

Seminar on Audit of SME: Practitioners Challenges



Western India Regional Council of
The Institute of Chartered Accountants Of India

Audit Manual & Documentation - Understanding the
appropriate documents for SME Audit

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Audit Manual & Documentation - Understanding the appropriate documents for SME Audit



Introduction

- What is Audit?
 - Verification of books of accounts
 - Opinion - accuracy, truth and fairness (Audit Report)
- Is Audit merely checking/verifying?
 - Disclosure
 - Documentation
- Audit Quality
 - Fulfilment of the audit objectives
 - Compliance with the established requirements
 - Public Interest
- Importance of Standards on Auditing (SA)
 - Applicable to audit of all entities
 - Additional guidance specific to SME audits



Standards on Auditing (SA)

- Auditing and Assurance Standards Board (AASB) of ICAI
- Renumbering/ re-categorisation as per IAASB format
- Mandatory & duty of members while carrying out attestation functions
- Mandated under section 143 (10) of Companies Act, 2013
- CG to prescribe SA - recommended by ICAI in consultation with NFRA
- Different Categories:
 - Standards on Auditing (SA)
 - Standards on Review Engagements (SRE)
 - Standards on Assurance Engagements (SAE)
 - Standards on Related Services (SRS)
- Standard on Quality Control (SQC) 1 is the mother Standard



Importance of Standards on Auditing (SA)

- Preface to the Statements on Standard Auditing Practices issued by the ICAI states that:
 - *“While discharging their attest function, it will be the duty of the members of the Institute to ensure that the Standards are followed in the audit of financial information covered by the audit report.*
If for any reason a member has not been able to perform an audit in accordance with the same, his report should draw attention to the material departures therefrom”
- Enshrined in the Chartered Accounts Act, 1949
- The Code of Ethics
- Peer Review
- Financial Reporting Review Board (FRRB)
- Quality Review Board
- Disciplinary Mechanism



