



# Is the Auditor “Clued up or Clueless”?

Martin Pollins gives some pointers on mitigating the risks when things go wrong

In difficult times, clients and banks look for someone to blame when things go wrong. As an auditor, there are ways to make sure that you do not suffer.

## Claimants want their dues

If you're an auditor, when something goes wrong, one thing is very certain - not having an engagement letter is going to be a big problem and it could cost you a lot of money.

With the challenging economic situation in which we now operate, it seems that claimants will be doing their best to ensure that they get paid what's due to them, particularly when they lose money and blame their auditor. In these times of high consumer awareness, clients will not hesitate to pursue a claim if they feel that they have received a service that is sub-standard. As Brenda Hannigan, Professor of Corporate Law at Southampton University aptly puts it: “Businesses everywhere are poring over their contracts, looking to see what protection they provide and hoping the drafting is up to scratch”. In bad times, every word in a contract (such as an engagement letter) must be scrutinised to see if what was intended in a contract actually works in practice.

## Litigation against auditors

In recent years, litigation against auditors has increased both in scale and frequency. Complaints that arise often reflect a mismatch between the expectations of the auditor and client. It is important when instructions are being given for both sides to understand clearly what is proposed and what results can be expected.

If you're an auditor and you get sued, two of the first questions you'll be asked are:

- (1) Do you have indemnity insurance? and
- (2) Do you have an engagement letter with the client that's suing you, setting out what was agreed? The lack



of either can make the defence against a professional indemnity claim all the more difficult.

## Professional Indemnity

Take a long, hard look at the last Professional Indemnity proposal form that you signed. The chances are that there are two questions you might have failed to answer properly. You were probably asked if you issue Letters of Engagement, detailing the Firm's scope of services for all new instructions (this doesn't just mean new clients - it means all clients and focuses on whether or not you clearly detail the scope of your services). You were probably also asked if you issue Letters of Disengagement (your procedures ought to go much further than writing to a client to say “we are no longer willing to act for you”).

**Clue 1:** make sure you have a proper and up-to-date 'audit engagement' letter.

### **Don't be clueless by signing everything**

The problem is not limited to auditors alone. Accountants seem to have got it into their heads that if they're asked to sign something (such as certifying accounts as being "complete and correct") then it's their professional duty to oblige the client. This is very dangerous ground. It's one of my "seven methods of mass destruction": the top ways in which an accountancy firm can commit suicide. This particular method succeeds when the partners add the firm's signature to a myriad of certificates, even though certification is not required.

For example, the accounts of sole traders and partnerships routinely do not need to be audited yet, many accountancy firms insist on adding a certificate along the lines of "these accounts have been prepared from the books and records of XYZ and from information supplied to us and are certified to be in accordance therewith." The savvy accountancy firm knows that this is stupid – why sign anything if it is not required? The savvy firm even takes this further by deleting all references to the firm from the accounts where an opinion is not expressed.

**Clue 2:** only sign if you have to do so.

### **Get clued-up**

When it comes to implementing a system to ensure that partners' signatures are not added to everything put on their desk, partners in audit firms might like to appoint a "Control Reviewer" and, if necessary, outsource the function to another firm. The Control Reviewer only authorises a signature to an audit opinion, or other opinion, if a "Control Sheet" is satisfactorily completed at the time the accounts are ready for sign off and all relevant paperwork is attached.

### **Control Sheet**

Try using what I call a 'Control Sheet' (email me for a copy if you're interested at [graham.davy@simsmm.com](mailto:graham.davy@simsmm.com)). I found it worked really well in practice and flushed out problem areas that had not been addressed when the audit file was reviewed. There should be no opportunity for the person in charge of the audit to take any short cuts whatsoever.

My Control Sheet has 18 top-level questions that must be answered by the audit manager before there is any authorisation for affixing a signature to an audit report. You can make it as long and as comprehensive as you wish but, try to get it down to one side of A4 – starting with the name of the client then:

1. What is the nature of the opinion being expressed of statement being made (a draft copy should be attached)?
2. What is the activity and business of the client and has it changed either since last year or since the accounts date?
3. What is the period covered by the accounts?
4. Are the draft accounts attached?
5. Is the Management Letter attached?
6. Is the Risk Analysis attached?
7. Is the Letter of Representation attached?
8. Have new work opportunities (providing more services to the client) been identified?
9. Is the Engagement Letter attached and is it up to date?
10. On the Fee and Work-in-Progress result to this point, what is the percentage recovery (attach copies of interim and proposed final bills etc)?
11. Is it expected that someone other than the directors, shareholders or the bank will rely on the accounts (details to be attached)?
12. Client/3rd Party Expectations (except for Audits etc)?
13. If appointed as auditor during the year, was professional clearance obtained? Has the previous auditor resigned? Does the directors' report mention the appointment?
14. List all FRS and say which are included or exempt.
15. List all SSAPs and tick all that apply.
16. Are there any external shareholders?
17. Has an AGM been arranged or dispensed with?
18. Final catchall Questions:

Are Board minutes complete and have they been signed? Are Directors' guarantees properly disclosed? Are leasing obligations properly disclosed? Have share issues been properly made (intra vires), properly disclosed and pre-emption rights properly acknowledged? Are there bank certificates for all accounts? Are there 3rd party certificates of assets ownership? Are Turnover, WIP and Stock properly and fully disclosed? (You can add to this list of catchall questions if you want to do so).

**Clue 3:** Ensure someone who's not involved on the audit (not even a file reviewer) take a step back and look at risk management.

*Martin Pollins MBA FCA CTA F IDM is Director of Bizezia Limited in the UK*