

CODE OFFERS GUIDELINES FOR AUDITORS TO FOLLOW

The Auditing Practices Board has drawn up an Auditors' Code which lays out the fundamental principles that auditors are meant to follow. Auditors are advised to retain a healthy degree of professional scepticism and only to work for 'acceptable' clients.

The independent audit is an important contributor to business trust and confidence. Shareholders rely on financial statements to present a true and fair view of the financial position and performance of a company. The purpose of the company audit is to provide independent assurance that this is the case. Carried out effectively, an audit enhances shareholder confidence in the figures produced by the financial director.

The Audit and Assurance Faculty of the Institute of Chartered Accountants in England & Wales has produced a document called *Audit Quality* following the fall in confidence of the integrity of corporate governance after the well-documented corporate collapses and scandals. The document should be useful both for FDs and for non-executive directors to understand what the auditing profession views as the components of a quality audit. In particular it should give those who have never been involved with an audit an insight into the working practices and procedures.

Auditors' Code

The Auditing Practices Board has drawn up an Auditors' Code, which lays out fundamental principles that auditors are meant to follow. These include accountability, integrity, objectivity and independence and judgement.

In today's climate the audit profession is trying to assert those key principles and would probably add that auditors need to have professional scepticism. They

should not accept what they are told by the management of their clients, or others, unless they have also obtained satisfactory evidence that corroborates what they have been told.

Audit is a well-established part of the regulatory infrastructure of the economy and represents an activity of significant public interest. It's the forming and giving of an opinion after an independent examination of the financial statements. The faculty stresses that a clean audit report provides reasonable assurance that the financial statements give a true and fair view.

Fraud

A long-standing question for auditors is their role in relation to fraud. The position is restated in *Audit Quality* that the primary role is to ensure the financial statements are free from material error. Misstatement could arise through error or fraudulent activity. But the audit is not designed to find every fraud.

Auditors can be put under pressure to complete their work to a demanding timetable and much of the work can be challenging when complex companies or sophisticated financial and business transactions are involved.

Audit is quality is not defined in law or regulations. Auditing standards provide guidance on what auditors need to do to perform audits. In particular the auditing standard SAS 240 (Revised) 'Quality control for audit work' sets standards for what firms need to do to achieve quality across their audit practice. It deals

with policies and processes that affect both individual audits and firm wide procedures, and individual and collective responsibilities for audit quality.

But standards do not cater for every situation and this is where auditors will have to exercise their judgement.

The publication divides audit quality into five key areas: leadership; people; client management; working practices and monitoring.

Relationships

Perhaps the section that will be of most interest to FDs is client relationships.

To achieve audit quality, firms have to manage their overall client base and work with the individual clients from day-to-day. Auditors act in the interest of the shareholders, while having regard to the wider public interest. On a day-to-day basis, the auditors usually deal with the executive directors and senior and middle management.

There is a concern that auditors may think of the directors and, more specifically, the senior management as the primary stakeholder. For listed companies, recognition of the dangers inherent in this situation has led to significant developments in corporate governance. This is particularly true in the evolution of the oversight role of audit committees, comprising non-executives. Auditors have responded to these developments and view communication with the audit committee as an integral part of effective client management. The auditor-management

relationship should be close enough to enable the auditor to understand the business but distant enough to retain independence. Auditors need the co-operation of company's employees to complete their work, yet have to maintain their objectivity and exercise professional scepticism.

Each firm should only accept and continue to work with those audit clients where it can deliver a quality audit. An acceptable client is one that the audit partner feels he can have an open and honest relationship and where there is mutual trust and respect. Auditors need to have in place client assessment procedures to help identify whether a client is acceptable.

Managing higher risk clients is likely to take more time and will often involve more experienced people. Firms charge fees based on what they consider appropriate fees for the skills employed, the value provided and the efficiency with which the firm believes it can undertake the audit. Auditors should be wary of client management where the only objective seems to be keeping the audit fee as low as possible.

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www.financialdirector.co.uk/briefing

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