Revised SA 230 – Audit Documentation

Effective for audits of FS for the period beginning on or after April 1, 2009

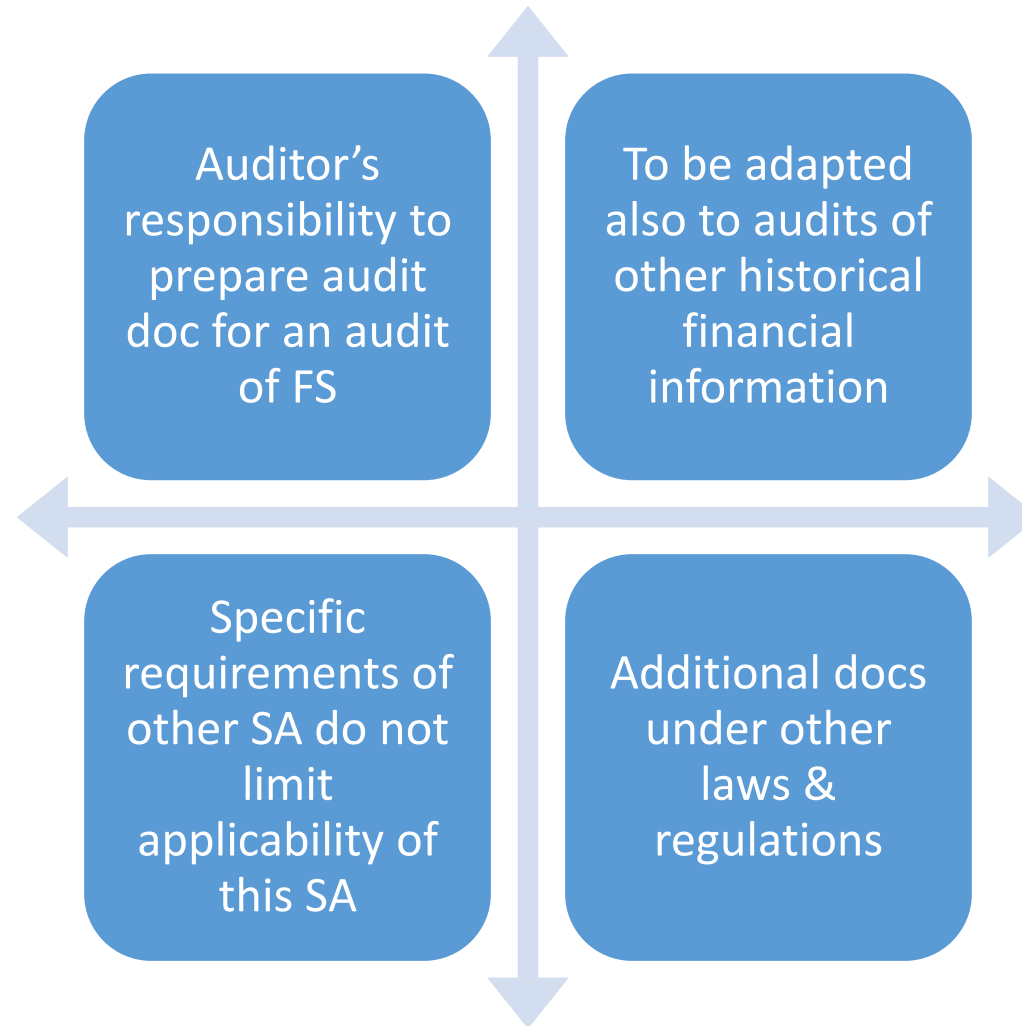


Overview of SA 230

- Introduction:
 - Scope of this SA
 - Effective Date
- Objective
- Definitions
- Requirements
 - Timely Preparation of Audit Documentation
 - Documentation of the Audit Procedures Performed & Audit Evidence Obtained
 - Assembly of the Final Audit File
- Application and Other Explanatory Material
- Material Modifications to ISA 230, “Audit Documentation”



