



# Generating Value from the Audit

A survey of small and  
medium-sized companies

AUDIT

# Foreword

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Finance directors in small and medium-sized companies have a difficult job to do. With limited resources and a remit that often extends far beyond pure finance, different issues compete for attention and time is always at a premium.

That is why it is so important to maximise the return on any investments.

The findings from our latest research into one investment that companies have to make every year – the audit – throw down a challenge, both for companies and for our profession.

For companies, the survey findings suggest that around half are missing out on an opportunity to generate greater value from their audit.

By the same token, our profession could therefore do more in some cases to deliver a greater range of insights to the companies they audit.

A strong and open relationship between a company and its auditor is vital if the audit is to deliver the sort of far-reaching benefits it is capable of producing.

Our research suggests that companies around the UK fall into two roughly equal camps: those that are getting real value, and those that are not. Companies need to ask themselves which half they are in, and whether they need to take action accordingly.

# Introduction



The role of the audit, long regarded as a routine chore or simple statutory obligation for quoted companies, has come in for significant reappraisal in recent years. A series of high-profile corporate failures in the early years of this century led to such initiatives as the Sarbanes-Oxley legislation in the US, a growing debate around the liability that auditors should shoulder, and, in the UK, scrutiny of the level of competition and choice in the audit market.

The effect of all this activity has been to put audit firmly on the agenda of legislators, regulators and indeed the media. It is no longer seen as a merely mechanical process, but is recognised as one of the central cogs around which the capital markets revolve.

But to what extent are companies – and specifically, small and medium-sized companies (with turnover of £500 million or less) – leveraging the audit to gain maximum value and insight into their business processes? What kind and level of relationship do they have with their auditor, and what importance is attached to the audit by the company and its stakeholders?

KPMG asked Opinion Leader Research to conduct an in-depth survey of 200 UK companies in order to find out.

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The research was conducted by Opinion Leader Research by telephone in October and November 2006 amongst 200 companies with annual turnover of between £5 million and £500 million. Respondents were Board level executives ranging from Financial Directors to Company Accountants to MDs.

# Generating Value from the Audit

## The Value of Audit

According to the research, it appears that around half of UK small and medium-sized companies are not maximising their return on investment in the audit.

Fifty-six percent of the 200 small and medium-sized companies surveyed see their audit as a routine chore that varies little from year to year, while only 40 percent of companies agree that the audit raises issues and learning points that are useful for the business as a whole outside the audit process itself.

On the other hand, 62 percent of companies recognise that there is a strong link between the strength of relationship with an auditor and the value derived from the audit.

Figure 1

The audit is a largely mechanical process that is more or less exactly the same each year

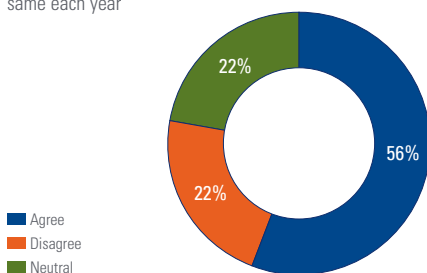


Figure 2

There is a strong link between the strength of relationship with an auditor and the value you derive from an audit

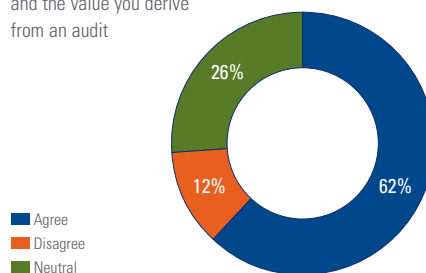
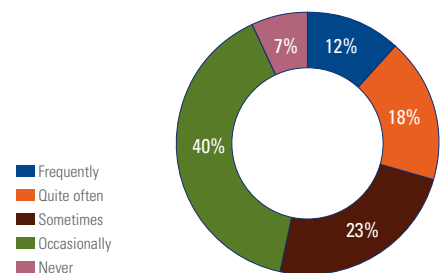


Figure 3

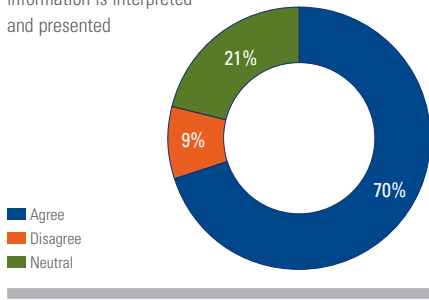
How often do you meet with your auditor outside the audit season?



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Figure 4

Our auditors are prepared to challenge us on the way that our financial information is interpreted and presented



Underlining the importance of the audit process to businesses, nearly two thirds (62 percent) claim that they would conduct their own audit process even if it were not a statutory obligation.

