AUGUST 2024

SPOTLIGHT ON:

What to expect from a statutory audit

JON DAVIES
ACCOUNTANTS

WWW.JONDAVIESACCOUNTANTS.CO.UK
TAX@JONDAVIESACCOUNTANTS.CO.UK
0151 380 8089

INSIGHTS TO PREVENT UNEXPECTED SURPRISES

A statutory audit may sound alarming, but it's a vital process that helps ensure a company's financial health and compliance.

Whether you're a small business owner or part of a large corporation, understanding what to expect from a statutory audit can ease any concerns and prepare you for a smooth experience.

UNDERSTANDING THE PURPOSE OF A STATUTORY AUDIT

A statutory audit is a review of the accuracy of a company's or government's financial records. The goal is to provide an independent opinion on whether the financial statements give a true and fair view of the entity's financial performance and position. This process helps maintain transparency and accountability, which are crucial for the trust of shareholders, investors, and the public.

A common misconception about statutory audits is that their primary purpose is to identify fraud. In reality, the main objective of a statutory audit is to provide an independent opinion on whether a company's financial statements present a true and fair view of its financial performance and position.

While auditors are trained to detect signs of fraud and financial irregularities, the audit process focuses more on ensuring accuracy, compliance, and transparency in financial reporting. Understanding this distinction can help businesses better appreciate the broader benefits of a statutory audit beyond just fraud detection.

In the UK, the Companies Act 2006 mandates statutory audits for public companies and large private companies that meet specific criteria. According to the Financial Reporting Council (FRC), over three million companies in the UK are subject to these regulations.

While statutory audits are mandatory for certain companies, some businesses choose to undergo these audits voluntarily, even when they do not meet the legal thresholds. This strategic decision is often made to satisfy the requirements of banks, customers, or suppliers who seek assurance of the company's financial health and reliability. Voluntarily opting for a statutory audit can enhance credibility, foster trust with stakeholders, and provide a competitive edge. It demonstrates a commitment to transparency and rigorous financial management, which can be particularly advantageous in securing financing, winning contracts, or establishing long-term partnerships.

STATUTORY AUDIT THRESHOLDS

Understanding the thresholds for statutory audits is crucial for compliance. In the UK, private limited companies are generally required to undergo a statutory audit if they meet two of the following three criteria: an annual turnover of more than £10.2 million, assets worth more than £5.1m, or over 50 employees on average. However, certain entities, such as public companies and large private companies, are subject to statutory audits regardless of these thresholds. For detailed information on audit exemptions and specific criteria, refer to the official guidelines on the UK Government website.

PREPARING FOR THE AUDIT

Preparation is key to a successful statutory audit. Here are some steps to help you get ready:

- **Organise your financial records:** Ensure that all financial statements, including balance sheets, income statements, and cashflow statements, are up-to-date and accurately reflect your financial activities.
- **Review internal controls:** Assess and document your internal controls and procedures. This includes checking for any weaknesses or areas that need improvement.
- **Communicate with your auditor:** Establish a clear line of communication with your auditor. Discuss the audit timeline, key areas of focus, and any specific requirements they might have.
- **Prepare your team:** Ensure that your finance team is ready to provide any necessary information and support throughout the audit process.

Statistics show that companies that are well-prepared for audits tend to experience fewer issues. A survey by Audit Analytics found that 75% of businesses that faced significant audit adjustments lacked proper preparation.

> *Ensure that your finance team is ready to provide any necessary information and support throughout the audit process.*

THE AUDIT PROCESS

Understanding the audit process can demystify it and help you know what to expect. Here's a breakdown of the typical steps involved:

- **Planning and risk assessment:** The auditor will begin by planning the audit and assessing the risk of material misstatement in the financial statements. This involves understanding your business, its environment, and the internal controls in place.
- **Testing of controls:** The auditor will test the effectiveness of your internal controls. This might include inspecting documents, observing processes, and interviewing staff to ensure controls are operating as intended.
- **Substantive procedures:** This phase involves detailed testing of financial transactions and balances. The auditor will verify the accuracy of your financial records through various techniques, such as sampling, analytical procedures, and confirmation with third parties.
- **Evaluation and reporting:** After completing the testing, the auditor will evaluate the findings and form an opinion on the financial statements. They will then issue an audit report, which includes their opinion and any significant findings or recommendations.

According to the FRC, the average audit process for a medium-sized company takes about three to six months from planning to reporting. However, the timeline can vary depending on the organisation's size and complexity.

COMMON CHALLENGES AND HOW TO ADDRESS THEM

While statutory audits are essential, they can come with challenges. Being aware of these potential issues can help you address them proactively.