Scope of SA 230



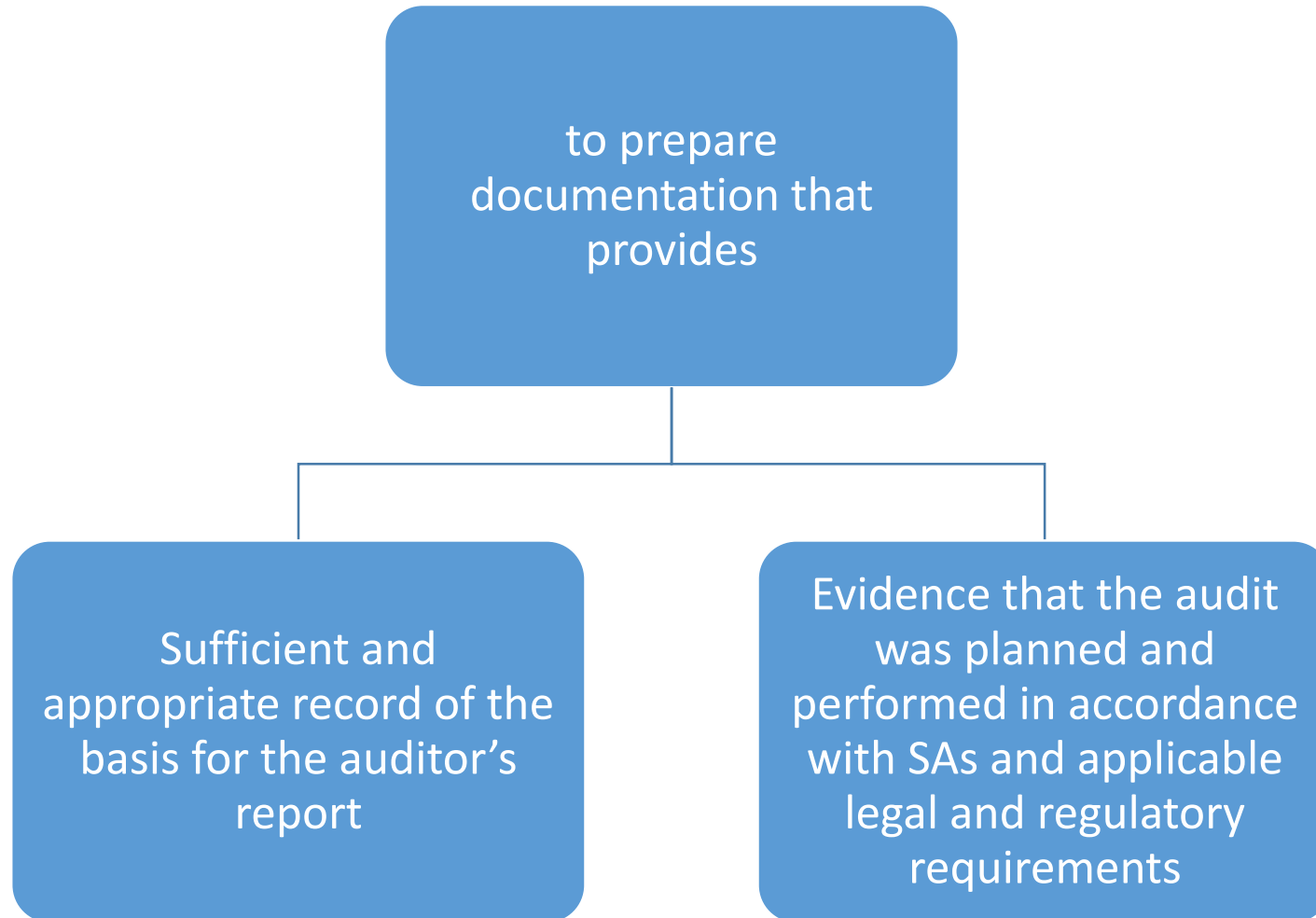


Nature and Purposes of Audit Documentation

- Evidence of the **auditor's basis for a conclusion** about the achievement of the overall objectives of the auditor; and
- Evidence that the audit was **planned and performed** in accordance with SAs and applicable legal and regulatory requirements
 - Assisting the engagement team to plan and perform the audit
 - Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220
 - Enabling the engagement team to be accountable for its work
 - Retaining a record of matters of continuing significance to future audits
 - Enabling the conduct of quality control reviews and inspections in accordance with SQC
 - Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements



Objective of SA 230





Definitions:

- **Audit documentation** – The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as “working papers” or “workpapers” are also sometimes used).
- **Audit file** – One or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement
- **Experienced auditor** – An individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of:
 - Audit processes;
 - SAs and applicable legal and regulatory requirements;
 - The business environment in which the entity operates; and
 - Auditing and financial reporting issues relevant to the entity’s industry



Requirements:

- **What to document**

- Audit procedures performed
- Relevant audit evidence obtained
- Significant matters & how they were resolved
- Discussion with management/ engagement team
- Engagement quality control review
- Audit conclusions reached

- **Mode of documentation**

- one or more folders or other storage media
- in physical or electronic form
- containing records that comprise audit documentation for a specific engagement



Requirements:

- **How much to document??**

Enough to:

- Assist in planning and performing
- Record matters of continuing significance
- Create accountability
- Assist external inspection
- Assist supervision and direction
- Assist quality control review

- **When to document?**

- Timely manner (docs prepared after audit are less accurate)
- Within 60 days of completion of audit (SQC 1)
- Retain for 7 years from the date of audit report



Other Matters:

- **Departure from a Relevant Requirement -**

- *“If, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement in a SA, the auditor shall document how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure”*