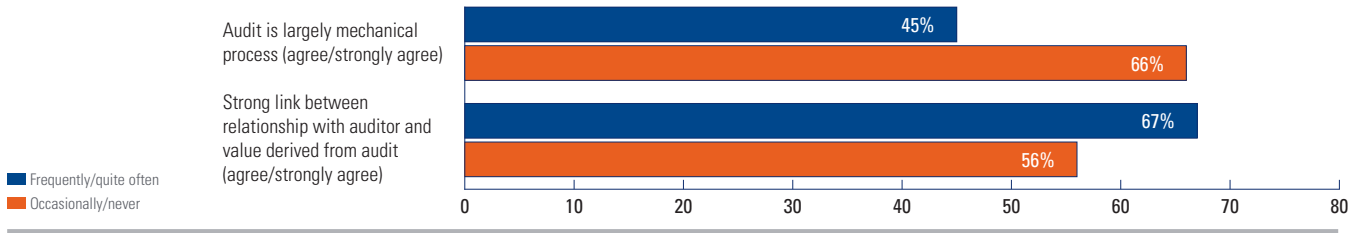
Auditors are viewed as performing a robust job regardless of the status of the relationship: 70 percent of companies said that their auditor is prepared to challenge them on the way that their financial information is interpreted and presented.

While only 40 percent of respondents overall agree that the audit throws up issues and learning points that are useful for the business as a whole, the research found that, behind this, there is a strong correlation between frequency of communication with the auditor and the value that is derived.

Among those companies that meet with their auditor frequently or often outside the audit season (30 percent), 67 percent believe that there is a strong link between the relationship with their auditor and the value they derive, and less than half (45 percent) perceive the audit as a mechanical process. However, amongst those that meet only occasionally or never (47 percent), two thirds view the audit as a merely mechanical process.

Figure 5

How often do you meet with your auditor outside the audit season?



### Choosing the Auditor

Nearly two thirds of the businesses interviewed (65 percent) have changed their auditors within the past 10 years, but over a quarter (27 percent) of businesses have not changed theirs for over a decade.

Two-thirds (66 percent) of respondents say that their company stakeholders' views would affect their choice of auditor.

#### Audit committees

Over two thirds (67 percent) of businesses interviewed do not have an audit committee – with the most common reason being that the company is not of sufficient size to warrant one.

Of the 32 percent of companies that do have an audit committee, they meet three times per year, on average.

Figure 6

When was the last time that you changed auditor?

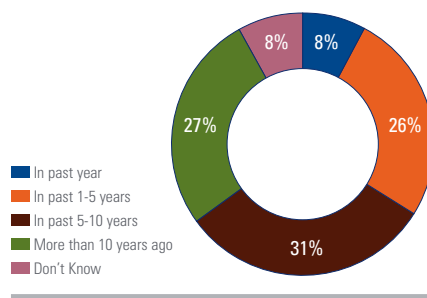


Figure 7

Would you say that your stakeholders' views would affect your choice of auditor?

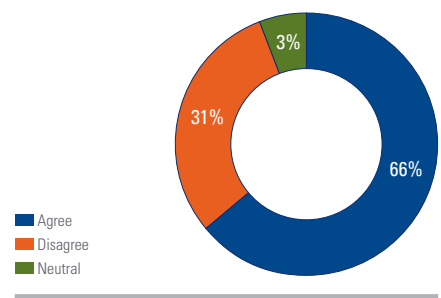


Figure 8

How important to you is the speed with which your accounts are signed off?

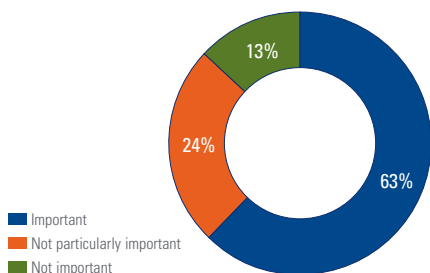


Figure 9

How happy were you with the speed of sign off of your last audit?

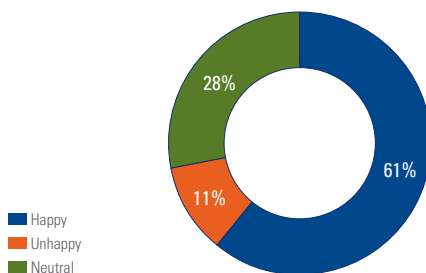
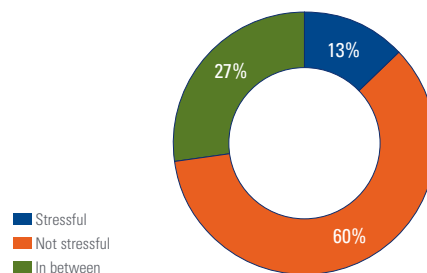


Figure 10

Was your last audit stressful?



