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Quality Bulletin

Issue 2

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Chair's welcome

Welcome to the second edition of the Kreston International Quality Bulletin. This edition contains articles on what it takes to be a great audit team and the impact of technology on the profession. We also continue our look at key issues in managing audit quality and the challenges encountered in audits. I hope you enjoy it.

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In October 2019 both World Standards Day and Global Ethics Day were celebrated. **World Standards Day** marks the efforts of experts worldwide who develop the voluntary technical agreements that are published as International Standards.

The accounting and auditing profession is unique in having both International Standards on Auditing (ISAs) and International Financial Reporting Standards (IFRS). These standards, which are adopted and applied in a large number of jurisdictions globally, enable us to be a mobile profession and make it much easier for companies expanding internationally.

Global Ethics Day encourages organisations to explore the meaning of ethics in international affairs. Ethical concerns are a daily feature in the life of an accountant, and in the area of audit this also involves a consideration of independence. Kreston International firms all commit to following, as a minimum, the Code of Ethics issued by the International Ethics Standards Board for Accountants. This helps to ensure that clients around the world are dealt with fairly whenever they do business with a Kreston member firm.

Personally, I have greatly benefited from working in other countries. I spent 6 months in Portugal and have visited numerous countries – both as a quality reviewer and as a group auditor visiting subsidiary entities. The platform of worldwide consistent standards and a common approach to ethics and independence has made this a much more straightforward process. It is something of which the accounting and auditing profession should be proud.

Whether as a member firm or as a client, being linked to Kreston International gives you the confidence that you can access a network of over 20,000 professionals in more than 120 countries, all of whom apply consistent standards. This enables your clients to expand internationally knowing they will receive a high-quality service whenever and wherever they need it.

Forum of Firms update

The Forum of Firms brings together representatives of the largest accounting and auditing networks to discuss the development of the profession. It also offers an opportunity to hear from and provide feedback to standard setters and regulators. Here are some highlights from the second meeting of 2019, held in London in October.

Group audits

- An in-depth review of proposed changes to ISA 600 on group audits. The delivery of high-quality audits involving firms in multiple jurisdictions is one of the key reasons why audited entities will chose to use a network.
- The proposals focus more attention on the responsibility of the group auditor to direct and supervise the work of component auditors. They also consider how individually immaterial components are assessed and appropriate audit evidence obtained. Finally, the interaction between local statutory audits and the work undertaken for the audit of the consolidated financial statements will also be explored to ensure an effective use of audit work.
- This review of ISA 600 will build on the work already undertaken on the quality management standards. Work is at an early stage and further documents will be issued in 2020.

Forum of Firms update

International Valuation Standards Council (IVSC)

- The audit and accounting profession has a long history of developing and working with consistent international standards. There are many situations where valuations of tangible and intangible assets and financial instruments will be important to financial statements. This is especially the case under International Financial Reporting Standards (IFRS), which call for the use of fair value in many situations.
- The IVSC presented the work it has been undertaking alongside a wide range of stakeholders to develop international standards for the valuation of assets and financial instruments.
- The standards are becoming more widely known and accepted. If your company uses valuations, or as a firm you provide valuation services, you are encouraged to learn more about the work of the IVSC at www.ivsc.org
- The standards cover the following topics:
  - Businesses and Business Interests (IVS 200)
  - Intangible Assets (IVS 210)
  - Plant and Equipment (IVS 300)
  - Real Property Interests (IVS 400)
  - Development Property (IVS 410)
  - Financial Instruments (IVS 500).

The future of assurance

Historically, the auditor's responsibility has been just to the shareholders of the entity, not to any other stakeholders. The current audit report and the work undertaken is carefully framed in this context. In many cases, this is to manage the liability risk that auditors could face from having responsibility to a wider range of stakeholders.

The financial crisis and other corporate failures have brought the role of the auditor into the spotlight. Regulators, politicians and other stakeholders are asking whether the audit is still fit for purpose. Attendees were challenged to think about what assurance work clients might request if the audit was not bound by the requirements of legal reporting requirements.

There is a wide range of possibilities, but under current statutory audit requirements the development of new assurance services is limited by the available budget. It is likely that entities will look for assurance in additional areas where there is demonstrable value. This may be in areas such as sustainability and environmental impact, which are becoming important to many stakeholders.