- **Matters Arising after the Date of the Auditor’s Report**

- *If, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor’s report, the auditor shall document:*
 - *The circumstances encountered;*
 - *The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor’s report; and*
 - *When and by whom the resulting changes to audit documentation were made and reviewed.*



Assembly of the Final Audit File:

- Assemble the audit documentation in an audit file on a timely basis after the date of the auditor's report.
- Not delete or discard audit documentation of any nature before the end of its retention period.
- Modification or addition in existing audit documentation:
 - The specific reasons for making them; and
 - When and by whom they were made and reviewed
- Regardless of the nature



“The skills of an accountant can always be ascertained by an inspection of his working papers”

Robert H Montgomery, Montgomery's Auditing, 1912



Practical Applicability:

- Form, content & Extent would depend upon:
 - Size & complexity of entity
 - Identified risk of material misstatement
 - Nature of audit procedures performed
 - Nature & extent of exceptions identified
 - Use of audit methodology & tools
 - Specific need – basis of conclusion drawn not readily determinable from audit docs/evidence obtained.



Documentations under other SAs:

- **SA 200: Basic Principles Governing an Audit**
 - Evidence that the audit was carried out in accordance with the basic principles
- **SA 220: Quality Control for Audit Work**
 - audit evidence obtained from substantive procedures & the conclusions drawn therefrom, including the results of consultations
- **SA 240: The Auditors responsibilities relating to fraud in an audit of FS**
 - understanding of the entity & environment, assessment of the risks of material misstatement required by SA 315
 - Management's response & communication to TCWG
 - Regulatory requirements like Companies Act, 2013, RBI etc.
 - Reasons for conclusion & reporting
- **SA 250: Consideration of Laws and Regulations in an audit of FS**
 - Various checklists e.g. Companies Act, IGAAP, RBI & NHB, Corporate Governance etc.
- **SA 260: Communication with those charged with Governance**
 - Oral, email, formal communication, Audit committee prestrations & management letters (retention of copy)



Documentations under other SAs:

- **SA 299: Responsibility of Joint Auditors**
 - Joint responsibility statement
- **SA 300: Planning an Audit of financial statements**
 - Pre audit meeting, overall audit strategy, plan & significant changes & reasons
- **SA 315: Identifying and assessing the risk of material misstatement through understanding the entity and Its Environment**
 - Discussion among the engagement team and the significant decisions reached;
 - Understanding of the entity's environment and internal control (IC) components;
 - Sources of information from which the understanding was obtained;
 - Risk assessment procedures performed;
 - Identified & assessed risks of material misstatement at the FS level and at the assertion level;
 - Risks identified, and related controls about which the auditor has obtained an understanding
 - Reporting on IFC over FS u/s 143 (3) (i) of the Companies Act, 2013



Documentations under other SAs:

- **SA 320: Materiality in Planning and Performing an Audit**

- Audit docs shall include the following amounts & the factors considered in their determination:
 - Materiality for the FS as a whole (overall)
 - If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosure;
 - Performance materiality; and
 - Any revision of materiality levels as the audit progressed & reasons thereof

- **SA 330 : Auditor's Response to Assessed Risks**

- The overall responses to address the assessed risks of material misstatement at the FS level, and the nature, timing and extent of the further audit procedures performed;
- The linkage of those procedures with the assessed risks at the assertion level; and
- The results of the audit procedures, including the conclusions where these are not otherwise clear.
- Conclusions reached about the operating effectiveness of IC in case the auditor has relied upon such test carried out in previous audit periods.
- The auditors' documentation shall demonstrate that the financial statements agree or reconcile with the underlying accounting records



Documentations under other SAs:

- **SA 505: External Confirmations**

- If the auditor agrees to management's request not to seek external confirmation regarding a particular matter, the auditor should document the reasons for acceding to the management's request.

- **SA 540: Auditing Accounting Estimates**

- The basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risks; and
- Indicators of possible management bias, if any

- **SA 550: Related Parties**

- Auditor shall include the names of the identified related parties and the nature of the related party relationships.

