8 Key steps to take before your first audit

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For a small UK company an audit can be a time consuming and often daunting task for management. The focus of the business tends to be on scaling, revenue generation, keeping costs under control and raising funds or finance. In the UK companies will reach a point where an audit moves up the priority agenda generally for one of two reasons:

An audit is required statutorily – there are sizes thresholds in the UK that mean once a business breaches these levels, the directors are required to have their accounts audited:

These levels are as follows:

A UK company requires an audit if for both this year and last year if met two out of the following three criteria:

- Turnover - £10.2m
- Total assets - £5.1m
- Number of employees – 50

The business has recently raised capital – typically venture capitalist or private equity. Therefore, an audit may be the requirement of the investment agreement, a bank loan agreement or the new investors and the Board recognise it is beneficial for the accounts to be audited. This will assist the directors through the business' next phases of development and eventual exit.

It is a common approach in the tech sector, where businesses regularly receive investment ahead of meeting the statutory audit thresholds.

Whether the requirement is because of law, another requirement on the business or voluntary, a first-year audit will be a rigorous examination of the company's books and records. It also provides confidence to stakeholders or prospective stakeholders that the numbers have been examined by an independent third party.

8 Considerations for tech companies preparing for their first audit

In my experience, the following will help in ensuring the audit is as pain free as possible:

1 'Get the right people on the bus'

To coin a phrase used by Jim Collins in his book 'Good to Great', getting the right people in place to ensure your audit is a success, whether the business is at an early stage looking to appoint its first head of finance or a CFO building their team. Ensuring people with the appropriate experience, GAAP knowledge and systems knowhow is imperative.

The audit will place additional pressures on your finance team. Making sure individuals have sufficient bandwidth to dedicate themselves to liaising with the auditors and dealing with audit requests will make the process run more smoothly.

2 Seek buy-in from key stakeholders and ensure they understand the time commitment

An audit is time intensive. For a small business you could typically expect the audit to be segmented into three phases: planning, fieldwork and completion.

Although timescale and cost vary depending on type of business, for a small company you would typically expect one week for planning, two weeks for fieldwork (including all detailed sample testing) and one week for completion and reviews of the financial statements.

These are the times that auditors will be 'on site', however there is considerable preparation time required by the finance team in between these visits, together with potential issue resolution on technical areas and meetings with management and the Board.

The success of an audit is seen as a hygiene factor for finance heads and can damage credibility if not run well. It is critical the Board and other key stakeholders are aware of what it entails and there is overt buy-in.

3 Identifying the people to turn to to support the auditors with their understanding of your control environment

Before entering into an audit cycle, it's a good idea to put process notes in place for your key transaction streams. As a starting point, the following will typically be transaction cycles the auditors will focus on: revenue, purchases, payroll and the financial reporting close process.

As a business entering its first audit, the control environment is typically less formalised than a larger/established business. This means that placing reliance on controls (to reduce detailed substantive work) is unlikely in the first audit. Your auditors will still need to gain a detailed understanding of the control environment and to test the design and implementation of the controls, which is typically done by 'walking through' an item from inception to completion of the process flow.

The burden on the finance team and wider business will be lower during the audit cycle if process notes or flow charts have been prepared in advance.

The auditors will typically want to have conversations with key personnel including: CEO, CTO, head of legal and head of sales. It is worth briefing them ahead of time.

4 Ensure your accounting records are in order

Typically, by the time a business reaches the size criteria or has been through due diligence in the lead up to investment, the financial records are in reasonable shape and the business is using a recognised accounting package. There may remain some use of excel files (e.g. the consolidation), though it tends to be more limited.

However, where companies are pre-investment, it would not be uncommon that the finance team is still small and that may mean records need to be collated and organised. Excel may be used in many instances to augment reports from the accounting package.

Early stage businesses that are scaling rapidly, expanding internationally and growing in complexity, that are now turning their attention to audit and investment in the finance team, may find that they have outgrown their existing accounting software and need to upgrade to keep pace with the group's growth.

5 Understand the audit risks

For the audit of a growing UK tech business, you would expect all or a combination of the following areas to be raised as audit risks (where relevant): revenue recognition, management override of controls, valuation of intangible assets & goodwill, capitalisation of development costs, valuation of share options, financial instruments, classification of equity transactions, opening balances and going concern.

These are the areas the auditors will focus the majority of their time on. Having an open dialogue on these areas up front will help you navigate them during the audit.

6 Set a clear timetable, with milestones and start early

Invariably, the setting of a clear timetable and holding your team and your audit firm to account will result in a smoother audit process.

Preparation and taking ownership of the numbers will pay dividends. It is not unusual for first year audits to overrun due to: the volume of information/evidence that is requested by the auditors, challenge to existing accounting policies and resolution of technical issues.

Allow contingency time in the first year audit timetable and also include extra contingency time in your communication to the wider Board or Investors.

7 Pick an auditor that is fit for purpose for your business

When determining the right auditor for your business, consider both the current size & shape of the business and future trajectory / ambitions: such as the next investment event, international expansion, support with additional services.

Does your auditor have a presence internationally for the footprint of the business now and where the business wants to expand to? Can the firm offer a full range of services to support the business as demands become greater?

Also, understand where you will fit in your auditor's client base. Service levels tend to be correlated with your relative position in the firm's client base.

8 Seek feedback on your control environment

During the audit process, your auditor should provide you with a list of observations and recommendations on the control environment as part of a management letter.

Common observations are: lack of segregation of duties due to a small finance team, documentation of reviews, work performed outside of the accounting system (which may be indicative that an upgrade is required).

This document provides valuable feedback on the audit process, which used in the right way, can bring positive change to the organisation, escalate issues in the finance function and strengthen the controls around financial reporting.