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Managing internal monitoring: The review cycle

The question of how often to perform internal monitoring, and the resources to apply, is an important aspect of managing an effective internal review process. The International Standard on Quality Control 1 (ISQC 1) expects the quality system to be monitored on an ongoing basis.

This is intended to ensure that firms' processes and systems are up to date and reflect latest developments. Procedures and systems also need to be updated in response to findings from file reviews.

The quality standard requires firms to review completed audit files; this should cover all audit partners on a cyclical basis. The developed good practice is to review the work of every signing partner at least every 3 years.

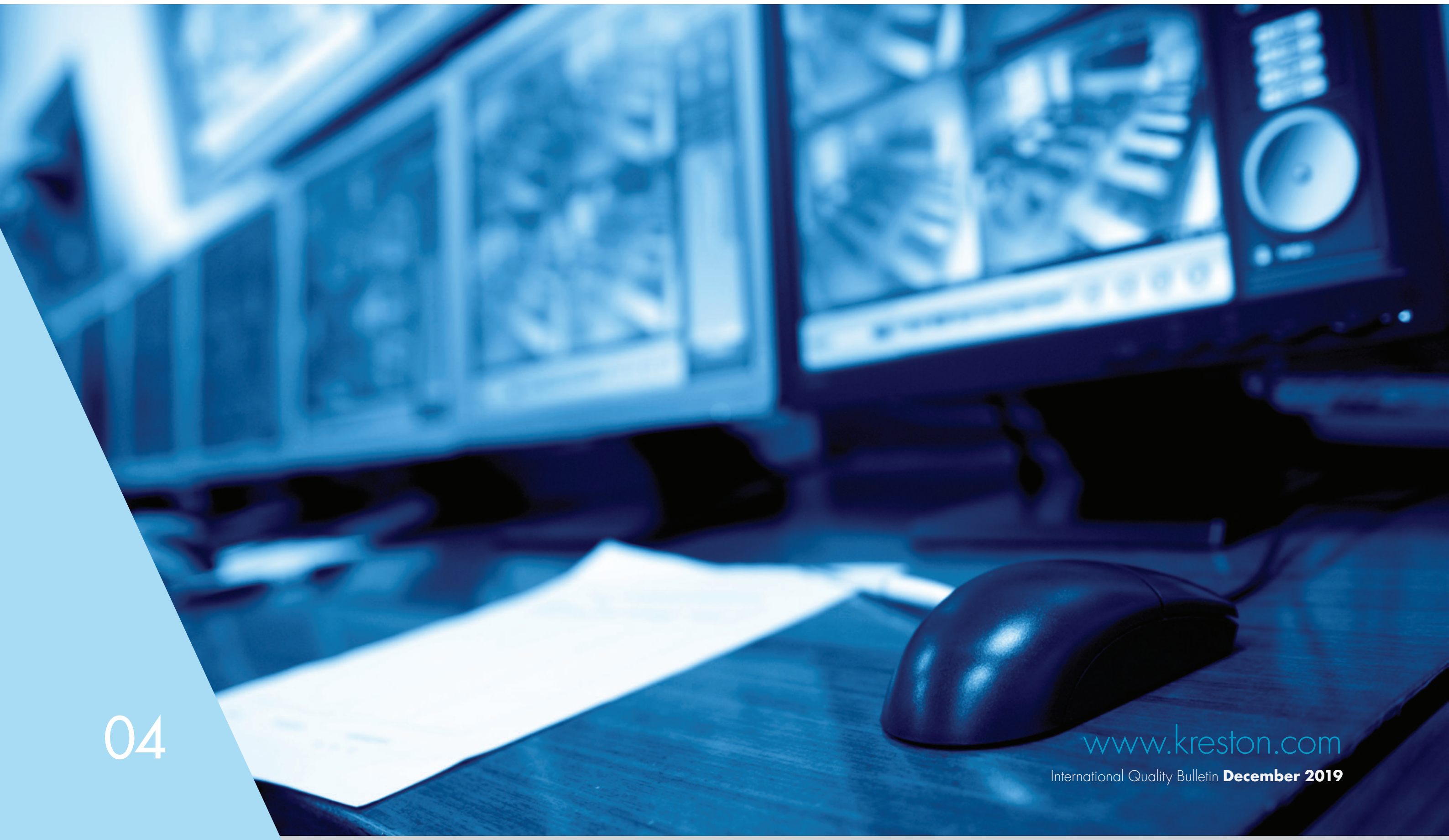
The approach taken by a firm should respond to the risk and size of the firm. In a large firm with highly developed systems and processes, a review of each partner every 3 years may suffice. However, if partners are working on higher-risk assignments, such as listed audits, then an annual review may be appropriate. Firms can also use external resources to provide even more transparency on the objectivity of the review process.