- **SA 580: Written Representations**

- Auditor is required to document identification of significant issues relating to the competence, integrity, ethical values or diligence of management or about its commitment to or enforcement of these. Matters where auditor has relied upon the management's explanation and information.



Documentations under other SAs:

- **SA 600: Using the work of Another Auditor**

- Components whose financial information was audited by other auditors & their significance to financial information of the entity as a whole;
- names of other auditors;
- conclusions reached that individual components are not material.
- Procedures performed and conclusions reached regarding components. For example, auditor would document the results of discussions with other auditor and review of written summary of other auditor's procedures.
- Any limiting procedures
- Conclusions reached
- Manner of dealing with modified report of OA while finalizing the PA's report



Documentations under other SAs:

- **SA 610: Using the Work Of Internal Auditor**
 - When the external auditor uses specific work of the internal auditors, the external auditor shall document conclusions regarding the evaluation of the adequacy of the work of the internal auditors, and the audit procedures performed by the external auditor on that work



Examples of audit docs:

- Appointment formalities and communication with previous auditor (code of conduct)
- Engagement letter (SA 210) (format issued by ICAI)
- Minutes Pre-audit meeting
- Audit Program/Plan (SA 300)
- Calculation of materiality levels
- Sample selection
- Process notes & Test of IC systems
- Audit working papers (docs/evidence obtained)
- Analysis & conclusion thereon (SA 520 Analytical Procedures)
- Issues memoranda
- Summary of significant queries
- Management's responses & basis of conclusion
- Confirmation & representation letters
- Signed Financial Statements
- Letter to the management (ML)



Permanent Audit File:

- Letter of Initial Engagement and correspondence with retiring auditor.
- Constitution of the client and relevant Acts and Statutes.
- History & Background of Entity
- List of Directors, locations & other details of business
- Organisation structure and nature of business.
- Contracts, agreements and minutes.
- Details of accounting policies & system, flowcharts, etc.
- Details of other Professional Advisor's list like solicitors, Credit rating Agency etc.
- Other details of permanent nature



Current Audit File:

- Annual reappointment letter
- Engagement letter
- Audit Plan
- Working papers containing information like groupings, audit programmes, Queries raised and explanations received,
- Third party confirmations and other documents
- Correspondence with other auditors and experts;
- Copy of Accounts, annual report,
- Management Representation Letter.
- Extract from minutes relating to accounting
- Communication with TCWG/management letter



Some important points to ponder:

