The 2023 audit handbook: unravelling the what, why, and how of audited accounts

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What do you think of when you hear the word: 'audit'? Do you picture weeks of stress and distraction from work, with auditors interrogating you on the minutiae of your financial records?

We're here to tell you audits are nothing to worry about and, in fact, they're incredibly important and useful for business owners who want to take their organisation to the next level. With one, you'll be able to make smarter financial decisions, reassure key stakeholders and maybe even secure much-needed funding for your business.

But let's take a step back and take a look at the what, why and how of audited accounts in your complete 2023 guide to audits.

What is an audit?

An audit is a systemic examination of an organisation's financial statements to determine whether they give a 'true and fair' view of its finances.[1]

In other words, auditors review documents to assess whether profits and losses have been properly accounted for, and to make sure any record of what the business owes is properly reflected in its balance sheet. They also analyse the risk of errors and fraud in your financial statements, and check they have been prepared in accordance with accounting standards and legal requirements.[2] This is called a **financial audit**.

There are different types of audits, however, each with their different goals. These include:

- **Operational audit:** These types of audits focus on evaluating the efficiency and effectiveness of an organisation's operations, processes and procedures. The goal is to identify areas for improvement in terms of resource allocation, cost savings and operational performance.

[1] 'EM2778 - Examining Accounts: Accountants and Auditors: What is an Audit?', HMRC Internal Manual, GOV.UK.
[2] 'What auditors do: the scope of audit', ICAEW.

- **Compliance audit:** If you want to assess whether your organisation is following specific laws, regulations and industry standards, a compliance audit will help.
- **Forensic audit:** These are conducted to investigate suspected financial irregularities, fraud or misconduct.
- **Performance audit:** Performance audits assess the economy, efficiency, and effectiveness of a program, activity, or organisation. They focus on achieving specific goals and outcomes and often involve assessments of the use of resources.
- **Tax audit:** The primary focus here is to ensure the company in question paid its full share of tax in the previous period. Tax audits, also known as investigations or compliance checks, are initiated by HMRC when it suspects a company has underpaid tax.

You can organise an even wider range of audits, including IT, environmental, and health and safety audits, all of which require different types of professionals — internal and external to your organisation.

However, financial audits should always be conducted by an external financial professional or accountant to ensure objectivity and an independent analysis. They're also the type we'll be focusing on in the rest of the handbook.

Who needs an audit?

Anyone can arrange a financial audit with an external examiner at any time. However, organisations above a certain size must arrange a statutory audit — sole traders and general partnerships are excluded from this.

Companies can qualify for an audit exemption if they are classed as a 'small' company under the Companies Act 2006.[3] To be a small company, any two of the following criteria must apply:

- their turnover is no more than £10.2 million
- they have total assets under £5.1 million
- they have no more than 50 employees in the business.

If a company meets at least two of these criteria in its first financial year, it will generally qualify as small. After that, a two-year rule applies which means the company must meet the conditions in both the current year and the year before.

Certain industries, however, are more strictly regulated, and will therefore be expected to carry out audits regardless of their turnover, assets or number of employees. This mostly impacts companies in the insurance and financial sectors, as well as public and subsidiary companies.

[3] 'Audit exemption for private limited companies', GOV.UK.

Charities also need to undergo audits, but it's a little different for them.[4] The rules are as follows:

- charities with a gross income of £25,000 or more must have an **independent examination**
- charities with a gross income of £1,000,000 or more must have an **external audit**, which goes into far more detail than an independent examination
- charities with assets above £3,260,000 and gross income of £250,000 or more must have an **external audit**.

However, just because your organisation might not need an audit, it doesn't mean you shouldn't arrange one. Sure, one a year may not be necessary for you, especially if you already have a brilliant finance or accounting team, but there's a reason why many exempt SMEs organise an audit...

The importance of an audit

Audits are incredibly important for any organisation for a number of reasons, meaning that even if the law doesn't require you to arrange one, it's often a great idea to do so anyway.

1. Financial audits provide **assurance to key stakeholders** that the financial information an organisation keeps and uses for strategic decisions is accurate, complete and reliable. That way, investors and lenders will have the confidence to partner with you.

If you're selling your business, buyers will also want to see a true and accurate picture of your finances before they proceed with any deal.

2. An independent examination of your accounting will ensure the figures you use for **strategic planning** are accurate. The last thing you can afford to do as the leader of an organisation is create plans based on faulty figures.

[4] 'Independent examination of charity accounts: guidance for trustees', GOV.UK.

