



Recent developments in Audit Practice;
Case studies and lessons to be learned -
are regulators overly punitive to audit
firms?

Jim McFie, Convenor RQA Committee

The Statutory Audit



All companies in Kenya must have their annual financial statements audited (Companies Act, section 709) by a member of the Institute of Certified Public Accountants of Kenya who has a valid practicing certificate and a valid practicing license for the year (Companies Act, section 772). If a company, at the end of its first year of operation, has turnover \leq Kes 50 million, and net assets at the year end \leq Kes 20 million, it need not have its financial statements audited unless a member of the company demands that they are audited (Companies Act, section 711).

The Audit Report



Basis for opinion: We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Kenya, and we have fulfilled our ethical responsibilities in accordance with these requirements and the IESBA Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Auditor's responsibilities (1)



Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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Auditor's responsibilities (2)



As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control

Auditor's responsibilities (3)



Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control.

Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

Auditor's responsibilities (4)



Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the company to cease to continue as a going concern.

Auditor's responsibilities (5)



Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the company to express an opinion on the company's financial statements. We are responsible for the direction, supervision and performance of the company audit. We remain solely responsible for our audit opinion.

Auditor's responsibilities (6)



We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

Auditor's responsibilities (7)



From the matters communicated with the directors, we determine those matters that were of most significance in the audit of the company's financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Wirecard: FT: 2020 06 26



EY Germany failed for more than three years to request crucial account information from a Singapore bank where Wirecard claimed it had up to €1bn in cash — a routine audit procedure that could have uncovered the vast fraud at the German payments group. The accountancy firm, which audited Wirecard for a decade, has come under fire after the once high-flying fintech company filed for insolvency this week, revealing that €1.9bn in cash probably did “not exist”. People with first-hand knowledge told the Financial Times that the auditor between 2016 and 2018 did not check directly with Singapore’s OCBC Bank to confirm that the lender held large amounts of cash on behalf of Wirecard. Instead, EY relied on documents and screenshots provided by a third-party trustee and Wirecard itself. “The big question for me is what on earth did EY do when they signed off the accounts?” said a senior banker at a lender with credit exposure to Wirecard. A senior auditor at another firm said that obtaining independent confirmation of bank balances was “equivalent to day-one training at audit school”.



Audit firm Deloitte has been fined a record £15m and been severely reprimanded for failings in its audits of the software company [Autonomy](#) between January 2009 and June 2011. Two former [Deloitte](#) partners involved in the audits, Richard Knights and Nigel Mercer, were also fined and sanctioned by the accounting watchdog, the Financial Reporting Council (FRC). The FRC said that Deloitte and Richard Knights failed to “act with integrity and objectivity”. Deloitte, one of the “big four” accountancy firms, has also agreed to provide a full analysis of the misconduct in its audits of [Autonomy](#), why the firm’s process did not prevent it, and whether the firm now has different processes in place. Cambridge-based Autonomy, which was founded by Mike Lynch, was acquired by Hewlett-Packard for £8.4bn in 2011. But the deal turned sour, and just a year later [HP wrote down \\$8.8bn](#) (£6.7bn) in relation to the purchase, alleging accounting irregularities.



Britain's accounting watchdog fined KPMG and a senior partner on Thursday for failing to challenge what a client was telling them about certain complex supplier arrangements. The Financial Reporting Council, which did not name the company being audited, said KPMG's fine was 700,000 pounds; senior partner Nicola Quayle was fined 45,000 pounds. KPMG and the other big accounting firms are facing major reforms to improve standards after company collapses at British builder Carillion and retailer BHS. Policymakers also want to put an end to what they consider cosy relationships between auditing firms and their clients and bring in more competition. KPMG, one of the world's top four accounting firms, in 2018 was put under "increased scrutiny" by the FRC for poor auditing. In the latest case, the watchdog said KPMG failed to obtain and document sufficient audit evidence in relation to supplier-funded rebates. Auditors should have been on alert to pay particular attention to "these types of complex supplier arrangements."



The accounting giant PwC has been fined £6.5m over its audit of the cloud computing firm Redcentric over a 'lack of competence' in audit. The FRC reduced the fine to £4.55m after PwC admitted its mistakes. The FRC said some of the breaches were of a "fundamental nature, evidencing a serious lack of competence in conducting the audit work". Two partners at PwC were each fined £200,000. Jaskamal Sarai and Arif Ahmad from the firm's Leeds' office will each pay £140,000 after co-operating. PwC apologised and said it had taken "numerous steps to strengthen processes". According to the FRC, Redcentric's 2016 financial statements were extensively restated, with net assets written down by £15.8m, and £5.3m in pre-tax profits restated to be a £4.2m loss. The regulator said a number of the breaches related to PwC's failure to exercise "professional scepticism". "Had scepticism been applied, it is likely that certain material misstatements would have been detected," said Claudia Mortimore, deputy executive counsel to the FRC.

FRC: Annual enforcement review 2020 (1)



Driving audit quality improvements remains a key priority. This year's review looks at repeated shortcomings and underlying causes. Failure to exercise professional scepticism is an ongoing issue. Reasons for this include auditors being too close to management and creating risks to objectivity and insufficient escalation to and involvement of the audit partner leading to a failure to appreciate the significance of issues in the context of the audit as a whole. Given the detrimental impact those failings can have on investors and wider society it is in everyone's interest that where standards are not met or ethical failures occur, they are addressed and rectified. Our message to firms last year was to identify, remediate and report. Whilst we have seen examples of good behaviours, it is disappointing that, overall, the response has been mixed. We look forward next year to highlighting firms that have demonstrated their commitment to this approach.

