Australian Government
Registered Organisations Commission

PODCAST

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ROCpod episode 1 – What to expect from your auditor

The ROCpod was a monthly podcast focussed on the regulation of registered organisations. It shared information, tips and tools for improving compliance with legislative requirements.

The podcast was key part of the Registered Organisations Commission's (ROC) education strategy. The ROC was abolished on 6 March. The Fair Work Commission (the Commission) is now the regulator for registered organisations.

Although processes may change under the Commission, much of the podcast content is still useful.

Email any questions about anything in an episode to regorgs@fwc.gov.au.

Speaker Key

CB	Catherine Bebbington
CG	Claire Grayston
AN	Announcer

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CB Welcome to *ROCpod*, talking with the Registered Organisations Commission, the official podcast of the ROC about the regulation of unions and employer associations.

My name is Catherine Bebbington, senior advisor for the education and reporting team, and in this monthly podcast we'll share essential information, uncover handy hints and tips and reveal our best tools for proactive compliance with the complex legislative requirements.

Don't forget to subscribe and see how *ROCpod* can help you and your organisation.

This is the first ever podcast of the Registered Organisations Commission, and today's topic is what to expect from your auditor. As many of you know, the Registered Organisations Act requires every reporting unit to produce a general purpose financial report at the end of their financial year. That report must be audited by an auditor who is registered by the ROC. The full list of registered auditors is available from our website.

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Today we're talking to Claire Grayston, policy advisor for audit and assurance at CPA Australia, about what to expect from your auditor. Claire, thank you for taking the time to help us understand the auditing process.

CG Oh, I'm really pleased to be here, Catherine.

CB It's excellent to have an expert here to talk about, for instance, what our clients should expect as part of the general purpose financial report process. I thought we would start with the really pressing question of: What are some of the common misconceptions about audits? Because I understand… In our first inaugural podcast, let's get straight to the heart of it.

CG Thanks, Catherine. I think there's some really big common misconceptions about what audit is and what the auditor can do, and essentially those misconceptions tend to focus on detecting or preventing the failure of an organisation and also the detection of fraud.

Now, ideally the auditor would detect fraud in every instance, but it just isn't possible to always detect fraud, and an auditor doesn't look at everything that could lead to failure. So they will look at going concern, but there are other factors that can lead to failure. So often the auditor is blamed for that. Obviously, we want a high-quality audit, and the auditor is responsible for that, but nevertheless even with the best quality audit at times an organisation can fail, at times fraud can occur and remain undetected or not be detected by the auditor.

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Perhaps I can just cover before we move on what the auditor can provide, and certainly the audits focus on giving confidence in that financial report. So the audit will give that confidence, but to be cost-effective obviously an auditor can't check every single transaction. They're not going to be checking every single balance to see if it's as material or every amount that's gone into that balance.

The auditor's work is based on risk assessment, so they're focussing on the highest risk areas. Maybe in a registered organisation it could be the loans or the grants or the donations or related-party transactions. In addition to focussing on those risk areas, they then use a sample for testing transactions and balances, and that's based on their assessment of materiality. For example, if the fraud's immaterial, they're much less likely to pick that up.

Typically, an auditor is not able to test 100% of transactions. As we get more IT focussed, things are changing, but even once IT is being used you get a lot of anomalies, and then it's how much those are then tested. So suffice it to say not all transactions are tested.

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I would note though that one of the key risks an auditor looks at is fraud. So you would expect them to look carefully at risks of fraud, but fraud, as I think most people are aware, is usually coupled with a concealment, often with collusion. It makes it really difficult for the auditor to detect those instances.

Fraud we're very sensitive to. If fraud is found, even if it is minor and immaterial, it causes a problem for the stakeholders, but the auditor may not be looking at those amounts.

In terms of preventing failure, I wanted to highlight that the auditor does look at going concern. So they will highlight if there's a material uncertainty in relation to going concern. They have a lot of responsibilities around highlighting that in their auditor's report even if the organisation has disclosed that uncertainty. So that will be an important flag if there is a material uncertainty. And the auditor will look ahead another 12 months to see if the organisation should be able to continue operating for that period or that an uncertainty is disclosed.