3. Audits can also help identify areas where a business or charity can **improve its financial reporting processes** and internal controls. By identifying weaknesses, you can then take corrective action to address them and strengthen their reporting practices. This can prevent errors and fraud in the future, which can otherwise be costly to an organisation and its reputation.

What happens during an audit?

What happens during an audit will depend on the auditor and their precise approach. Broadly speaking, though, they will gather and evaluate financial evidence about your business for the last financial year and verify that your financial statements have been prepared according to Companies House and HMRC rules.

They will evaluate the appropriateness of your accounting policies, and the reasonableness of accounting statements and related disclosures made by directors. What they're ultimately looking for is any signs of error or fraud.

After this, an auditor has to send a report to your business on the information you have produced and their findings.[5] Broadly speaking, this contains:

- Information on your organisation and the accounts subject to audit.
- A description of the financial reporting framework that has been applied in the preparation of those accounts – the two main standards are generally accepted accounting principles (GAAP) and international financial reporting standards (IFRS).
- A description of the scope of the audit and the accounting standards by which it's been conducted.
- Your auditor's opinion on whether your accounts give a 'true and fair view' of your organisation's affairs and whether they've been prepared in accordance with the correct laws and regulations.

[5] 'Auditor's report - Companies Act 2006', legislation.gov.uk.

How to prepare for an audit

For the organisation requesting an audit, it's unfortunately not as simple as hiring an auditor and expecting them to be able to get to work right away. Instead, there are some things that you need to do to prepare for an audit.

1. Organise your financial records

First, it's your responsibility to give the auditor access to your accounts, financial statements and other information. You're also responsible for ensuring that all the information you give them is factual and correct.

But there's no need to stress about it. Instead, think of it this way: the easier you can make an audit for your examiner, the quicker their job will be, and the more accurate and useful their evaluation.

So, before your audit, make sure you organise your financial records, including bank statements, invoices and receipts. By maintaining well-organised records, you can streamline the audit process to save time, money, and effort.

2. Review your internal controls

Internal controls are the procedures and policies of a business that are designed to safeguard its assets and prevent fraud. An auditor will be extremely interested in reviewing these, so you can get ahead of the game by reviewing them yourself first. Strong internal controls not only enhance the efficiency of your business operations but also instil confidence in the auditor.

3. Communicate with your auditor

Communication is key, especially if it's your first audit, because it lets you create the audit your organisation needs. Speak to them and you can decide on a high priority list for tasks together, as well as a viable timeframe.

You could also find out exactly which piece of information they need from you and in what order they would like your records to be available. Being transparent will make the process less stressful and more efficient.

[6] 'Directors responsibilities for financial reporting', ACCA Global.

4. Be prepared for questions

During the audit, you should expect your examiner to ask questions about your financial statements, transactions and internal controls. This is where knowing what your financial records say and what internal controls you have in place comes in handy.

5. Remember the purpose of an audit

Crucially, always be open and transparent during your audit. After all, audits aren't always about catching malicious companies. Instead, you should think of them as a service designed to help you identify and rectify weaknesses in your accounting procedures. Auditors are not there to trip you up. As such, you won't get anything out of the service if you're being purposefully vague and uncooperative. .

How long does an audit last?

An audit is split between the planning stage and the audit itself. The length of time needed for these stages will depend on various factors, including the size of the business and the complexity of its operations.

For a very large company, the planning side might take a couple of weeks, followed by around three to four weeks for the actual audit fieldwork and a further couple of weeks for completion. A public limited company audit can take many months.

Small and medium companies should expect a shorter timeframe than this, with planning taking a week, audit fieldwork estimated between one and two weeks, and a week for completion.

How much does an audit cost?

Because all businesses are different, the cost of an audit can vary significantly. It depends on the level of work an auditor needs to do, which itself depends on the size and complexity of your business.

The Institute of Chartered Accountants in England and Wales has provided a list of resources and surveys about audit costs to help with benchmarking.

For small companies that don't need a statutory audit, it's even more difficult to give a general costing, so the easiest way to get an idea is to contact an auditor or accountant for a no-commitment quote.

Our audit services

As a distinguished team of chartered accountants and registered auditors, we're ready to alleviate the burden of audits for your business. With our extensive experience in audit and assurance, we'll help you navigate the intricacies of the auditing process.

Our insights will help you create a robust accounting and financial reporting system to help you make smarter decisions and bolster stakeholders' confidence in your financial statements.

Audit doesn't have to be a stressful experience. We're here to help you and your company through the process in any way we can. Get in touch with us today.

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