Some firms make the decision that, as this is a key service, it is important to review every partner every year. They will also look to review the work of every manager over time. The manager can be very important in setting the tone for quality work within a firm.

At a smaller firm, the knowledge, experience and qualifications to sign off an audit report may be concentrated in one or two individuals. In these cases, it can be more important that internal monitoring is performed on a regular annual basis to ensure the audit approach continues to comply with required standards. As discussed in the last newsletter, this monitoring can benefit from using external resources.

When planning the review cycle, it is helpful to consider:

- What is the appropriate review cycle given the size of the firm, its audit profile and the risks faced?
- Who should be included in the scope of the review, and who is best placed to undertake it?
- How will the review be resourced?



Quality corner: 'Going concern'

The auditor's work in assessing 'going concern' status is often cited by regulators as an area in need of improvement. Corporate failures also highlight this area, with stakeholders left wondering 'Why didn't the auditor spot this was coming, and warn us?'.

In the UK, the recent failure of the Thomas Cook holiday company resulted in thousands of employees losing their jobs and over half a million holidaymakers finding themselves stranded.

The auditor does have a responsibility in respect of going concern. Financial statements are usually prepared on a going concern basis. This assumes that assets will be realised and liabilities settled in the usual way. If a business is not a going concern, assets will need to be realised more rapidly; and this can have a dramatic impact on their carrying value. Liabilities may also need to be paid more quickly, which has an adverse impact on the balance sheet. If an entity is not a going concern, then that is not an appropriate basis for preparing the accounts, which should be prepared on a break-up basis. However, judging 'going concern' status often requires company management to predict the outcome of future events in an already volatile situation.

When considering going concern it is important to remember that responsibility rests with management. The auditor's job is to consider whether enough appropriate audit evidence is available to support the going concern assertion made by management.

ISA 570 covers the responsibility of the auditor in respect of going concern. Where conditions are identified that cast significant doubt on the entity's ability to continue as a going concern, the auditor is required to perform the following additional procedures:

- Request management to make its assessment, if not already done.
- Evaluate management's plans for future actions – including considering whether the plans will improve the situation, and whether they are feasible under the circumstances.
- Where the entity cashflow forecast is a significant factor, evaluate the reliability of underlying data and the adequacy of support for the underlying assumptions.
- Consider any additional information since management made its assessment, and request written representations from management and (if appropriate) those charged with governance.

"These procedures work well, if applied with a suitable level of professional scepticism and a probing mindset."

However, the Financial Reporting Council (FRC) in the UK has recently issued further requirements as part of a UK revision of ISA 570. Effective for periods starting after 19 December 2019, these do not apply outside the UK but can be useful when auditing going concern. The FRC also hope that the international standards will follow this more robust approach, which requires:

- Greater work on the part of the auditor to more robustly challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of management bias, and make greater use of the viability statement.
- Improved transparency – with a new reporting requirement for the auditor of public interest entities, listed and large private companies to provide a clear, positive conclusion on whether management's assessment is appropriate, and to set out the work they have done in this respect.
- A stand-back requirement to consider all the evidence obtained, whether corroborative or contradictory, when the auditor draws their conclusions on going concern.

Quality corner: 'Going concern'

Going concern can be a complex and sensitive area. The following actions can help the auditor:

- Keep in regular contact with the business, to keep track of its position.
- Understand management's process to assess going concern; if this is inadequate, discuss how it can be improved.
- Remember that going concern is the responsibility of management.
- Having assessed the risk, if it is significant plan the work early.
- Allocate the work appropriately. Checking mathematical accuracy may be the responsibility of a more junior team member, but challenging management on their assumptions and the outcome of future actions will require more experience. Consider whether the team needs to be supplemented by individuals with valuation or business recovery expertise.
- Follow your firm's consultation procedures.
- Where there is significant risk, consider inviting a second partner to review the work.
- Communicate with management and those charged with governance.
- Be specific in the representations requested.