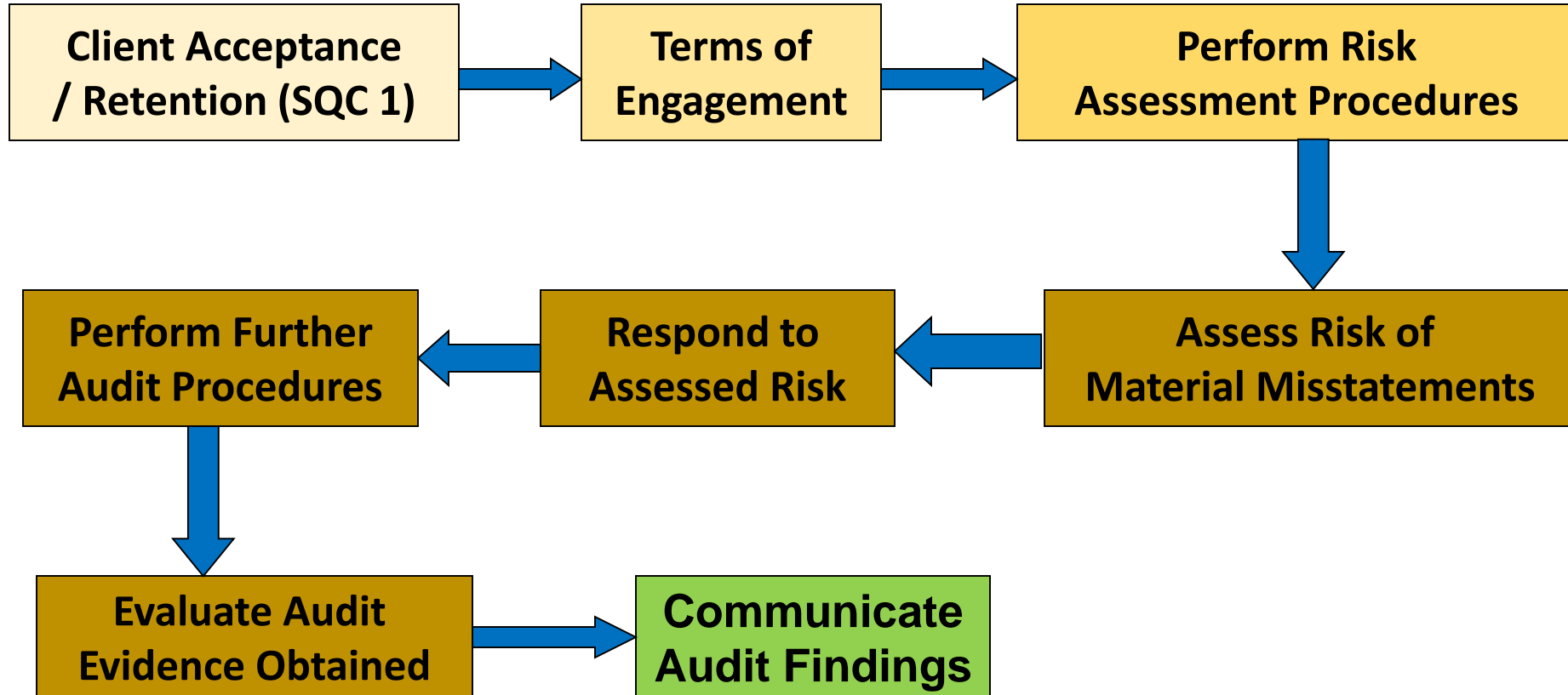
- Balance between cost & benefit
 - Difficulty in implementation (challenges like competent staff, evidence, client insensitiveness)
 - Costs involved
 - Time factor
- Not valid reasons for auditor to omit audit procedure for which there is no alternative or to be satisfied with less persuasive audit evidence
- Avoid collecting unnecessary docs and missing out on important
- Collect all docs – judgment is used by auditor
- Use of accounting estimates
- Relied on work done by others/experts/internal auditors
- Joint Auditors' responsibility



Some important points to ponder:

- Specific consideration in case of audit of consolidated FS
 - Reliance on component auditor
 - Tests carried out by principal auditor
- Backup for audit opinion (SA 700, 705 & 706)
- Ownership of Documentation – sharing with others?
- Creates more opportunities to offer new services
- Improves writing/ communication skills of staff.
- Factor while estimating billing/cost
- Available software tools

Audit Process





Other attestation functions:

- Request letter from management
- Engagement letter (clearly spelling out purpose, responsibility of management & auditor)
- Standard format (date, certificate no. etc.)
- Entry in register
- Control sheet (all details incl. initials of preparer and verifier, time spent, bill reference)
- Initials on annexure (management to certify)
- Limitation on scope (reliance on management & verification procedures applied)
- Limitations on use and circulation
- Signatures



Audit Manual:

- Preamble
- History of the firm
- Service Verticals
- Planning & Monitoring
 - Partner meeting with client
 - Partners meeting – client related, staff related, administrative & communication with partners, staff & others
- Firm's Policy & Procedures
 - QC policies and procedures
 - Requirements of SQC-1 (ethics, independence, training etc.)
 - Documentation as discussed
- Formats
- Checklists



“No documentation means no audit done”



Thank you !!

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