Unit 16. SCARY AUDIT JARGON

Many large UK companies' annual financial statements are audited by a firm of external auditors. The auditor's opinions are published in the audit report, included in a company's annual report.

This unit looks at the different opinions UK auditors can give on a company's financial report.

Read the article and do the tasks below.

Scary jargon in a jittery market

by Jennifer Hughes

A Auditors' jargon rarely enters normal conversation but one phrase – 'added emphasis' – has the power to terrify boardrooms. It is a phrase that auditors sometimes use to indicate possible dangers hiding below the surface of a company's balance sheet.

B Every January, just after the books close for more than half the UK's top companies, investors begin the wait for the full-year financial statements. Most years, the auditor's report – a page of largely standardised phrases, including an opinion of whether the business is a valid going concern – attracts little interest. In a bad year, however, that 'going concern' statement is critical to investors.

C Technically, 'going-concern approval' means that the auditors consider the business to be viable for at least a year from when the accounts are signed off. At worst, auditors can give an 'adverse opinion', indicating a general and serious disagreement with the directors' statement of the company's financial position. In volatile markets, however, even a 'qualified opinion', indicating a limited and specific concern, can act as a death warning.

D Rather than a 'qualified opinion', an auditor's report is more likely to include 'emphasis of matter' paragraphs, which are designed to draw investors' attention to crucial disclosures. In difficult times, you see more of these in audit reports.

E Says Steve Maslin, a partner at Grant Thornton, a large firm of accountants, 'Take the case where you don't disagree that the business is a going concern, but there is an important disclosure, perhaps about the company's financing facilities for the next year. You want to tell investors "you need to read and understand Note 27". So we'll add a paragraph in the report [to highlight this fact].'

F In auditing standards, these 'emphases' are preceded by terrifying phrases such as 'significant level of concern' and 'material uncertainty'. 'The wording is horrid. There is a danger that the market will react to this and it will become a self-fulfilling prophecy,' says Martyn Jones, National Audit Technical Partner at Deloitte.

G Auditors have good reason to worry about professional liability. After the failure of many dotcom companies in 2001, a wave of lawsuits against audit firms followed. Since then, regulators have made it clear they will take a firm line with audit firms. 'There are no excuses these days for saying "when we signed off, we didn't think about that,"' said Paul Boyle, Chief Executive of the Financial Reporting Council in a warning issued to the FTSE 350.

H In a difficult economic environment, investors can start to panic at any delay in the publishing of the annual report, so the nightmare scenario is a last-minute hitch in the financing plans – without which the auditors will not sign off a clean opinion. Take the situation 'where a client is heavily dependent on a bank facility and the bank suddenly wants last-minute information. You end up having meetings late into the night,' says Mr Ratcliffe, an audit partner at PwC.

I This means that, despite auditors' best efforts to prepare, the outcome is not in their hands. So in a difficult year, auditors are even more rigorous than usual. No matter how well-run the client company is, a year of difficult economic conditions is the year you sit down and make sure you really, really understand that bank mandate or those liabilities.

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A. UNDERSTANDING THE MAIN POINTS

Read the article and choose the correct option: TRUE or FALSE.

1. TRUE FALSE In general, investors pay careful attention to the auditors' report on a company.
2. TRUE FALSE A negative auditors' opinion indicates that the auditors disagree with the statements that a company's directors have made about it.
3. TRUE FALSE In difficult economic times, investors might react more strongly to a negative opinion, to the extent that they push the company into complete failure.
4. TRUE FALSE Auditors are not held responsible if they fail to indicate that a company's financial affairs look unhealthy, then the company goes bankrupt.
5. TRUE FALSE Financial regulators require auditors to clearly indicate a company's poor financial outlook.
6. TRUE FALSE Poor economic conditions make auditors even more cautious when writing their report.

B. UNDERSTANDING DETAILS

Read the article and answer these questions. Give as short answers as possible, e.g., just the date, etc.

1. When do the majority of UK companies have their year end? ____
2. How long is an auditor's opinion on a company valid for? ____
3. What is the worst opinion an auditor can give? ____
4. What does every company want its auditor to give it? ____
5. Which paragraph alerts investors to important information? ____
6. Which two phrases might auditors put before this paragraph? ____
7. Which series of events in 2001 was very costly for audit firms? ____

C. VOCABULARY

Word search

Find words or phrases in the article which fit these definitions.

1. __________________________ - the technical vocabulary that a certain industry or profession uses (title - 1 word)
2. __________________________ - volatile, nervous (title - 1 word)
3. __________________________ - what the phrases in an audit report are said to be when the wording of opinions varies very little from one report to another (1 word)
4. __________________________ - what the accounts are said to be when a company's financial accounts have been inspected and the auditors have found them to give a true and fair view of the company's finances (2 words)
5. __________________________ - extra information which the directors of a company give in the notes to the financial report (1 word)
6. __________________________ - a company which does business using the Internet or provides an Internet service (1 word)

7. ________________________ - a charge, complaint or claim against a company or person made in a court of law. Several audit firms suffered these after the dotcom crash in 2001. (1 word)
8. ________________________ - when auditors are satisfied that a company is in good financial health for the coming year (2 words)
9. ________________________ - an arrangement made by a bank for its customers which lets them borrow money (2 words)
10. ________________________ - an official instruction given to a person or organization by a bank, allowing them to do something (2 words)

D. DEFINITIONS

Match these phrases from the article (1-4) with their meanings (A-D). <u>Write letters A, B, C or D in front of the relevant phrases.</u>

____ 1. going concern A. given in an audit if the auditor disagrees with the treatment or disclosure of a specific piece of information in the financial statement, or of the auditor feels that the audit has been too limited in its scope

____ 2. emphasis of matter B. a business that functions without the intention or threat of liquidation for the next 12 months

____ 3. qualified opinion C. when the auditor decides that the financial statements of a company are materially misstated and, when considered as a whole, do not confirm with the generally accepted accounting principles in force at the time (such as IFRS)

____ 4. adverse opinion D. a paragraph which draws attention to a specific point disclosed in a company's financial statement which the auditor considers to be of great importance to the user's understanding of the statement

E. SENTENCE COMPLETION

Use words and phrases from Exercises C - D to complete these sentences.

1. The auditors were very pleased to give the company their ______________ approval for the next year.
2. Therefore, they _____________ its financial report.
3. The banks were having financial difficulties and called the company's directors to a meeting to discuss its _______________ for the coming year.
4. The auditors were satisfied in general with PRQ company's accounts, but in their report, they drew attention to a specific ____________ in an __________ of _________ paragraph.
5. The auditors were totally dissatisfied with the financial affairs of XYZ company. They gave an ______________ in their report.

F. UNDERSTANDING EXPRESSIONS
Choose the best explanation for each phrase from the article.

1. '… it will become a *self-fulfilling prophecy…'* (lines 54-55)
   a) actually make the disaster happen
   b) describe the disaster
2. '… a *wave* of lawsuits …' (line 61)
   a) a small number
   b) a large number
3. '… they will *take a firm line with* audit firms.' (lines 63-64)
   a) create a new audit firm
   b) be very strict with
4. '… the nightmare scenario is a *last-minute hitch* …' (lines 73-74)
   a) a problem which occurs late in the process
   b) a last-minute drop in the company's share price
5. '… *the outcome is not in their hands.'* (lines 84-85)
   a) they are not responsible for the final result
   b) they are not responsible for what they publish
6. '… even more *rigorous* than usual.' (lines 86-87)
   a) difficult
   b) careful and thorough