



# *Future of Audit – Internal Control Effectiveness*

GEOFF SWALES AND KATHARINE BAGSHAW



# *Today's presenters*

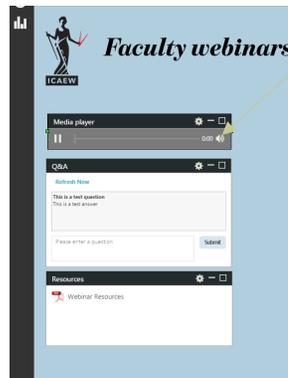


Geoff Swales  
PwC



Katharine Bagshaw  
Audit and Assurance Faculty, ICAEW

# *Introduction*



Audio problems?

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## *Internal controls: Why they matter*

- Current reviews of UK audit
- Does UK need SOX equivalent?

## *Internal controls: Why they matter*

- Robust internal controls ('ICs') help businesses to
  - make good quality decisions
  - keep customers happy
  - avoid regulatory penalties
  - understand profitability

## *Internal controls: Why they matter*

- Five components of controls
  - control environment
  - entity's risk assessment process
  - information systems
  - control activities
  - monitoring controls
- Controls over financial reporting - true and fair view

## *Internal controls: Why they matter*

- Always a risk
  - human error
  - collusion
  - management override

## Financial reporting failures

- weaknesses in the control environment
- weaknesses in routine controls

## Poor quality decisions

- when, where, why and by whom?



***What has gone wrong?***

## UK framework for controls

- UK company law
  - maintenance of adequate accounting records
  - preparation of financial statements
- UK Corporate Governance Code
- Companies seeking a listing

Requirements need streamlining and clarifying



***What has gone wrong?***

- 2002 SOX
  - CEOs and CFOs personally responsible for internal control
  - with external auditors report annually on IC effectiveness
- Criminal penalties for non-compliance



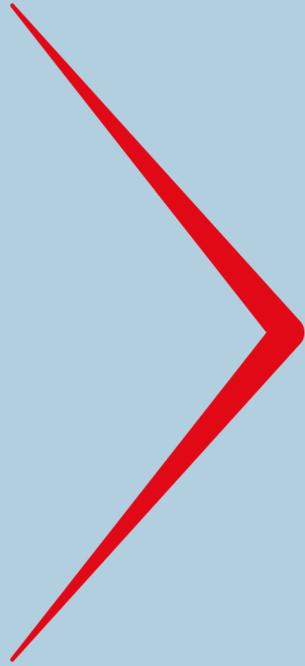
## ***SOX in the USA***

- Implementing SOX expensive initially
  - over-zealous regulation
  - excessively low-level implementation
  - lack of guidance for directors
- SOX eventually strengthened ICs over financial reporting
- Highlighted controls which were:
  - missing
  - ineffective
  - undocumented



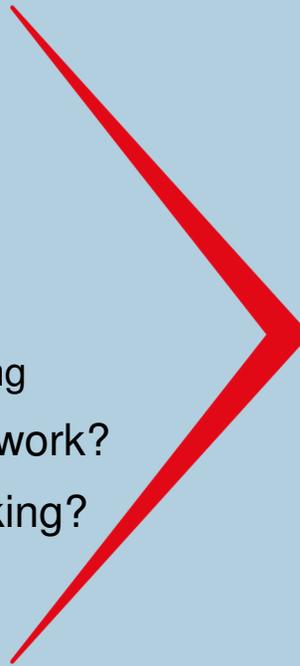
## ***SOX in the USA***

- Superimpose US regime on existing UK regime?
- Attempted elsewhere with limited success
- Underestimate differences in legal, regulatory, business and cultural environment



## ***SOX in the UK?***

- Politically attractive but risks being
  - sub-optimal
  - costly
  - ineffective
- Benefits might be
  - better corporate discipline
  - enhanced control over financial reporting
- Alternatively, develop existing UK framework?
- Understand why UK framework not working?



## ***SOX in the UK?***

- Need greater clarity
  - linking accounting records and financial statements
  - about what is expected of directors
- Motivating directors to keep better quality records
- Are current sanctions appropriate?



## ***Internal controls: UK company law***

- Should directors and auditors report on the adequacy of accounting records
  - publicly
  - explicitly
  - annually?
- Currently
  - no reporting requirements for directors
  - auditors only report by exception
- Or eliminate these requirements?



## ***Internal controls: UK company law***

- Scope for UK Code and associated guidance to be
  - better understood
  - more robustly applied
- Enhancing director accountability for the application of the mandatory Principles?



## ***Internal controls: UK Code***

- Requiring auditors to report on wider range of corporate governance statements
- Streamline and clarify reporting requirements in
  - financial statements
  - audit report



## ***Internal controls: UK Code***

## Listing Rules

- directors must establish procedures providing 'reasonable basis' to make proper judgements about 'financial position and prospects'
- reporting accountants invariably engaged



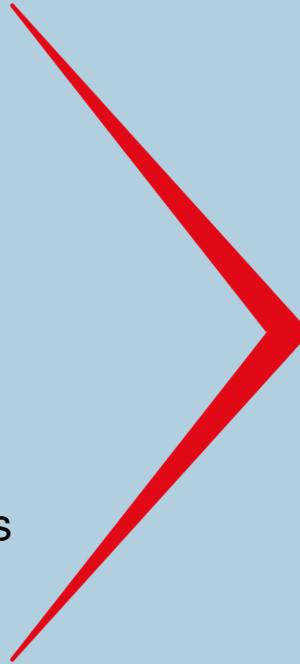
# ***Controls in companies seeking a listing***

- Framework for reporting accountants
  - ICAEW Tech 14/14 CFF Guidance on financial position and prospects procedures
- As with UK Code it covers
  - controls over forward-looking information
  - a wider range of controls than in the USA
- Scope for directors and auditors to report on eight criteria annually - not just for IPOs



## ***Controls in companies seeking a listing***

- Clarity and discipline of the SOX controls understood by wide range of
  - investors
  - directors
  - regulators
- Clarity does not guarantee internal control effectiveness
- Clarity about directors' responsibilities likely to improve internal controls



## ***Learning from the US experience and next steps***

- UK requirements need to be streamlined and clarified
- Statements about responsibility for IC - more often, explicitly and publicly, as in USA?
- ARGA should be tasked with developing UK framework for public reporting by directors and auditors



## ***Learning from the US experience and next steps***



*Any questions?*



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04 October 2019

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 +44 (0)20 7920 8493

 [tdaf@icaew.com](mailto:tdaf@icaew.com)

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