

# JOHN SELWOOD'S AUDIT CLINIC

John tackles some topical questions on smaller entity audit documentation and on audit reports for academy schools and groups

## QUESTION

**When auditing group accounts, my standard group audit report expresses an opinion on the company's income statement, as well as that of the consolidated income statements. Is this correct?**

## ANSWER

Group audit reports can present problems. I have seen audit reports on group financial statements that did not mention the consolidated financial statements at all.

As ever, be careful when using example audit reports. Remember that some groups present their consolidated financial statements separately from the company's own financial statements. Also, not everyone uses the exemption available under s408 to not present the company's own income statement. When using example audit reports, make sure that you use the right example.

I have heard the argument put forward by auditors that even when the s408 exemption is used, the auditor is still required to report on the company's own income statement. After all, they did have to audit it when auditing the consolidated

accounts. This logic doesn't work. Auditors express an opinion on the financial statements. So, if it is not in there, do not express an opinion on it.

I always use the ICAEW helpsheets to check audit reports (see box), including:

- *Preparing an audit report for a group*
  - *combined audit report for the group and parent company;* and
- *Preparing an audit report for a group*
  - *separate audit reports for the group and parent company.*

## QUESTION

**The Financial Reporting Council (FRC) has withdrawn Practice Note (PN) 26 - Guidance on Smaller Entity Documentation. Its website states: "The current version of the Practice Note was issued in December 2009, and no longer supports the documentation requirements of a high quality audit." This is really alarming as my audit methodology is based on PN 26. Does this mean that I am not doing 'high quality audits'?**

## ANSWER

I can't comment on the quality of your audits. That is between you and your cold file reviewer. What I can say is don't panic!

In my view, PN 26 has been withdrawn because the FRC is focusing its efforts on audits of public interest entities (PIEs), as these are the audits the FRC directly oversees and inspects. The sort of documentation guidance on smaller entity audits that is in PN 26 is peripheral to the FRC's remit. Plus, with an amended International Standard on Auditing (ISA) (UK) 540 imminent and a revised ISA 315 on the horizon (see *Technical updates* on page 16), PN 26 was going to need a major makeover. It is true that the audit profession was very excited about PN 26 when it was first published. As much as anything, it was great that the FRC (or rather its predecessor) showed an interest in the efficiency of small entity auditing. Until then, we didn't know they cared.

Also, remember that the ISAs applied from 2005 onwards and the methodology that you follow has been developed to comply with the requirements of the ISAs. PN 26 is not an audit methodology, it provides some guidance on how the audit working papers might be documented when you are using an appropriate methodology. By the time PN 26 was issued in 2007, major training organisations had already worked out for themselves how to efficiently document a

small entity ISA audit. So PN 26 merely confirmed the approach being taken in the major commercially available audit methodologies.

In its current form PN 26 had probably outlived its usefulness. Nobody would have noticed its withdrawal except for the wording on the FRC website page where PN 26 once was, stating that it “no longer supports the documentation requirements of a high quality audit”.

In any event, quality auditing has got very little to do with making audit documentation systems more elaborate. Audit quality is more about well-trained and thoughtful auditors, properly assessing risk, applying scepticism and making informed challenges, when appropriate. The faculty is taking a keen interest in exploring how best to support members on these matters. In previous articles and webinars, the faculty has emphasised the advantages of using free-form memos that promote thinking, avoid checklists and prevent unnecessary repetition.

In my opinion, withdrawing PN 26 changes nothing. In fact, it presents an interesting opportunity for someone else to produce more useful guidance.

## QUESTION

**I audit several academy schools and my cold file reviewer has told me that I am not getting the audit report right. I copied my report from one that a big audit firm had produced for a large multi-academy trust. Why isn't that good enough? Where do I get a good example of an academy school audit report?**

## ANSWER

Sadly, I do not know of any good audit report examples that are specific to academy schools. However, as academies are charities, you can use the ICAEW helpsheet, *Preparing an audit report for a charity* (see box). I know that academy schools have a specialised accounting framework that needs to be specified, but that bit seems fairly straightforward to me.

Your question, once again, illustrates the danger of copying another auditor's report. As I have said before, it is very easy to think that you are dealing with the same circumstances as the auditor that you are copying when this may not be so. Also, other auditors make mistakes, particularly when there is a big change in the audit reporting regime. Over the past



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### ICAEW AUDITOR'S REPORTS HELPSHEETS

The faculty has produced a number of helpsheets, designed to help firms to prepare their audit reports for certain specific situations.

They cover the main changes that need to be made to the examples in the October 2016 FRC *Compendium of illustrative auditor's reports on United Kingdom private sector financial statements for periods commencing on or after 17 June 2016*.

ICAEW's audit reports helpsheets are at [tinyurl.com/AB-AR-Helpsheets](http://tinyurl.com/AB-AR-Helpsheets)

The FRC Compendium is at [tinyurl.com/AB-Compendium](http://tinyurl.com/AB-Compendium)

year or so, there have been momentous changes for periods commencing on or after 17 June 2016, under revisions to the revised ISAs (UK) 700, 701, 705, 706, 720 and 570 (see [tinyurl.com/AB-ASG2016](http://tinyurl.com/AB-ASG2016)).

Also, be aware that large audit firms have large technical departments and they often 'personalise' their audit reports for technical and commercial reasons. Copying this personalisation without understanding its rationale would be foolhardy. In short, do not copy other auditors' reports. Instead, I suggest that you always use the FRC's *Compendium of illustrative auditor's reports* in conjunction with ICAEW's helpsheets (see box). At this stage, by all means compare your report against other similar reports. If they are different you should now be better placed to understand why.

A particular area that the auditors of charitable companies (and by extension the auditors of academies) are getting wrong is the reporting on other matters under the Companies Act 2006. So I am including the relevant extract:

“Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the trustees' report, which includes the directors' report and the strategic report prepared for the purposes of company law, for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report included within the trustees' report have been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the [strategic report or the] directors' report included within the trustees' report.”

Pay particular attention to how precise the wording of the reporting is on 'compliance with applicable requirements', specifying the strategic report and the directors report not the whole of the Trustees Annual Report. ●

**John Selwood is a member of the Practitioner Services Panel and freelance lecturer and writer**