The financial crisis both in Ireland and abroad has focused the attention of regulators, the media and politicians alike on the audit profession. Both high profile business failures and corporate governance issues, most recently in the charity sector in Ireland, have led to questions regarding the role the auditor has played in these scandals.

A key challenge facing auditors is keeping abreast of an ever changing and increasing set of international standards on auditing not to mention changes in both legal and regulatory requirements. The International Standards on Auditing apply equally from the smallest of audit engagements, such as a small owner management company, through to large publicly listed entities. The application of the full standards to small and medium enterprises (SMEs), rather than, as many would assume, being more straightforward, can on a practical level be more difficult for auditors to apply. The design and execution of an appropriate audit plan whilst ensuring compliance with the full international standards is often more challenging for auditors of SMEs. Against this backdrop how can we as auditors ensure delivery of consistency and quality in audit thereby enhancing the public perception of the profession?

Quality Control

The International Standard on Quality Control 1 (ISQC1) requires firms to establish and maintain a system of quality control for audit engagements. The system of quality control includes documenting policies and procedures that address each of the following elements:

a. Leadership responsibilities for quality within the firm
b. Relevant ethical requirements
c. Acceptance and continuance of client relationships and specific engagements
d. Human resources
e. Engagement performance
f. Monitoring

The design, implementation and effective monitoring of a system of quality control has an integral part to play in delivering both consistency and quality in the audit of financial statements. For example a firms’ policies and procedures in relation to engagement performance often include written or electronic manuals or other forms of standardised documentation, such as audit programmes. The use of such standardised documentation promotes consistency and quality across all audit engagements in statutory audit firms.

Getting the Plan Right

“By failing to prepare, you are preparing to Fail” (Benjamin Franklin)

The initial steps in any audit engagement is to plan the audit so that it will be performed in an effective manner. The auditor in planning the engagement is required to gain an understanding of the entity and its environment in order to be able to identify areas of significant risk and risk of material misstatement at the financial statement and assertion level. In response to assessed risk sufficient appropriate audit evidence should be gained in respect of risks as assessed, this will be achieved through the design and implementation of an appropriate response to those risks.

Through the performance of appropriate planning activities the auditor ensures that adequate resources are directed towards areas of risk as identified, and that unnecessary steps are not undertaken. Directing sufficient resources to the upfront work required by the auditing standards thereby helps ensure consistency and quality in audit engagements through focusing on areas of risk as identified in planning activities. Planning activities apply equally to an audit engagement for a small and medium enterprise as they apply to the audit of a publicly listed company, although the work performed and documentation of the same will vary according to the size of an entity.
Documentation

The objective of audit documentation is to provide a record of the basis for the auditor’s report and to provide evidence that the audit was planned and performed in accordance with the International Standards on Auditing (UK and Ireland) and the applicable legal and regulatory requirements.

Documentation should be sufficient to enable an experienced auditor with no prior knowledge of the client to understand the work that has been performed. This would include understanding the nature, timing and extent of the audit procedures performed, results, audit evidence obtained, significant matters arising and the conclusions reached including significant professional judgments made in reaching those conclusions.

It is neither necessary nor practical to document every matter considered or professional judgement made in an audit of financial statements. Audit documentation should demonstrate the risks considered and the overall response to the assessed risk. It is not however a requirement of ISA 230 to include a photocopy of every document viewed in substantiating a balance. The use of standardised templates documenting the objective of the test to be performed, the sample size, the actual test to be performed, results of the test and a conclusion greatly enhance the overall quality of the audit file.

What is clear is that getting documentation right is of critical importance for auditors in delivering quality in audit engagements and in demonstrating the work performed and professional judgement exercised in an engagement.

Fraud Risk

The objectives of the auditor under ISA 240 are broadly to identify and assess fraud risk, to obtain sufficient appropriate audit evidence regarding the assessed risk and to respond appropriately where fraud has been identified.

Fraud arising from fraudulent financial reporting and misappropriation of assets are identified in ISA 240 as the two types of intentional misstatement relevant to the auditor. The standard further identifies three characteristics of fraud as;

1. An incentive or pressure to commit fraud
2. The opportunity to commit fraud
3. A rationalisation of the act

An audit must consider the fraud risk factors present in the audited entity, which will vary according to the audited entity for example;

- In an audited entity with significant debt obligations there may be significant pressure to maintain financial ratios in order to avoid breach of loan covenants.
- In a small owner managed company the personal financial position of management may indicate the existence of an incentive or pressure to commit fraud.

The Financial Reporting Council published in January 2014 a thematic review in relation to “Fraud risks and laws and regulations”.

The scope of the project, conducted by the audit quality review team, was to review the audit methodology, guidance and training provided by the six largest audit firms in the United Kingdom to staff in respect of fraud risks and consideration of laws and regulation.

Whilst observing that there were many areas of good practice with regard to audit methodology in relation to consideration of fraud in accordance with ISA 240, the following key messages were identified by Financial Reporting Council;

a. An increased focus to be placed upon identifying fraud risk factors and the risks of material misstatement in both planning and conduct of the engagement.

b. Tailoring of assessment of fraud risks and audit procedures to the circumstances of the audited entity.

c. Fraud risks should always be identified as significant risks, resulting from this the auditor should evaluate the design and implementation of the entity’s internal controls to detect and prevent fraud, where such risks are identified.

d. Auditors should exercise greater professional scepticism in identifying and addressing fraud risks.

Whilst the review focused on the six largest audit firms in the United Kingdom many of the key messages can be applied to all audit engagements. Consideration and documentation of fraud in accordance with ISA 240 is an essential step on all audit engagements irrespective of the size of the audited entity.