planning

As with all effective audits, time spent upfront at the planning stage is time saved later in the process. The first step is to ask the obvious: 'Who are your related parties, and what transactions have taken place with them?'. We may need to clarify the definition of a related party. A questionnaire can be helpful in collecting this information.

Every team member must be aware of the related parties identified at this stage; consider making it a standard point on the planning meeting agenda. Keep the list consistently recorded, in the same location on all files. Ensure that it is up-to-date, and question the client if they stop mentioning related parties declared in previous periods.

Away from the client, do some research. Look at their statutory filings. Observe other entities that directors/shareholders have an interest in. Be aware of family names. Google your client; it's surprising what you can discover. If your firm also provides non-audit services, discuss potential related-party transactions with team members who perform those services.

We must also document our understanding of the systems and controls (if any) operated by the client, including who is responsible for operating them and how IT is used.

Risk assessment

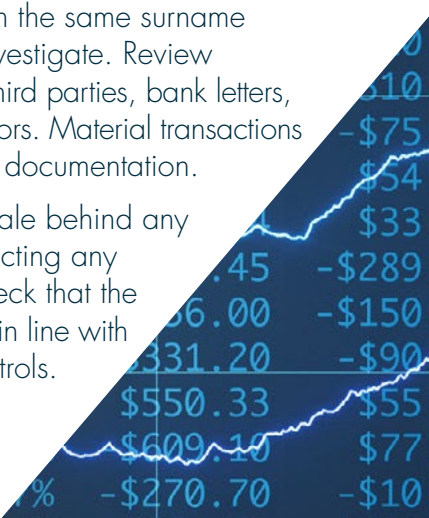
The risk of material misstatement, through error or fraud, associated with related parties must be assessed. Review the structure of the entity and the industry in which they operate. If you discover previously undisclosed transactions, consider the implications and possible motivating factors: Is the client attempting to hide transactions with family members? Are owners trying to hide transactions with other businesses that they have an interest in? Is the owner exerting influence over the finance function of the entity, bypassing the identified controls?

▼ *We must review the rationale behind any unusual transactions, inspecting any associated contracts to check that the transaction was authorised in line with the client's established controls*

Fieldwork

The whole team must be alert to related-party transactions and exercise professional scepticism. Expenses significantly increased, for no apparent reason? Payroll entries with the same surname as a director? We must investigate. Review information received from third parties, bank letters, correspondence with solicitors. Material transactions must align with supporting documentation.

We must review the rationale behind any unusual transactions, inspecting any associated contracts to check that the transaction was authorised in line with the client's established controls.



Auditing related parties continued

The whole team should be made aware of any non-disclosed transactions identified, and seek to uncover any others. Establishing the client's rationale for non-disclosure will determine next steps in our risk assessment.

Completion

We must obtain written representations from the client confirming related-party transactions. Any findings from the fieldwork must be communicated to those charged with governance – especially in the case of an entity whose owners are not involved in day-to-day management, or a charity that must report to trustees.

The completeness and accuracy of disclosures in the financial statements must comply with the requirements of the relevant financial reporting standards.

If the client refuses to make the required disclosures, the audit report may need to reflect this.

Common pitfalls

Documentation and scepticism are key. If work is not documented on file, then it did not happen. All discussions, both within the team and with the client, must be documented. Never mark the related parties section of the file as not applicable: even if no transactions are identified, consideration of related parties must be documented.

Consider the recoverability of related-party debtors. Similarly, if a holding company is providing support, assess their ability to provide that support.

When auditing smaller entities, related-party transactions can be harder to identify and the client may not fully understand their disclosure obligations; they might also lack appropriate controls.

The file must evidence assessment that any transactions that the client asserts are performed on an 'arm's length' basis do indeed qualify as such.

Conclusion

The audit of related-party transactions is complex, and every client is unique. Discuss, document, communicate, investigate and remain sceptical.





UK

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Senior Business Development Manager
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**SUPPLIER
SPOTLIGHT**

Inflo is an independent 3rd party software provider that works closely with a number of Kreston member firms

10 Best Practices for Valuable Audit planning

A number of Kreston firms work with Inflo. In this article Inflo outline how their technology solution can assist and add value to the planning process.

Want to increase the value your clients receive from your audits when you plan your work?

Inflo was created to transform the day-to-day work your team does, create more value for your clients during each interaction, and transform you into your clients' trusted business advisor.

Leveraging preliminary analytics is the first step in this journey. For those entering audit 'busy season', Inflo have produced 10 top tips for audit planning.