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What makes a great audit team?

Delving into the world of data analytics

With origins dating back to the 1860s, BHP's ability to evolve and adapt has always been fundamental to its success. Certain episodes in the firm's long history have had a marked impact in shaping and driving it, and BHP's recent journey into the world of data analytics has been a significant milestone in the evolution of the business – with the firm's work in this area recognised at the 2019 British Accountancy Awards.

Quality, added-value and proactive advice have always been a central focus of the firm, but BHP has now harnessed the power of data analytics to improve audit quality, provide leading-edge insight and enable new ways of working for both the firm and its clients.

While BHP's journey with Inflo started over 2 years ago, 2019 has been a defining year with the firm formally rolling out its use across the entire audit client base from January. Fast-forward 10 months, and around three-quarters of audit clients are benefiting from the use of Inflo – with numbers increasing daily.

Central to this success has been the appointment of a manager into a role specifically leading on data analytics, along with five designated 'Inflo Champions' in each office to support clients and employees in overcoming any obstacles.

BHP's Data Analytics Manager has played a key role in breaking down barriers, ensuring buy-in from all parties and guaranteeing a smooth transition process for clients, while also providing training and support to audit managers.

The primary goal when adopting data analytics was to improve audit quality, but the impact for both staff and clients has been significant.

Clients have particularly benefited from valuable business insights that would previously have been invisible. Furthermore, the use of the tailored file sharing portal has meant improved transparency over the audit progress for clients and helped increase efficiencies in obtaining information for the audit team. This improved transparency and timeliness has not only prompted great client feedback but also strengthened BHP's competitive advantage, helping to secure new audit clients.

With employees, there has been a real change in mindset and people are working in new ways. With Inflo doing more of the legwork, employees are free to dedicate more time to critical thinking, exercising their professional judgement and – most importantly – getting to know the people behind the business, building relationships and business understanding more than ever.

Not only has BHP pioneered Inflo with its clients, but the firm is going further to actively champion this fundamental change in the mid-size sector to improve industry standards across the board. BHP is a thought leader in this area, working with the Institute of Chartered Accountants in England and Wales to provide speaker slots, webinars and articles.

We've learnt lots on our journey so far, and we're keen to help others also thinking about delving into the world of data analytics. If you are looking to begin your journey, feel free to get in touch to discuss how you can benefit from our experience.

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The Impact of Technology

Using people power in the age of technology

Technology is having a significant impact on many areas of the finance profession. Invoice processing, credit decisions and communication are just some of the many activities reaping the benefits of an increased use of technology, such as:

- Robotic machine learning – can help to automatically scan and post invoices to finance systems
- Data analytics – can be used to highlight unusual activity during the audit process
- Artificial intelligence – can help make sense of complex financial scenarios.

More powerful software, while making our jobs easier, has also brought with it a sense of insecurity: will our jobs become obsolete, or our skills redundant?

Of course, certain tasks will inevitably be replaced by automated systems. However, rather than having a negative impact on the accountancy industry, this should create more appealing opportunities.

For example, the advent of Making Tax Digital has compelled thousands of VAT-registered businesses to move onto an electronic bookkeeping package. This kind of software is easier than ever to use, and directly links into modules for preparing statutory financial statements. This means less time is spent posting invoices and preparing the year-end accounts. Levels of production will increase: more accounts, tax returns and VAT returns can be prepared, more quickly than ever.

In turn, this frees up time to provide value-added services to clients. Tax advice, budgeting, forecasting, scenario planning and many other activities can be offered instead. The human element of being a trusted financial advisor will be increasingly important.

Audit

Without question, technology is also having an impact on the statutory audit industry. Data analytics allows for vast ledgers to be quickly analysed, with unusual transactions being brought to the auditor's attention and information exchange portals allowing for the speedy exchange of information. However, I can't help feeling that at the heart of auditing will always lie human intuition, otherwise known as professional scepticism.

The demonstration of professional scepticism is crucial to a successful audit. Knowing what questions to ask, and when to ask them, to get to the root cause of an issue is not something that is going to be within the capabilities of software anytime soon, at least to the level of placing total reliance on it. Software can help the auditor decide where to focus their efforts; but experience, knowledge and a questioning approach are still key attributes required of auditors.

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About Kreston

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

A cohesive network of over 200 firms in over 125 countries that is home to more than 20,000 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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