**Audit, Assurance and Compliance**

# Executive Summary

Recently, it is found that the auditing companies are failing to adhere to the requirements and hence are facing the issues of dilution. It is necessary for the companies to carry out their auditing to ensure that they are complying with the auditing and other legal rules of the government and other regulatory agencies. It will further help the respective companies to overcome the problems of - conflict of interest, complex accounting problems, gain public trust, overcome remoteness challenges, and also ensure to follow the principles of transparency and accountability in the respective organization.

To determine how the auditing practices are carried out, this report will conduct an analysis of the company - Xero Ltd. The auditing firm of Xero Ltd. is Ernst & Young. It will also include the major practices that need to be conducted by Ernst & Young at a given organization. They need to fulfill their responsibilities and accordingly suggest recommendations for further improvement to the management team of Xero Ltd. It will help them overcome major management challenges from the accounting and auditing perspective in a given working environment.

There are different reports analyzed by the auditing firm and hence it is important for them to inspect them carefully; only then they will be able to determine the gaps and accordingly suggest solutions to the firm. This report will finally provide recommendations on audit operations and will also suggest changes to the auditing firms to ensure that they are performing as per the expectations.

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# Introduction

In the given environment, it is found that the performance of the different companies is constantly deteriorating. These companies despite conducting audits are not able to perform as per the expectations. It has thereby become necessary for the regulatory authorities and other governmental agencies to inspect the operations performed by these companies as well as the auditing firms (Kuo, 2014).

There is a need to revise certain strategies and principles so that the auditing firms can follow the Ethical Code of Conduct in their routine practices. For this purpose, IAASB has modified the auditing audit reporting requirements.

It is the responsibility of the auditing firm - to review the accounting and other internal control systems of the organization, assess the different transactions carried out in a given financial year, review the efficiency and effectiveness of the organization, conduct investigations into suspected cases, review the practices and determine whether the company is complying with the norms or not, and finally, examine the financial information of these firms (Kuo, 2014). It will thereby help the organizations to overcome their gaps, ensure following of ethical practices, and thereby achieve desired auditing objectives in a given working environment.

# Independence Requirements

CPA Australia ensures that there are independent rights provided to the auditor for the purpose of carrying out different auditing tasks in a given work environment (Ho & Wang, 2013). It is noticed by researchers that there are potential risks associated in a given firm if the auditors are not made independent.

The major risk issues found include - ignoring discrepancies in the different practices of the organization, failing to report to the senior management about control breaches, accepting explanations from the staff without any evidence and support, turning a blind eye to the unethical practices carried out, despite viewing that the principles of transparency and accountability are not followed, the auditing team will not be able to perform any corrective actions, and giving underserved positive feedback to the organization.

It is thereby important for the government to allow these auditors to remain independent and thereby perform the best practices in a given environment. It will overcome the treats that include - self-interest of the companies, familiarity issues of the clients, advocacy norms, self-reviewing problems, and intimidating challenges (Di Porto, Persico, & Sahuguet, 2013). The Corporation Act Section 307C was thereby formulated with an objective to ensure that the auditing firms will remain independent and will ensure appropriate corporate governance in the organization.

They will make the employees of Xero Ltd. to follow the ethical principles in their daily practices in a given organization. Also, the audit report of Ernst & Young states that they are independent of the company as per the Professional and Ethical Standards and will thereby comply with the independence requirements.

# Non-audit services performed by the Auditor

It is observed that despite non-approval of such services, the auditing firms are still conducting non-audit services for the organization to ensure that they provide a strong financial image of the firm. The different services carried out under this category include - internal audit services, accounting and book-keeping services, storing important financial information, providing services related to the IT systems for preparing different financial records and reports, actuarial services, valuation services, performing certain management functions to manage certain activities of the organization, investment and banking services, and even recruitment services for hiring staff that will be looking after the audit operations of the firm (Di Porto, Persico, & Sahuguet, 2013).

However, these can raise several challenges for the public as they will not be able to get the actual image of the performance of the company. Also, the auditing firms will face the clause of conflicts of interest and hence will not be able to conduct audit later. The management of Zero Ltd. in this case clearly states that they are not allowing the auditor - Ernst & Young to perform non-audit services for the company.