Benjamin Franklin is credited with saying 'If you fail to plan, you are planning to fail!'. Few people understand this better than auditors – planning an engagement is a crucial part of our work.

With the help of the latest technology, the planning process can achieve much more than simply satisfying compliance standards. It can drive the delivery of more effective, higher-quality services, completely transforming the experience for both your team and the client.

In this guide [PDF], we'll walk you through the 10 simple changes you can make to the audit planning process that will help deliver more valuable outputs to your clients in less time:

- Tailored information requests
- Digital client collaboration and workflow
- Access to transactional data
- Enhanced preliminary analytics
- Scoping and assessing risk

- Purpose-driven walk-throughs
- Front loading testing
- Introducing other services
- Constructive client interactions
- Fees based on value

Download the guide [PDF] to discover how a focus on digital collaboration, a tailored approach and impactful client communications can deliver a new, more valuable experience for you and your clients.

For more information about audit planning in practice, how to best use Inflo in your firm or to hear how others around the globe are benefiting, please reach out to Lindsay Wemyss who looks after the Kreston Network.





UK



ROBERT HOLLAND

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James Cowper Kreston

Going concern and letters of support

During the current COVID-19 pandemic, the issue of going concern – always important – has become even more critical to auditors forming their opinion.

As time goes on, the impact of the various measures that governments have taken around the world to combat the pandemic have become clearer. However, the risks arising in the period over which going concern is assessed are much more uncertain than they may have been previously.

▼ *Much of the world considers going concern for a period of 12 months from the balance sheet date. Here in the UK, we go further and consider it 12 months from the signing date*

Much of the world considers going concern for a period of 12 months from the balance sheet date. Here in the UK, we go further and consider it 12 months from the signing date; indeed, we consider the impact of significant events in the period beyond 12 months that would be foreseeable within that timeframe.

In such times, component auditors often obtain letters of support from the group holding company stating that they will continue to support the subsidiary over the relevant going concern period. A common misconception is that these are somehow contractual and, in themselves, provide sufficient comfort over going concern.

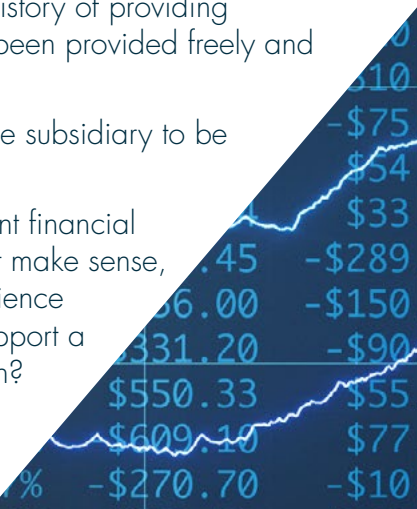
Caselaw exists in the UK (*Carillion Construction Ltd v Zelf Hussain and Robert Jonathan Hunt [Joint Liquidators of Simon Carves Ltd]*) that makes it clear that letters of support by a parent company do not have contractual force. Instead, they do no more

than provide the directors of the subsidiary (and certainly not the auditor, unless addressed to them) with evidence of the group's intention.

For them to be binding, they would need to be contractual and all the usual legal requirements of contract in the relevant country would need to be satisfied. Even then, they would not be sufficient in terms of audit evidence, unless supported by the financial position and prospects of the group.

So what do component auditors need to do to satisfy themselves in respect of going concern? Among many possible factors, some key aspects to consider include:

- Does the component actually need a letter of support in order to be considered as a going concern, or does it have sufficient headroom in terms of the resources and facilities available to it to be considered a going concern on a stand-alone basis?
- Are group financial statements or draft financial statements available that show that any letter of support signed by the group holding company can be fulfilled?
- Does the group have a history of providing support, and if so has it been provided freely and not on onerous terms?
- Does it make sense for the subsidiary to be supported?
- Are group and component financial projections available that make sense, are consistent with experience and expectation, and support a going concern conclusion?



Going concern and letters of support continued

- What is the position of other components in the group (i.e., will they absorb most or all of the available resources)?
- When is the letter of support dated? (Clearly, a letter dated immediately before sign-off is likely to be more reliable than one signed off some time before.)
- Are there any conditions or caps to the support that limit their usefulness?
- Do the financial statements of the component make it clear that they are reliant on the support of the parent and that this is not legally binding?
- What other letters of support have been issued?

Clearly, now more than ever, components will be keen to ensure they have a clean going concern audit opinion. As a result, it is particularly important that auditors satisfy themselves properly that such an opinion can be given.