But nevertheless audit doesn't provide a guarantee about the financial report, its accuracy, but it is concluding on whether it's fairly stated in all material respects.

Catherine, I wonder though before you move on, can I just mention about auditor's responsibilities in relation to non-compliance…

CB You certainly can.

CG With laws and regulations? Thank you because I think that is an area that may give stakeholders and organisations some comfort as well. There's increased responsibilities in the last couple of years for auditors to actually act in relation to non-compliance with laws and regulations. That means that they can't turn a blind eye if they see something that they suspect or confident is a non-compliance with laws and regulations, and they need to take action.

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That doesn't mean rushing to the authorities immediately. Depending on the circumstances it might be appropriate for them to go to management, and then if they're not satisfied that management take appropriate action, then they can escalate that. And in certain circumstances they can put aside confidentiality and go to the authorities and particularly if they're required to do so, they must report that.

I think that's comforting, that the auditor is not going to brush over these things. They need to take those on and ensure they're properly addressed.

CB I would certainly emphasise that if you've got any problems appearing through the audit in your financials, that it is worth coming to the regulator early to have that conversation either as an officer in the committee of management or as an administrator to find out the best way to go about approaching those inconsistencies. Because sometimes they're not necessarily caused by things like fraud. Sometimes it is just inconsistencies.

To summarise, some of the major misconceptions about an audit is going to be that the auditor absolutely guarantees that this is 100% correct and free of fraud, and they're going to give you a reasonable coverage that there's no material misstatement within the reports.

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They're also going to do a sampling, so organisations and branches shouldn't be expecting the auditor to look at every single transaction or every single account statement or bank statement or credit card statement. They are going to be doing a sampling through this process.

CG Yes, that's absolutely right.

CB What else should organisations expect from the auditor process? How does it start, for instance?

CG Well, initially, when you first engage an auditor you'd expect them to send you a letter of engagement essentially to agree the terms of their engagement. Now, that doesn't necessarily get reissued every year. Usually, the auditor is retained for at least the five years till they have to rotate out.

Often the auditor will reinforce the terms by sending the engagement letter again, but that's not necessarily required. So they need to communicate what the plan, scope and timing of the audit is expected to be and any significant risks that they've identified in advance of conducting the audit.

Then following on from that agreement of how the audit is going to be conducted, they will need full access. That sort of sounds obvious, but they need to get a look at all the financial records. They need to be able to talk to any staff, or I'll say consultants because it's not always that staff will be preparing all the financials. There might be external assistants, but they need full access to make sure the process is efficient and effective. Obviously, if the records are in electronic format, they'll need full access to your accounting system.

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CB Should our organisations expect this to be done in their office? Should they be setting up a desk or something for the auditor to come in? Or is this the kind of thing that can be done off site by your auditor?

CG That's a really good question, Catherine, and I think it very much varies with the organisation. I would've expected the organisation to see the auditor at least to some degree. However, with records being so electronic these days, there is an awful lot of work that can be done by the auditor back at their own office. So it very much depends on how they're getting access to that information.

Certainly it wouldn't be a measure of concern if they weren't spending the whole audit at the offices. Although I know that auditors are encouraged to spend time with the client because you pick up a lot from being out there seeing how the operations are running. And of course it's a matter of negotiation as to whether the organisation has space to accommodate the auditor or their team at their premises.

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I talked about access to all staff, and I wanted to mention as well, jumping to the end of the engagement… We can talk more about what happens in the middle, but certainly once they've gone through their audit and provided their report, then you'd expect them to come to the general meeting, and you'd expect them to be prepared to answer questions.

Now, often auditors aren't in fact asked questions, but they certainly should be willing to field any questions. And certainly you'd hope that they're having along the whole way an open discussion with management about the things that they're finding and any issues that are arising.

CB A lot of our organisations and branches don't have a general meeting. They just have a committee of management meeting. So you're saying the auditor should be expected to attend that meeting and answer questions there for the officers?