And, even if in some case if they require any such assistance, the auditors need to take the permission of the senior management. Later, after approval they will be able to perform such operations in a given environment. The auditing firm thereby needs to focus on major aspects of accounting such as cost accounting, financial accounting, managerial accounting, and tax accounting (Guiral et al., 2010). It will provide them with a better overview of the performance of the organization. They can thereby provide recommendations on further improvement and bridging the gaps from the operational perspective.

# Auditor’s Remuneration

It is noticed that the auditing fees will depend on the type of the company as well as on the level of operations carried out within the company. As per one of the research reports, it was found that General Electric paid around US $126 million in 2008 to KPMG for the different auditing operations. Similarly, American International Group paid US $116 million to PwC (Free, Radcliffe, & White, 2013).

The Royal Bank of Scotland paid US $88 million to D&T. There are several other companies who have paid large auditing fees for the purpose of their different auditing transactions. As per another research report, it was found that the audit-fees and non-audit fees were paid to the firms based on a fixed percentage.

As a result, the smaller audit firms will become more dependent on the companies that are paying them good fees. The following table demonstrates an analysis of auditor remuneration derived by Ernst & Young from Xero Ltd.:

Ltd.:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **(Amounts in '000)** |  |  |
| **Year ended 31 March** | **2018** | **2017** | **Difference** | **Difference %** |
| **Audit and review of financial statements** | 252 | 236 | 16 | 6.78% |
| **Taxation Services** | 28 | 28 | 0 | 0.00% |
| **Other Assurance Services** | 135 | 87 | 48 | 55.17% |
| **Other Services** | 2 | 4 | -2 | -50.00% |
| **Total Auditor's Remuneration** | 417 | 355 | 62 | 17.46% |
| **Revenue** | 406,579 | 295,389 |  |  |
| **Audit fee as a percentage of Revenue** | 0.10% | 0.12% |  |  |
| **Total Assets** | 289,076 | 293,250 |  |  |
| **Audit fee as a percentage of Total Assets** | 0.14% | 0.12% |  |  |

It will be important for the researchers to determine the relationship between the auditing firms and the companies from their earning perspective. In this case, the audit fees of the company have decreased, and on the other hand, the total revenues of the company have increased (Matschke & Schöttner, 2013). Hence, it is questionable to this fact and there is a need to carry out proper investigation in this direction.

# Key Audit Matters

It is necessary for the auditing team and the company to identify the major issues or concerns and communicate them to the top-level management of the organization. They thereby need to take steps for further improvement in the near future. In this case, Ernst & Young identified two such matters for Xero Ltd. These include - Impairment of Capitalized Development Costs and Capitalized Development Costs (Bowlin, 2011).

Capitalized Development Costs refer to the total costs incurred for the development of internal systems and architecture. The costs then will be amortized for the useful life of these systems over a given period. However, the auditing team needs to check the operational level of the system, the control settings, and the usefulness of these systems in the organization from the application perspective.

Only then they will be able to justify the total costs associated with the installation of these new systems in the organization. The Impairment of Capitalized Development Cost refers to the impairment of the costs capitalized by the company (Bourgeon & Picard, 2014). The auditing team of Ernst & Young ensured that all the accounting aspects were considered for the new technological module installed and the new software purchased.

They also checked the amortization period feasible for these new equipment and devices. The team has further applied appropriate principles to ensure that the organization has met different standards and regulations to comply with the legal norms. It is important for the auditing team to highlight these auditing mattes so that the management team can take necessary steps in this direction.

# Audit Committee

CPA Australia stated that the organizations need to have an auditing committee to help the board members with the corporate governance as well as for exercising internal controls in a given work environment (Kotowski, Weisbach, & Zeckhauser, 2014). Even, in this case of Xero Ltd, the company has appointed an auditing committee. They will be responsible for overseeing the areas of risk, compliance, and audit.

Accordingly, they will be preparing the key reports and submit them to the top-level management of the organization. Further, the committee will comprise of three members and will also include one non-executive member of the organization and one independent board member of the organization (Ronen, 2010).

It will help them identify the gaps and weaknesses in the current practices of the organization from the accounting and auditing perspective. The committee will thereby assist the board in overcoming these risk factors and thereby ensure in complying with the norms of the legal authorities in a given working environment. However, it should be noted that the audit committee will be restricted in taking actions unless they obtain approval from the Board Members.