CHINA



HONGCHANG ZHANG

Director
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CICPA strengthens accounting firms' self-discipline supervision in their practice

The new Securities Law of the People's Republic of China, implemented on 1 March 2020, has had a profound impact on the CPA industry. To strengthen accounting firms' level of management and practice, the Chinese Institute of Certified Public Accountants (CICPA) released the *Instructions on Strengthening Accounting Firms' Self-discipline Supervision in their Practice in Securities Services* (hereafter, 'the Instructions') on 18 September 2020.

In recent years, since the financial fraud cases of listed companies are frequently observed, the quality of audit has raised concerns from all parties. The new Securities Law waives restrictions on accounting firms' eligibility to provide securities-related services, significantly increases penalties on accounting firms' non-compliant acts, and imposes higher demands on the audit quality of securities service. CICPA puts forward some instructions to strengthen accounting firms' self-discipline supervision on securities-related service (both during and after the service). The Instructions further enhance measures for self-discipline supervision, improve awareness on business risks, raise penalties and disciplinary actions, improve public access to relevant information, and promote stricter standards for accounting firms' auditing quality. In outline, the Instructions:

- Establish a system for questionings and inquiries. As one of the measures of risk warnings and post-service supervision, this system shall apply to significant and urgent matters that may affect the public interest.
- Improve the mechanism for processing complaints, news media questioning and other matters. This mechanism shall apply to minor non-compliant

business acts that do not incur penalties or disciplinary actions.

- Refine the monitoring mechanism for abnormal circumstances, establish documentation of regulatory leads, and initiate supervision procedures (e.g. questionings, inquiries, and individual investigations) in due course to enhance the efficiency of supervision.
- Intensify the inspection and supervision of accounting firms undertaking securities-related services for the first time, and partners with a high volume of business.
- Strengthen the accountability system for principal partnership, such as chief partners of the firm, partners in charge of audit business, partners in charge of quality control, and partners in charge of audit business projects.
- Improve public access to relevant supervision information including routine disciplinary actions against misconduct, improve the information transparency, and enhance the deterrent effect of penalties and disciplinary actions.

CICPA seeks to establish a comprehensive mechanism to oversee securities-related service (both during and after the service) and corporate credit. By doing so, CICPA aims to enable multidimensional supervision and to empower the administration, the market and the industry to take action against non-compliance acts. CICPA will provide more evaluation and coaching to accounting firms that provide securities-related service. CICPA will also improve the joint supervision mechanism and build a credit supervision system.





SWITZERLAND



EMRE ÖZDEMİR

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Safe in uncertain times: Audit, assurance and advisory services acquire new significance

The COVID-19 crisis has highlighted what many of us have known for years: auditing is crucial to the smooth running of economy and society.

For many companies, the economic impacts of the pandemic and the lockdown in spring 2020 resulted in considerable liquidity problems and earning shortages. Some experienced liquidity bottlenecks immediately, because decreased sales no longer covered fixed costs.

The emergency legislation of the Federal Council (*Bundesrat*) provides the following tools to help the economy overcome these obstacles:

- State-warranted COVID-19 bridging loans (10% of revenues up to CHF 500,000), to partially cover fixed costs
 - Subject to certain conditions, including payout block (e.g. back-payment of loans or dividend distribution to shareholders)
- Compensation for short-term work, to cover personnel costs
 - Subject to no dismissal of personnel
- Temporary suspension of debt collection in case of over-indebtedness, to avoid bankruptcy.

As auditors, we have a central role to play in each of these measures, which have enabled many companies to survive the first wave of COVID-19 without further damage. We must monitor compliance with the criteria for emergency loans and short-term work compensation, and determine when balance sheet dumping is appropriate.

These are significant roles that carry a high level of responsibility, and companies may not always be aware of (or adequately reward) the extra work

involved. Newer tasks like this are sometimes simply assigned to the auditors without a full appreciation of what's involved. From the auditor's perspective, the remit could increase the 'expectation gap', placing unrealistic demands on our time.

▼ *As auditors, we must consider the new risks and work more closely with the board of directors or management of our clients without jeopardising our independence*

We are in the middle of the second wave, which inevitably means more lockdowns and similar disruptions. As remote working increases, we can expect a corresponding rise in cyber risks and compliance issues. We are progressively using completely new approaches in the digitalised data world (process mining, data analytics) and artificial intelligence (deep learning, machine learning processes). As auditors, we must consider the new risks and work more closely with the board of directors or management of our clients without jeopardising our independence.