CG Yes, they should be. It's preferable that they attend that meeting. It's really the final opportunity for any issues or concerns to be shared with the auditor and the auditor to be able to stand behind their report.

You talked about the committee of management, but, and I mentioned it along the way, the auditor should be communicating anyway. In fact, in the auditing standards the auditor is required to communicate certain things to management.

For example, they're required to communicate their views on the organisation's accounting practices. Significant accounting treatments they think might not be appropriate. Now, sometimes the auditor can still sign their report if the accounting treatment's allowed by the accounting standards, but they might not feel that it is the appropriate treatment for the organisation.

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They should be highlighting any significant difficulties they've had during the audit, significant matters that they discussed along the way, clarifying what those were and other circumstances that affect the auditor's report, so their opinion, and any significant matters regarding the oversight of that financial reporting process.

Now, this is done in a management letter. So in addition to the auditor's report, which goes with the financial report, you'd also expect a management letter to cover off these things to clarify any concerns that have arisen. And it's very usual for the auditors to find things, maybe some controls that can be improved or areas where they'd like to see some additional work done before the next audit.

CB How much does an organisation or branch have to follow these things that are put to them or these recommendations or suggestions? How independent is the auditor of the reporting unit?

CG The auditor independence is absolutely critical. Now, with providing that management letter you would not want them to be stepping over the mark in terms of independence. However, providing that kind of feedback is not seen as breaching independence.

In order for the auditor to be independent they need to actually be independent of mind, so believe they're independent and operate in an independent way, but also appear to be independent, and that's quite… The perception of independence also really critical as well.

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There's quite a number of threats that can arise to independence, so things that auditor needs to look out for to make sure that they're not overstepping the mark with independence.

For example, self-reviews. If they were providing services to the organisation and then that's part of the financial reporting… For example, if they prepared the financial report, they couldn't audit it because they're reviewing their own work. Self-interest threat where they've got an interest in the organisation or an advocacy threat where they're trying to promote the organisation in some way.

There's a couple of other threats. Familiarity. For example, if there's some close association that rotation auditor is trying to account to that and make sure that that association doesn't become too close, but maybe other associations through perhaps family, memberships of the organisation, that kind of thing.

And also intimidation threat. If you have an aggressive client that pressures you to accept perhaps the kind of treatments you don't feel comfortable with or brushes over evidence that you're wanting to obtain.

I know the registered organisation does actually exclude a whole range of people from being an auditor, so it's quite clear cut in that way, which is really helpful. For example, an employee or officer of the organisation is clearly not able to conduct the audit, or an employee of an officer or relative.

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If there's a liquidator in respect to any property involved with the organisation or a person who's owed money by the organisation, as well as someone who's just deemed to not be able to have that objective, an impartial judgment. So there are quite a number of circumstances that are clearly cut out in terms of independence.

CB You mentioned, for instance, that it might be a threat if an auditor is asked to review their own work. Is there any role or function that the auditor cannot perform? Now, for many of our organisations or our smaller branches, this may be one of their biggest expenses through their financial year, bringing in this expert to audit their financials.

So is there anything that they shouldn't be asking the auditor to do because it may be a threat to their independence?

CG Absolutely. I think the key thing to understand with independence is that the auditor absolutely cannot take on any management responsibilities for the organisation. That means they can't take a leading role in decision-making in relation to the financials or any other aspect of the operations of the organisation. Management need to do that.

Management need to make all the judgments, the decisions, and if management don't have the necessary knowledge and experience to be able to make all of those financial decisions and prepare the financial report, then they might need to call in external advice to assist them in doing that. They can't rely on the auditor because then it does push the auditor in that area of lack of independence

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That said, there is a fine line in that the audit process absolutely does necessitate that the auditor discuss with the management things like the application of the accounting standards, the disclosure requirements, whether they've met the accounting standards, the appropriateness of the controls, methods used for determining the values of assets and liabilities. These are normal discussions.

