

Audit exemption availability set to increase (Lecture A864 – 5.18 minutes)

As noted in section 7 of these notes, the government are consulting on increasing the company size thresholds which will enable more business to fall into the small companies' regime. As the audit exemption thresholds are coupled with the small companies' thresholds, more businesses will be able to claim audit exemption.

For many practising accountants, the audit regime has become costly. In 2023, the number of audit firms recognised with Recognised Supervisory Bodies continued to decline. The total number of registered audit firms was 4,310 as at 31 December 2022, compared with 4,745 in 2021 and 5,007 in 2020.

These figures confirm that audit firms, particularly at the smaller end of the scale, are finding audit unsustainable for their practice or it may be that former audit clients have contracted and become small hence they are able to claim audit exemption. In addition, the current recruitment crisis in the auditing profession suggests that many entrants into the profession are choosing to avoid audit. This could be due to many factors; but it goes without saying that today's auditing profession is very demanding (some would say too demanding) and the recent high-profile corporate scandals that have rocked the auditing profession have clearly not helped.

Benefits of an audit

Setting aside the scandals that have rocked the auditing profession in the last decade, there are clear benefits to having an audit:

An audit identifies weaknesses in controls

Part of the audit process involves assessing the entity's system of internal control to identify weaknesses. For example, if there is a lack of segregation of duties in the payroll department, this creates a fraud risk factor as a 'ghost' employee could be set up to divert funds. Additionally, if bank reconciliations are not reviewed by a senior official, or if reconciling items on the bank reconciliations are not investigated, this could also create a fraud risk factor.

Fraud deterrent

An audit is a rigorous process and much of this process involves carrying out audit procedures on the amounts and disclosures in the financial statements to ensure the accounts give a true and fair view. These procedures are much more in-depth than, say, a compilation engagement.

Having an audit can also be a fraud deterrent as any potential fraudster may be nervous of being caught out by the audit process.

Reduced risk of management bias

An audit may reduce the risk of management bias (e.g. deliberately inflating revenue or decreasing expenditure to improve profitability) as it is likely that an auditor will detect such bias during the course of their audit procedures.

Improved credibility of the financial statements

Audited financial statements enhance the credibility and reliability of the figures because they have been subject to a review by an independent audit firm. Lenders and prospective investors prefer to receive audited financial statements than unaudited ones. In addition, tax authorities (such as HM Revenue and Customs) place more reliance on audited financial statements than unaudited ones. Although, that is not to say that an audited entity stands a lesser chance of being selected for a tax enquiry than an unaudited entity.

A business has many stakeholders who will all require different levels of information from the financial statements. Audited financial statements can provide some level of comfort to these stakeholders, who may be:

- Banks/other lenders
- Employees
- Suppliers
- Customers
- Insurance companies
- Current and potential investors
- Shareholders

It is true that the auditing profession has come under increasing levels of scrutiny over the last few years due to the high-profile corporate collapses such as Carillion and Patisserie Valerie. The Brydon review of auditing also included many recommendations to improve the profession. However, the FRC are aiming to restore trust and confidence in the auditing profession and while this does come at a cost to auditors (in the form of increased requirements through revised and new ISAs (UK)/ISQMs (UK)), the benefits are worthwhile.