

# MANNERS MAKETH THE AUDIT

Good audit means conducting proper relationships at all levels.

IT'S THAT TIME OF YEAR when many of you are frantically trying to get your year-end results out. A large measure of the joy of this work is caused by the presence of the auditors. As a CIMA-trained man, I've never had the experience of performing an audit. But from the other side of the desk I've seen enough audits and auditors to know the difference between the good, the bad and the downright incompetent.

Ah, those long days (and nights) spent crossing swords with auditors... This particular bout of nostalgia stems from the publication *Audit Quality*\* by the Audit & Assurance Faculty of the English ICA. While knowing in theory why an audit is a Good Thing - it provides assurance that a particular set of figures is true and fair and thus gives widespread confidence in the entire capitalist system - I find it too easy to dismiss audit as a backward-looking exercise which adds little value.

Audit firms have engineered their own downfall by treating the audit as a commodity over the last 15 years. They've low-balled audit fees, subsuming the reputation of the process to their desire to sell high margin consultancy services (oops!) and caving in over tactics such as opinion shopping.

Immediately post-Enron there were signs that the audit profession was determined to regain some of its lost prestige. Enron helped in the sense that most FDs got a lot less price-sensitive about their audit. The latest reforms announced by the Government in January, along with the Smith report, will also help to stiffen any drooping auditor resolve.

In *Audit Quality* the auditors



Sir Robert Smith, non-executive chairman of Weir Group and the man who's put the beef back into the audit committee. But auditors will have to work hard to win back the trust of shareholders and FDs.

name characteristics that make up a quality audit: strong leadership; regard for the public interest; hiring and training the right people with technical competence, professionalism, good judgment and ethical behaviour; managing client relationships; proper audit team-working practices; and robust monitoring.

Most of those are matters for the audit firms to mull over themselves - or for them to prove to the new set of regulators. It is their comments about "managing client relationships" that intrigue me most. Auditors approach this challenge at various levels. At a firm level they have to ensure that they win and retain enough clients to be financially viable. Typically, this means building up critical mass in particular industries so they build a reputation for expertise in certain sectors. At the same time, they usually specialise in a certain size of companies. So, point one: you need auditors who aren't going to need basic training in what your company actually does when they arrive.

Auditors also need technical

competence. They really ought to understand how the accounts are produced at their client companies - but that's not a given. One company I was involved with used the general ledger as the basis for the statutory accounts - but used a parallel spreadsheet system for producing management accounts. The only problem was the profit on the spreadsheets didn't reconcile to the profit on the general ledger. This was an issue that disturbed me greatly. But it didn't appear to bother the auditor as long as the general ledger was posted (which it was once a year, for their benefit!). Point two, then: the firm should treat its clients - and their systems - on a case-by-case basis.

Point three is more complex. It concerns the day-to-day relationship that you, as FD, have with auditors. Some FDs can barely conceal their hostility to the audit and see it only as a statutory burden. Auditors see clients like that as a risk. The hostility suggests a lack of an open relationship. (Auditors, bless them, reckon they need "mutual trust and

respect" with their client in order to do a good job.) It may even suggest the client would conceal information.

Auditors seem much more aware of the need to distinguish, for the sake of the sacred concept of independence, between the real client - the shareholders - and the de facto client, the board and in particular the FD and his or her staff.

Enter Sir Robert Smith's report. Auditors are latching onto audit committees to act as a surrogate for the shareholders. The audit committee - which Smith says should be beefed up - is the proper conduit for strategic concerns over the audit. A problem remains for the audit profession in finding a way of proving to shareholders that not only does the company have a clean audit report, but that it's been subject to a quality audit. Just ask shareholders of some US firms audited by Andersen.

The well-conducted audits I've witnessed do involve the two sides - the finance staff and the auditors - working well together, but being mindful of their distinct roles. And there is one area where they have the same interest - the numbers. The FD's job is to produce the right numbers, and the auditor's is to check they're right. If that's not the primary motivation of both sides, everything else is a waste of time.

\*The Audit and Assurance Faculty has published an abridged and a full version of *Audit Quality*. The abridged version is available electronically on the web site or in print for £5. Copies of the full version are available in print for £15 from the Faculty on 020 7920 8493.

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