# Audit Opinion in 2017

There are four types of audit opinions that include - qualified during the matter of concern, unqualified when all the practices are inappropriate, disclaimer when the auditor cannot take actions on the given financial statements, and adverse when the matter is significant. Now, in the given case of Xero Ltd, the audit opinion of EY is unqualified. They have ensured that the financial statements of the company are true and are prepared in a fair manner.

The auditors have taken steps to ensure that there are no manipulations made in the report. It will thereby ensure that the financial statements disclosed by the company will provide a clear and fair image of the performance of the organization in given working conditions (Lin et al., 2011).

The shareholders and other concerned stakeholders can thereby put their trust in this company and carry out necessary actions. Also, the auditing team can provide suggestions in a case wherein there are gaps identified in the financial statements of the company. It will help them follow proper ethical principles in a given working environment.

# Difference between Director’s and Management’s responsibilities from auditor’s responsibilities

The AU Section 110 clearly states that the preparation of the financial statements is the responsibility of the management team of the organization and not the responsibility of the auditing team. Further, ASA 700 states that the auditor firm needs to define their roles and responsibilities; it will subsequently define their boundary role in the organization.

Hence, in the reports of Xero Ltd., it is clearly stated that the role of EY is not to prepare the financial statements but to provide their opinion on the financial statements. The management committee, irrespective of having any technical knowledge of accounting needs to ensure that they prepare the accounting statements and other financial statements of the organization (Lin et al., 2011).

However, it is the responsibility of the EY team to verify and check that the figures and other facts are not manipulated by the management committee of a given organization. They can inform any of the important objectives through proper communication channels to the top-level management and thereby ensure that Xero Ltd. has followed the compliance and other norms of accounting standards.

# Subsequent Events

AASB 1110 states that the company needs to disclose any of the subsequent events that will occur after the reporting date and before the financial statements are issued in public. However, in this case, Xero Ltd. has not recognized any such subsequent events in their annual reports of 2017.

# Effectiveness of material information reported by Auditor

It is important for the auditor to provide all information as per the reported transactions in the company. The company needs to submit their operational reports on a daily basis so that the audit team can verify and work on it accordingly.

The auditor also needs to take into consideration then needs of the other stakeholders and hence cannot report any false facts in the report. To improve the overall effectiveness, the auditor needs to analyze the facts, report them in the financial statements, and inform the shareholders bout the profit or losses made in a given working environment (Serra, 2012). In this case, there is no material information provided by the company. However, the opinion of the auditor will install confidence to the third party stakeholders and ensure that the trust is not broken between them.

# Under-reported Material Information

There is under-reported material information in the annual report of Zero Ltd. The first one is related to audit matters and second is regarding providing of non-audit services to the organization. The auditor needs to explicitly communicate about both these issues so that the external regulatory authorities can take a note of it (Serra, 2012).

The auditing team, however, needs to bridge the gap by following the different elements of the audit strategy. They need to ensure meeting the requirements of - developing relationships with all the entities, ensure effective functioning of the organization, manage planning of the different auditing services, and arranging for the submission of the reports within given timeframe.

# Follow-up Questions to the Auditor

There are several questions that can be asked to the auditor but it will depend on the type of activities of the organization, and the activities recorded by the auditor in a given environment. The auditor needs to specifically mention about all the direct and indirect transactions made, how they are recorded, their purpose of carrying out in different modes, and subsequently reflect them in the financial statements of the company (Serra, 2012). Also, the auditing team can be asked about the different assumptions made in the reports.

# Conclusion

This report examined the auditing approach of Ernst & Young at Xero Ltd. It first provides the discussions on the practices of auditing team in the organization. It then highlighted the concerns of non-audit services, and how the organizations can overcome it.

Further, the report analyzes the concerns of - key audit matters, role of the audit committee, the difference in the responsibilities between the auditing team and the management team, and reporting responsibilities of the auditing firm in a given environment. It is important for the auditing organization to ensure fair and ethical practices and thereby develop financial reports of the companies that will adhere to the legal compliance of the regulatory authorizes in a given environment.