It's not that the auditor can't discuss the different options with management… And they may even suggest some adjusting journal entries, that kind of thing. But ultimately management have to make those decisions. They are giving an opportunity… Rather than the auditor needing to qualify their report at the end, allowing the organisation the opportunity to make corrections and adjustments that are going to mean that the financials are acceptable to the auditor. But that's considered part of the normal audit process.

The kinds of services that the auditor really cannot provide in addition to not preparing the financials for the organisation, they can't do things like other bookkeeping services, payroll services, valuation services, internal audit or provision of IT systems, legal services, recruitment services.

That said, they'll need to consider their circumstances. There may be some circumstances where there's very inconsequential services being provided that the auditor can justify, and really they work through the Code of Ethics for Professional Accountants to determine whether those services are appropriate or not. So whilst I presented it like it's a blanket ban, it's a little bit more complex than that. Although I'd say if in doubt, don't ask you're auditor to do other non-assurance services to not compromise their independence.

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CB So our organisations and branches need to be very aware of the fact that the independence of the auditor protects them as well because it adds credence to that protection around their financial reports. As you've said, it's not just an actual lack of independence. Our organisations and branches have to be careful they don't make it appear that the auditor is not independent as well.

CG Absolutely, yes, because the public are also looking at registered organisations and making their own assessment of what confidence they have.

CB So how should our organisations and branches be preparing for this audit since it is such a big deal and for many of them a big expense? Is there anything they can do to ensure that the process moves as smoothly as possible?

CG The organisation needs to be really well prepared in terms of having all their documentation to support all the transactions and balances that are in their financial report as well as the other… The committee management statement, the section 255(2A) report and the officer declaration, that all needs to be fully supported by documentation.

CB So you're suggesting that we shouldn't be going with the shoebox way of doing our audit where I just provide you with all of my receipts in a little box and say, here you go.

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CG Yes. The auditor can't compile the financials for you. So the organisation really needs to be on top of that before the auditor comes in. Now, within a larger organisation the auditor can come in during the year to do some controls testing and other testing. That's a little bit of a different scenario.

But if your auditor is coming in after year-end, you need to have everything ready to go and have the accounting software, the actual hard copy documents, if they are in hard copy, available, readily accessible. Perhaps you need to organise access for the auditor without them being able to change anything to that information.

So thinking through the issues around access to everything they need and also access to the staff. So having that staff ready, available to find information the auditor needs and to justify or discuss treatments in the accounting treatments, in the financial report and so forth.

CB Occasionally we do receive auditor reports that have a qualified opinion. What does this mean in accounting and auditing terms for you?

CG There's a few different sorts of qualifications to the opinion. None of them are common, I would say. However, the more common one is a qualified opinion, and that's where there's a specific aspect of the financial report or the other statements, not just… All of the statements that the auditor is providing their opinion on that contains a material misstatement. Or they don't have enough evidence to be able to conclude one way or the other that that fact or amount is correct or not materially misstated.

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Now, it would be a material error, but it must be a discrete area in order for it to be just a qualified opinion. That is still very serious, but the auditor is very clearly flagging what that issue is.

Now, the reason why this is not very common is that usually… We were talking before about the auditor talking with management and discussing areas where they have concern or differences of view, and usually the auditor and management will try to work that through to come to a resolution that they both agree with. So that the auditor is comfortable with signing a clean opinion. However, obviously the qualified opinion occurs where they can't come to that agreement or they simply cannot provide enough evidence to satisfy the auditor.

Then in more extreme circumstances where the auditor simply cannot obtain enough evidence to have confidence in the financial statements as a whole, they'll issue a disclaimer opinion. That's where really the lack of evidence is pervasive through… And they really can't conclude on any of the material items in the financial report. Otherwise if they do have sufficient evidence, but they believe the misstatements that they've identified are pervasive, and so they impact the whole financials, they can issue an adverse opinion.

CB What should I do if I'm unhappy with the way the auditor has performed their audit? A lot of our branches and organisations will be dealing with this one professional, perhaps for the first time if they've just rotated out their last auditor under the provisions. So what does an organisation or branch do if they're unhappy?

