

GO ON, SURPRISE ME

Auditing standards are putting pressure on auditors—who are passing it on to finance teams.

YOU MAY NOT BELIEVE this, but auditors are now meant to surprise you, their clients. Not, regrettably, in the sense of whisking you away for golfing weekends in Spain or to Wimbledon, but in the actual work that they do during the audit.

This fresh corkscrew on the roller-coaster ride that is the annual audit has been introduced by a new International Standard on Auditing (ISA) – not of course to be confused with international accounting standards (IAS). ISA 240 *Auditor's responsibility to consider fraud in an audit of financial statements* states: "In determining overall responses to address the risk of material misstatement due to fraud at the financial statement level, the auditor should incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures." In other words, say "Boo!" a bit more.

So how is this working in the field? One of my clients is a large multi-national. As I was working with them on management accounting and financial controls in their shared service centre, I became fairly involved in the audit process.

Turmoil isn't new to them – this time last year, divisional finance directors, auditors and the markets were obsessed with finding out how the International Financial Reporting Standards (IFRSs) would impact reported numbers. Of course, the hype outstripped the reality by some way. But at least everyone associated with reporting knew it was happening. In contrast, the introduction of ISA has been low-key to the point of non-existence. So we were certainly surprised by how much the Big Four firm



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wanted to hike its fees as a result.

If the auditors have changed their approach, you'd certainly expect FDs and their staff to change theirs, too. And that's what happened. The minute we twigged that they wanted to "surprise us", we were determined not to be caught out. So, in effect, we constructed a shadow audit and assigned our own project manager to the whole process.

Every time the auditor requested some information or a schedule, the request and its reply were also given to the project manager (thank goodness for email and the cc: option). That meant we could keep track of the information that the auditor was receiving; co-ordinate the production of the required data; and make an assessment of the likely result of the auditor's work ahead of time.

Is that an over-the-top response? Not according to my client. ISA represents a big step towards mandatory auditing practice – something that has not been experienced in the UK. The auditors certainly think the standards are now much more prescriptive. (It's even noticeable interms of the thud factor: the

new auditing rule book is 60 per cent heavier than its predecessor.) There are a couple of the new standards which seem to be unduly exercising them. Want to try it with your own firm? Ask them about ISA 500 *Audit Evidence* and ISA 505 *External Confirmations*. There is also increased emphasis on auditing fair value.

Those of us who are ex-auditors of a certain age were highly amused to learn the new rules on external confirmations meant that debtor circulations are now back in vogue. Who can forget the happy afternoons spent trying to persuade grumpy accounts departments to confirm the amount they owed us? Today's auditors will face as many problems as their predecessors. As a matter of principle, I never reply to debtor circs – unless I've just completed the reconciliation, the balance is likely to be wrong, and I'm not signing off on dud numbers!

But while audits and debtor circs can be amusing, materiality caused more moans than smiles. Audit group materiality this year dropped for the first time to the level of individual

subsidiaries and was worked out in a desperately formulaic manner with no apparent reference to sound judgement. The result is that this multi-million-pound company was subject to a materiality level amounting to just a few hundred pounds. You can imagine the sort of sample sizes and testing that resulted. At one point the audit team was inquiring whether a £3.20 invoice had been accrued for. How the hell were we supposed to know?

As in every audit, some errors were found – in this case amounting to a few thousand quid. That was OK. What wasn't OK was the procedure by which the auditor extrapolated those errors and solemnly announced that there must be errors amounting to hundreds of thousands of pounds and they would have to be adjusted for and reported to the audit committee. You can imagine how the finance team felt about that. In the end, thankfully, the team was able to demonstrate to the auditors that there was not, in fact, a black hole in the purchase cycle.

After all that effort, the question remains: has this trickier audit triggered by ISAs helped generate more accurate and reliable financial information for the shareholders? The answer is probably "yes". Is it worth the added costs? Hmm. But perhaps more importantly, it's pleasing to note that the auditors never *really* managed to surprise us. There's always next year...

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