Audit Preparation: A Formula for High Return on Audit Investment

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If your next audit were a stock you held, how would you characterize the return you'd like to see? You might say high RO(A)I—Return on Audit Investment—would include an accurate presentation that is in full compliance, completion in a timely manner, and fees that are fair and in line with expectations.

Unfortunately, many companies find themselves scurrying at the last minute to respond to auditor requests, as well as blindsided by findings and shocked by large fees at audit completion.

Why does this happen? More often than not, the answer is simply that companies are not committed to comprehensive audit preparation. In fact, a recent CFO Magazine survey found 47% of CFOs reporting they only sometimes prepared or did not typically prepare all of their audit work papers before an audit. And when they reported dissatisfaction with their auditors, 49% pointed to their auditors being too expensive.[1] These two sets of figures are not a coincidence: lack of audit preparation correlates directly with higher fees.

Faced with higher audit standards, more complex reporting requirements, and a mandate to do more with fewer resources, many companies are struggling to successfully address the three critical audit factors—preparation, documentation and collaboration—that contribute to better audit outcomes and can result in lower fees.

This article looks at these three areas with an eye to identifying processes and actions likely to improve audit efficiencies and help keep costs in line with expectations.

Preparation

Audit preparation and planning should ideally begin in the first month of the fiscal period being audited, rather than just before the auditors arrive. With a proactive collaborative process in play, auditor requests will have been anticipated, and requested documents will be readily available in an organized fashion.

The company typically provides in advance a list of prepared-by-client (PBC) documents. A clear, organized PBC file, cross referenced to the list given by the auditors, will increase efficiencies for both parties, but the audit firm will not rely exclusively on them. During fieldwork, auditors will request production of documents prepared by independent third parties, such as banks and taxing authorities, to verify the accuracy and credibility of PBC documents. A company not sure of the best PBC format can ask the auditing firm for guidance.

All documents should be internally reviewed before being handed over to the auditors so that any mistakes or unclear areas can be corrected. It's also helpful for the audit team leader and members to review the audit procedures and results documented in previous years in order to discover what the likely course of the audit will be. Staff likely to be interviewed in the course of the audit should be alerted and counseled if necessary.

Detailed back-and-forth communication before the audit gives the audit firm a sense of the company's diligence in its financial affairs and provides the company with an idea of the areas of scrutiny which the auditors plan to analyze.

Documentation

The pre-audit assembly of thorough and accurate documentation of financial controls, positions and transactions is a daunting task. Yet when all of these are presented in a transparent, organized and easily-tracked manner, auditor questions are more easily resolved and the audit process can occur at a faster pace.

Established business controls should be regularly reviewed, and periodic internal assessments should be conducted to ensure that the controls are being followed. Documentation of these controls, their approval by senior management, and related internal audit results should be regularly maintained throughout each fiscal year by the finance team and made available for the audit firm's review.

An essential part of audit readiness planning is being prepared to support positions on areas such as business controls and business cycles. Companies should maintain documentation of these practices and should be prepared to explain them to the audit firm. The Public Company Accounting Oversight Board's Auditing Standards require auditors to thoroughly document subjective topics such as valuations and cash projections. Each step and assumption should be noted and tested.

The fluctuating global economy has caused many businesses to adopt practices—such as extended payment terms and incentives for futures orders—that impact revenue recognition. As the Financial Accounting Standards Board and the International Accounting Standards Board continue work on how best to converge U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards, companies should use the planning process to prepare positions on the potential outcome of converged standards like retrospective application of proposed revenue recognition rules.

A company should also be prepared to explain both its historic and projected business cycles, as well as demonstrate how external economic factors have impacted and are likely to impact them.

Collaboration

Successful audit preparation and audit completion are deeply grounded in the working relationship between the company and its audit partner, and the leader of the audit preparation team sets the tone for collaboration.

A key element of this tone lies in creating and maintaining an atmosphere of honesty (as openness) and integrity (as values). In a recent article on CFO.com, Bud Kulesza noted, "Honesty is telling the truth to other people. Integrity is often described as doing the right thing when no one is looking. What is it when you do the right thing when others are looking? I call it leadership." [2]

Additionally, the audit preparation team leader encourages the internal team members to be co-operative, proactive, accountable and responsive in working with the auditors. The audit partner relationship deserves the same respect, attention and care the company would give the relationship with its number one client.

As the single point of contact inside the company, the audit preparation team leader is responsible for communicating with the auditors, responding to their requests, and providing needed documentation. The leader should reach out early and connect with the point person at the auditing firm to ask about what areas they will be focusing on and how many samples they will require for which controls. While auditing firms cannot give advice, the preparation team should speak early with the auditing team to share issues. The auditing firm can comment how issues are viewed and point the company in the right direction.

Early proactive activities that send the strong collaborative message, “we are a motivated and responsible audit client,” include the following:

- Inform the auditors about the structure of the internal audit team and how it functions.
- Provide an advance summary of the company’s financial structure as well as a description of the role finance and legal teams play in senior management’s and/or directors’ oversight of the business.
- Invite input from the audit firm in advance of the audit about specific anticipated areas of inquiry.
- Describe any changes the company has recently made or plans to make (i.e., an acquisition or sale of an underperforming subsidiary).
- Establish a schedule for both client-based and end-report deliverables.
- Ensure priority responsiveness to audit preparation issues from key internal stakeholders like senior management and the board of directors.

Establishing a close relationship from the very beginning allows a company to predict the likely approach and supports efficient information exchange and issue resolution. These actions not only save valuable time and allow both parties in the process to hit the ground running in the current audit—they set the stage for the future. Auditors thrive on continuity, and it is likely that some members of the audit team will return knowing that this client prepares well.

Closing Comments
The complexity and volume of information to be reviewed during audit preparation can severely strain companies that do not have needed accounting resources internally. And the need to focus on core strategic and operational financial matters may leave high level financial executives with little time for the detailed management of the client’s side of the audit preparation process.

In these cases, companies may want to consider an outsourcing relationship with a firm experienced in audit preparation. Professional services firms of this nature are familiar with the latest accounting principles, have knowledge of the documentation required, and frequently have an existing relationship with the audit firm.

Whether audit preparation is done internally or externally, proactive audit preparation, documentation and collaboration mitigate risks imposed by audit complexities and time constraints, as well as better control audit fees, minimize business interruptions, and generate the highest return on audit investment.

1 Can This Relationship Be Saved? Kate O'Sullivan; CFO Magazine; May 1, 2008; http://www.cfo.com/article.cfm/11078659?f=related
2 When No One Is Looking; Bud Kulesza; CFO.com; May 5, 2011; http://www.cfo.com/article.cfm/14574003/?f=rsspage

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