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FRC: Annual enforcement review 2020 (2)



A renewed focus on early resolution of cases has brought a 58% increase in cases resolved through Constructive Engagement. As well as financial sanctions, we have also continued to use bespoke non-financial sanctions to drive the long-term changes in behaviour that we expect following enforcement action. In the last year non-financial sanctions have required firms to undertake firm wide training, to introduce and provide written reports to the FRC on quality performance reviews, and to monitor and support regional offices. In addition to the published case outcomes included in this Review, major hearings have taken place in the year including proceedings in the Court of Appeal concerning legal privilege and a seven-week hearing before the independent Tribunal in relation to the audit of Autonomy Corporation plc. A vast amount of material and evidence was considered by the Tribunal at what is our longest contested hearing to date.

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THE PCAOB



Accounting firms must register with the PCAOB to issue an audit report for a public company. The PCAOB seeks to engage with registered accounting firms to raise awareness of PCAOB standards and rules and to assist auditors in complying with them by providing staff guidance, publications, videos, and other communications. The PCAOB inspects registered public accounting firms to assess compliance with the Sarbanes-Oxley Act, the rules of the Board, the rules of the Securities and Exchange Commission, and professional standards, in connection with the firm's performance of audits, issuance of audit reports, and related matters. Our inspections are designed to review portions of a firm's issuer audits and evaluate elements of a firm's system of quality control. The process aims to drive improvement in the quality of audit services through a focus on effective prevention, detection, and deterrence of audit and quality control deficiencies—and oversight of firms' remediation of identified deficiencies.

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IAASB: Quality control (1)



IAASB Approves New Audit Quality Standards

The quality of audits has come into question from international regulators after a series of high-profile accounting scandals, with the most recent being Wirecard. Last week, the International Auditing and Assurance Standards Board (IAASB) approved a new and revised set of quality management standards designed to improve audit quality, as reported by [Accounting Today](#). While the standards won't take effect until December 15, 2022, some firms have already begun implementing some of the changes.

IAASB: Quality control



IAASB approved a new and revised set of quality management standards Wednesday 23 September 2020 for auditors to use around the world, starting at the end of 2022, and firms like KPMG are already gearing up to use them to improve audit quality. The International Standards on Quality Management, [ISQM 1](#), [ISQM 2](#) and the International Standard on Auditing, [ISA 220 Revised](#), are now awaiting approval by the Public Interest Oversight Board, a global group of regulators that oversees the International Federation of Accountants after some governance changes at IFAC and its affiliated standard-setting boards, including the IAASB. “The passage of our three Quality Management standards is the culmination of our response to the changing environment, the challenges of the effectiveness of our pre-existing quality control standards, and growing market participant needs,” IAASB chair Tom Seidenstein wrote Wednesday. “The resulting suite of standards are aimed at a more robust System of Quality Management for firms using the IAASB’s standards, and marks an evolution from a traditional, more linear approach to quality control.”

PCAOB Concept release



We are considering revising PCAOB quality control (QC) standards to focus firms on improving their QC systems. Effective QC systems are crucial for consistent high quality audits and other engagements under PCAOB standards. We are considering an approach that would be based on the proposed international standard for firms' quality management systems, ISQM 1, with certain modifications. Under PCAOB standards, a system of quality control is broadly defined as a process to provide a firm with reasonable assurance that its personnel comply with professional standards applicable to its accounting and auditing practice and the firm's standards of quality. Registered firms are required to design and implement a system of quality control to provide this reasonable assurance. Our current QC standards were originally developed and issued by the American Institute of Certified Public Accountants (AICPA) before the PCAOB was established. The auditing environment has changed significantly since that time, including evolving and greater use of technology by firms in performing engagements and in relation to QC activities. Some firms have also significantly increased their focus on governance and leadership, incentive systems and accountability, and monitoring and remediation. Current PCAOB QC standards do not reflect these developments.

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Our considerations for revising PCAOB QC standards have been informed by a variety of activities. Observations from our oversight activities have shown that firms' improvements in QC systems can enhance the quality of audits, but there is still room for further improvement. Outreach to our advisory groups has indicated general support for strengthening the QC standards, including support for implementing a risk-based approach and for enhancing requirements for firm governance and leadership. We have also considered relevant academic research and literature. We have noted developments and trends in internal control, enterprise risk management, and quality management frameworks, all of which reflect a shift toward more proactive and risk-based approaches, as well as developments relating to corporate governance and audit firm governance. In addition, the International Auditing and Assurance Standards Board (IAASB) is in the process of updating its analogous firm-level QC standard and recently proposed International Standard on Quality Management 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements (Proposed ISQM 1 or the proposed standard). Proposed ISQM 1 is designed to focus firms' attention on proactively identifying and responding to quality risks that may affect engagement quality.

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The proposed standard includes specific requirements related to current developments not addressed in PCAOB QC standards. We are considering using Proposed ISQM 1 as a starting point for a future PCAOB QC standard. Information gathered through our oversight, outreach, and research activities persuades us that our QC standard should be built on an integrated risk-based framework, as Proposed ISQM 1 is. In addition, many firms that follow PCAOB standards are also subject to other QC standards (including the IAASB's and the AICPA's standards), so they are required to implement QC systems that comply with both PCAOB standards and those other standards. Due to the foundational nature of QC systems, we believe that it would not be practical to require firms to comply with fundamentally different QC standards. Unnecessary differences in QC standards could even detract from audit quality by diverting firms' efforts from focusing on matters of fundamental importance to effective QC systems. We understand that the IAASB is in the process of considering comments and making revisions to Proposed ISQM 1. We will continue to monitor the IAASB's work as ISQM 1 is finalized.

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