- **Lack of preparation:** As mentioned earlier, inadequate preparation is a common problem. To avoid this, start preparing early and ensure that all records are complete and accurate.
- **Poor communication:** Miscommunication between the auditor and the company can lead to delays and misunderstandings. Establish clear communication channels and keep all parties informed throughout the process.
- **Internal control weaknesses:** Weak internal controls can result in significant audit adjustments. Regularly review and strengthen your internal controls to mitigate this risk.
- **Resource constraints:** Audits can be resource-intensive, both in terms of time and personnel. Plan ahead and allocate sufficient resources to ensure a smooth audit process.

A study by PwC found that 60% of audit issues stem from internal control weaknesses and insufficient documentation. Addressing these areas can significantly reduce audit challenges.

BENEFITS OF A STATUTORY AUDIT

While the audit process might seem rigorous, it brings several benefits to your business:

- **Enhanced credibility:** An unqualified audit opinion boosts your company's credibility and can enhance investor and stakeholder confidence.
- **Improved internal controls:** The audit process often identifies areas for improvement in your internal controls, leading to more efficient and effective operations.
- **Regulatory compliance:** A statutory audit ensures that your financial statements comply with legal and regulatory requirements, reducing the risk of penalties and legal issues.
- **Fraud detection and prevention:** Auditors are trained to detect signs of fraud and financial irregularities. An audit can help uncover and prevent fraudulent activities within your organisation.

According to the FRC, 80% of businesses that undergo statutory audits report improved financial reporting quality and internal controls. This highlights the tangible benefits that audits can bring to your organisation.

DIFFERENT TYPES OF AUDITS: STATUTORY VS. INTERNAL AUDITS

In addition to statutory audits, there are other types of audits, such as internal audits, each serving distinct purposes. An internal audit is conducted by a company's own staff or an internal audit department and focuses on evaluating and improving the effectiveness of risk management, control, and governance processes. While statutory audits provide external assurance to stakeholders, internal audits help organisations enhance their internal controls and operational efficiency. Understanding these differences can help businesses leverage the right type of audit for their specific needs.

THE IMPORTANCE OF AUDITOR INDEPENDENCE

One critical aspect of a statutory audit is the independence of the auditor. Independence ensures that the audit opinion is unbiased and objective. Auditors must not have any financial or personal relationships with the company they are auditing that could impair their judgement.

The Companies Act 2006 and the FRC's Ethical Standard provide strict guidelines to ensure auditor independence. For instance, auditors must rotate after a certain number of years to prevent familiarity threats. A study by the Institute of Chartered Accountants in England and Wales (ICAEW) found that auditor independence is a key factor in maintaining the credibility of financial statements. Ensuring that your auditor is independent can enhance the trust stakeholders place in your financial reports.

ADDRESSING POST-AUDIT RECOMMENDATIONS

Once the audit is complete, it's essential to address any recommendations made by the auditors. These recommendations often aim to improve internal controls, compliance, and financial reporting processes. Implementing these suggestions can help your business operate more efficiently and prevent future issues. For example, if auditors identify weaknesses in your inventory management system, addressing these weaknesses can reduce errors and improve the accuracy of your financial statements.

Additionally, responding to audit findings demonstrates to stakeholders that your company is committed to transparency and continuous improvement. According to a survey by KPMG, companies that promptly address audit recommendations often see a 20% improvement in their financial reporting quality. Taking these steps can also make future audits smoother and less time-consuming.

ENGAGING WITH STAKEHOLDERS

Effective communication with stakeholders throughout the audit process is crucial. Keeping shareholders, employees, and other stakeholders informed about the audit's progress and findings can build trust and confidence. Regular updates and transparent communication help stakeholders understand the purpose of the audit and its benefits.

Additionally, involving stakeholders in the process, such as soliciting their input on potential areas of concern, can provide valuable insights and foster a collaborative environment.

Companies that engage stakeholders during the audit process experience higher levels of stakeholder satisfaction and trust. This engagement can also highlight the company's commitment to transparency and good governance practices.

"Companies that engage stakeholders during the audit process experience higher levels of stakeholder satisfaction and trust. This engagement can also highlight the company's commitment to transparency and good governance practices."

WRAPPING UP

A statutory audit should not be viewed as a one-time event but as part of an ongoing process of continuous improvement. By regularly reviewing and enhancing your internal controls and financial reporting processes, you can maintain a state of audit readiness. This proactive approach can help identify and address potential issues before they become significant problems. Implementing a culture of continuous improvement can also lead to more efficient operations and better financial performance.

A study by the Chartered Institute of Management Accountants (CIMA) found that companies that adopt continuous improvement practices in their audit processes see a 15% increase in operational efficiency. Staying audit-ready not only simplifies the audit process but also strengthens your company's overall financial health.

Ultimately, an audit is an investment in the integrity of your business. It reassures stakeholders that your financial statements are reliable and that your company is well-managed.

If you're preparing for a statutory audit, remember that we are here to support you through the process.

JON DAVIES ACCOUNTANTS

Business First, 23 Goodlass Road, Liverpool, L24 9HJ