### Resourcing and Speed of Sign-off

On average, according to the study, auditors spend around two weeks on site during the audit, with the accounts being signed off 97 days after the company’s year-end.

The challenge of achieving this was highlighted, however, by the tight resources of small and medium-sized companies. On average, just five people in the internal finance team are involved in compiling the year end financial figures.

The speed at which businesses’ accounts are signed off is important to the majority (63 percent) of participants. The vast majority report that auditors tend to spend between one and three weeks on site (87 percent), although some take up to 11 weeks to complete their checks. More than one in three businesses (39 percent) are less than happy about the length of time their audits have taken overall.

Just over one in ten (13 percent) businesses feel that the audit process is actively stressful, while 88 percent accept that managing the audit process is an integral part of the job of the finance function.

### Communication and interaction

As we have seen, frequency of communication with the auditor appears to have an impact on the level of value that is perceived to be derived from the audit.

Our research found that there is some divergence in terms of how often a company communicates with its auditor outside the audit season itself. 30 percent of companies meet with their auditors ‘quite often’ or ‘frequently’, but nearly half meet only ‘occasionally’ (40 percent) or ‘never’ (7 percent).

The majority of businesses feel that the interaction they have with their auditor outside the audit season is about right (85 percent), with only a small proportion (13 percent) reckoning that there is insufficient contact with the auditor during this period.

Figure 11

Is your frequency of interaction with your auditor...?

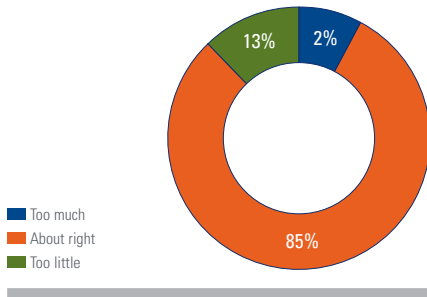
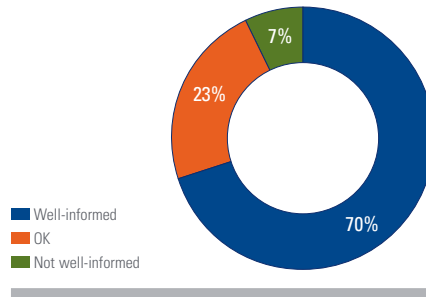


Figure 12

How well informed do you feel your auditor keeps you during the audit?



During the audit itself, the research found that levels of satisfaction with the auditor relationship are generally high: 70 percent of respondents agree that they are kept well informed by their auditors of any issues that arise, with only 7 percent actively unhappy about the quality of communication.

### International Financial Reporting Standards

An area of ongoing debate has been the introduction of International Financial Reporting Standards (IFRS) for small and medium-sized businesses, with an exposure draft issued in February 2007 by the International Accounting Standards Board. Should there be a simplified version of IFRSs for smaller companies, and if so what should they look like?

Our research found that a clear majority of businesses (71 percent) do indeed favour simplified versions of IFRSs for companies of their size. This is perhaps not surprising in itself!

However, few companies believe that IFRSs will make the job of reporting their performance to external shareholders any easier than it was under UK Generally Accepted Accounting Principles (GAAP). Only 16 percent believe that it will be easier, while 18 percent believe it will be more difficult. The clear majority (66 percent) believe the task will be about the same.

Figure 14

Do companies of your size need simplified IFRS standards?

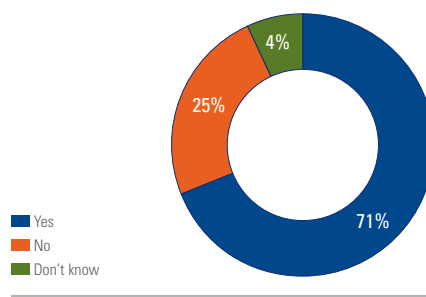
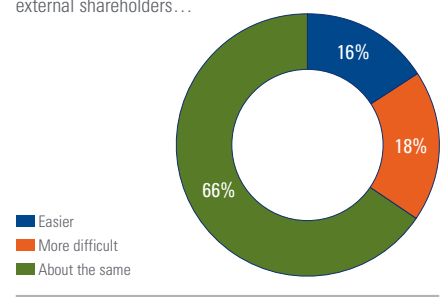


Figure 15

Will IFRS make the job of communicating your company's performance to external shareholders...



# Conclusion



This study suggests that the company audit is an under-exploited asset among many small and medium-sized companies.

Whilst overall levels of satisfaction with the audit process are high, this may be because some companies are 'setting the bar' too low.

The audit process has the potential to generate insights and learning points that are useful for a company outside the audit itself.

Companies need to ask themselves whether they are getting the value they could be getting out of their annual audit.

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