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CG I guess it depends on what the basis of their concerns are. For example, if they feel perhaps the auditor hasn't done enough work, perhaps their previous auditor, they saw them more during the audit process, or there was more evidence of the work that… They'd asked more questions.

The organisation can ask for information about how many hours they've done, staff that they've been using, what work they have done. I think it's quite reasonable to ask for more information about the service that you're paying for. Obviously, different auditors will operate in different ways, but allowing the auditor the opportunity to explain what they have done…

They're not actually required to share their working papers. So it wouldn't be reasonable to say, I want to see your whole audit file, because those are their papers that they use to form their opinion. However, it is reasonable to ask for further information.

Ultimately, if you feel that the auditor hasn't met the terms of the engagement, you can terminate that agreement. Obviously, there's legal ramifications to that depending on the timing, or you may choose not to renew that audit engagement the following year and appoint a new auditor.

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If you have really serious concerns about competence or integrity of the auditor, obviously, you can contact the professional body that they're a member of, whether that's CPA Australia or one of the other professional bodies. Or, I'm sure, the Registered Organisations Commission can help provide advice in those circumstances.

I do note that all members of professional accounting bodies are subject to quality review, and they are subject more frequently when they provide audit services than for other services. Usually, that's about every three to four years. So there is robust processes in place to oversee those auditors.

Nevertheless, any professional accounting body will take any concerns very seriously, and if appropriate that can be referred to professional conduct, and they'll follow up and look into those concerns. Or it may be that quality review can do a review and just make sure that there's no problem.

CB Is this also a part of the dialogue that you're having back and forth between management and your auditor? There's no point waiting until the very end to express your unhappiness if you think there's something happening during the audit. This is part of the dialogue that you were speaking about during audit. If you have any questions or concerns about how the process is going, discuss them with your auditor because it could just be a lack of understanding on behalf of the organisation or branch as to what to expect or the process that's being used?

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CG Yes, exactly. I think earlier on we were talking about the auditor is supposed to communicate the risks that they've identified, their plan, or how they intend to conduct the audit. So that should be a basis from which to then query them as to where they are along in that plan, whether the organisation's comfortable with the risks that they've identified. If there's concerns that they aren't providing an adequate service, that should be a starting point to be able to say, can you demonstrate or share with me how that's working?

I would say, however, that another aspect that could ruffle the feathers perhaps of organisations could be the opposite to what we were just discussing, and that is where the auditor is asking a lot of questions. And if an organisation feels a little overwhelmed perhaps by the amount of information they're requiring, that could be the opposite scenario.

Just highlight that auditor is required to apply professional scepticism, and as part of being sceptical the auditor must challenge management not on every single tiny thing, but they need to think about if the opposite is possible. If the evidence actually supports something different to what's been presented in the financial statements or the other statements that are being audited.

So it's absolutely natural for there to be some level of challenge, questions and discussion, robust discussion in some instances, between the auditor and management, and hope to have that in a quality audit.

CB This is certainly something that management can learn from and build into future processes for future financial years if it turns out that there are perhaps some better ways of keeping their records, for instance.

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One of the problems that our organisations or branches do sometimes encounter with the auditor is time frames because we actually have a series of time frames in our legislation. Would you strongly recommend making sure that your auditor is well aware of when we absolutely need that signed report by? Because it's not uncommon for reports to go out to members, for instance, on time but not be signed by the auditor because that process hasn't finished yet.

CG Yes, absolutely. The earlier that you can engage your auditor or have the planning discussions with them around the timing of when they can come, when they'll be able to sign off and also when you are going to be ready as an organisation to provide the draft financial report and the supporting documentation.

Often the delays can be around not having all the evidence readily available. Obviously, the more streamlined the organisation can be in supporting the audit process, the more likely it is that the auditor will also meet their deadlines.

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CB Well, thank you very much for talking to us today at *ROCpod*, Claire. It's been absolutely wonderful speaking to you. It's wonderful to have a strong voice of expertise about auditing which a lot of our clients do run into once a year every year. So thank you very much for your time today.

CG Oh, it was great to be here. Thanks, Catherine.

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