However, the assessment of complex issues – such as the value of assets due to uncertain future business expectations – will continue to require the use of human intelligence, perhaps more than ever. In these uncertain times, deeper insight into the factors involved for a business involves more than just data processing. Only the combination of digital support and human interaction can provide the confidence and security necessary to sustain a growing economy.





MEXICO



JUAN ESPINOSA
SC Audit Partner
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Internal monitoring of control quality: Issues identified and root cause analysis

The International Standards on Auditing (ISA) issued by the International Federation of Accountants (IFAC) have long contained guidance on ensuring audit firm quality. Monitoring their own control quality, mainly in the audit area, has become a very important issue for public accounting firms. Identifying key issues around any deviation from applying the IASs, and most importantly locating the root cause of this deviation, should be a priority objective to avoid quality control problems that can seriously damage the firm's reputation, resulting in loss of credibility for their auditors.

Commonly identified issues that reflect poor audit quality include:

- Insufficient audit evidence
- Inadequate internal paperwork
- Failure to book material adjustments
- Small sample sizes
- Accepting doubtful evidence
- Untimely modification in audit procedure planning.

Such issues often arise from a misunderstanding of the client's industry and operations, as well as a weak process of supervision by higher-level personnel in the firm that is compounded by lack of supervision from the engagement partner. One of the most common points in non-compliance with the standards is the **closing of the working papers 60 days after audit completion**; this happens when there is no clearly defined process for this step.

Another frequent deviation from the ISAs is **documentation of training records**, which are usually controlled only for the audit partner,

overlooking other employees such as auditors – often because no formal structure is in place for the training or ongoing evaluation of personnel.

Selection of the client portfolio, and periodic reassessment of **client portfolio risk**, are fundamental risk monitoring and control processes for audit firms; but sometimes, a client acceptance process is lacking. Firms must develop methods to monitor and control the risk that their professionals might violate auditing standards or professional values in the act of performing their responsibilities. The ISAs on quality control state that audit firms must have in place an effective system of risk monitoring; firms are required to have policies and procedures in place to determine whether to accept or continue a client relationship or specific engagement. These policies should minimise the potential dangers of association with a client that lacks integrity.

Finally, peer review within the firm can be underdeveloped due to lack of planning and allocation of insufficient resources. It is important that internal monitoring is given appropriate priority by firm leadership.





AUSTRALIA



KAMAL THAKKAR

Partner
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Audit quality framework in Australia

A business can be conducted in Australia as a sole trader, partnership or joint venture, through a trust or corporation. Most foreign companies conduct business in Australia through a wholly or partly owned subsidiary, or through an Australian branch.

Foreign companies can register a new company in Australia. The most common form of business entity in Australia is a company limited by shares. These could be either proprietary companies or public companies. Only public companies can be listed on the Australian Stock Exchange.

The conduct and operations of Australian companies are governed by the laws of the Australian Corporations Act 2001. The Australian Securities and Investments Commission (ASIC) is an independent body of the Australian government and is Australia's integrated corporate, markets and consumer credit regulator. ASIC is therefore charged with the monitoring of proper compliance of Australian companies with the law.

Under the Corporations Act, the following types of entity are required to prepare and lodge audited financial reports (unless eligible for certain audit relief):

- All disclosing entities
- Public companies
- Companies limited by guarantee (except small companies limited by guarantee)
- All large proprietary companies that are not disclosing entities
- All registered managed investment schemes
- Small proprietary companies that are foreign controlled

- Small proprietary companies that have one or more crowd-sourced funding shareholders at any time during the year.

An Australian company is considered to be large if it satisfies two of the following three criteria:

- The consolidated revenue for the financial year of the company and any entities it controls is AU\$50 million or more
- The value of the consolidated gross assets at the end of the financial year of the company and any entities it controls is AU\$25 million or more
- The company and any entities it controls have 100 or more employees at the end of the financial year.

In some circumstances, small proprietary companies may also have to lodge audited financial reports (e.g., certain foreign-controlled entities).

Financial reports prepared in accordance with the Corporations Act usually must comply with the Australian Accounting Standards, which have aligned with International Financial Reporting Standards (IFRS) since 2005.

The Australian Auditing Standards Board (AUASB) and the Australian Accounting Standards Board (AASB) respectively set the standards by which a company's financial reports are prepared and audited.

Company audits must be carried out by Registered Company Auditors (RCA), approved through a rigorous application process administered by ASIC. To meet ASIC criteria, an auditor must:





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.

www.kreston.com



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