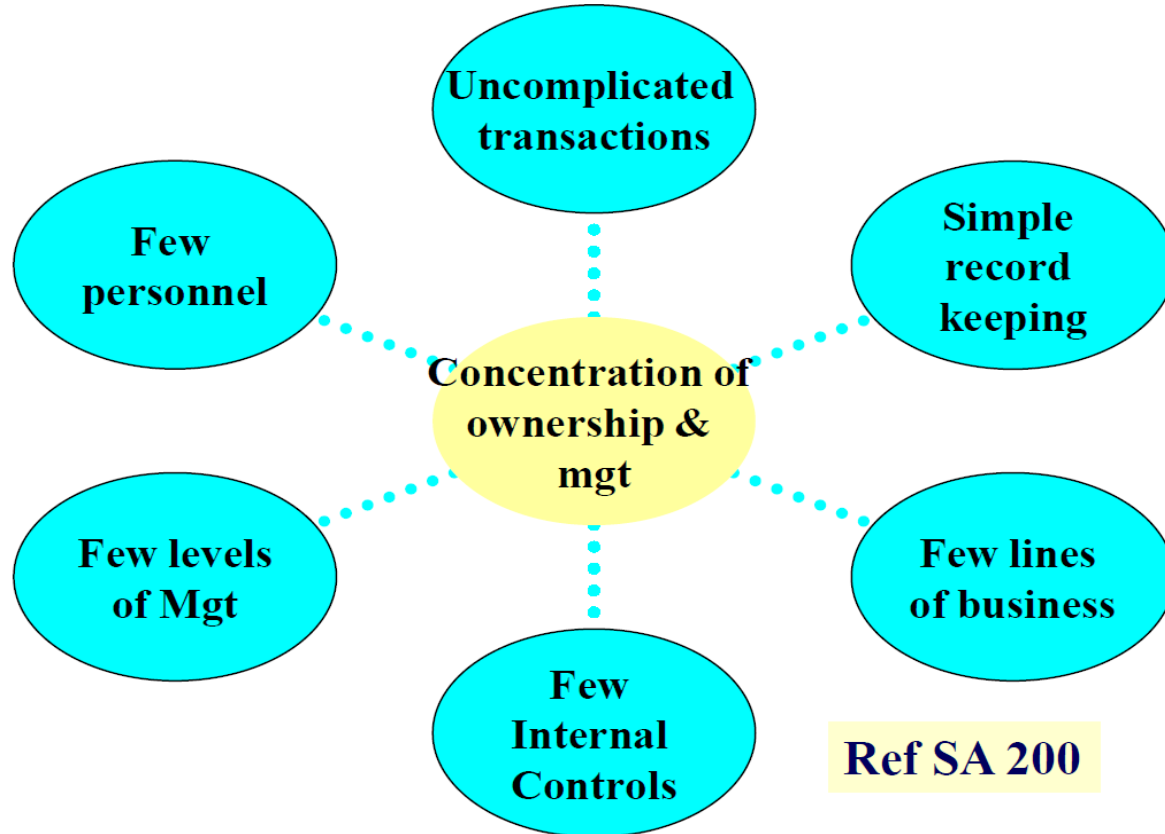




Documentation / Other important Standards with SME perspective

SME -



Definition of MSMEs in India

(As Per Micro, Small & Medium Enterprises Development (MSMED) Act, 2006)

Manufacturing Enterprises – Investment in Plant & Machinery		
Description	INR	USD(\$)
Micro Enterprises	Upto Rs. 25 Lakh	Upto \$ 62,500
Small Enterprises	Above Rs. 25 Lakh & upto Rs. 5 Crore	Above \$ 62,500 & upto \$ 1.25 million
Medium Enterprises	Above Rs. 5 Crore & upto Rs. 10 Crore	Above \$ 1.25 million & upto \$ 2.5 million

Service Enterprises – Investment in Equipment		
Description	INR	USD(\$)
Micro Enterprises	Upto Rs. 10 Lakh	Upto \$ 25,000
Small Enterprises	Above Rs. 10 Lakh & upto Rs. 2 Crore	Above \$ 25,000 & upto \$ 0.5 million
Medium Enterprises	Above Rs. 2 Crore & upto Rs. 5 Crore	Above \$ 0.5 million & upto \$ 1.5 million

SA - ensure & enhance quality of audit engagements

- ▶ Preface to the Statements on Standard Auditing Practices issued by ICAI states –

“While discharging the attest function, it is the duty of the members of ICAI 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”

- ▶ The same finds its relevance in –
 - The Chartered Accountants Act, 1949 / Code of Ethics
 - Peer Review / Financial Reporting Review Board (FRRB)
 - Quality Review Board (QRB) / Disciplinary Mechanism

 - SA deals with responsibilities of the auditor & it's application to specific areas.
 - SA contains guidance & other explanatory material.

Considerations in Audits of SMEs

- ▶ Differences between SMEs and larger entities should be recognized
 - Scalability – i.e. Audit approach may vary with circumstances (simpler/more complex)
- ▶ Requirements do not usually specify audit procedures
 - Professional judgment needs to be applied
- ▶ Application of SAs designed to be proportionate
 - Apply proportionate to audit circumstances, level of complexity, nature of audit
 - Proportionality ≠ modification of requirements

How do SAs demonstrate proportionality?

▶ Through the requirements:

- SA 260, where management = TCWG in case of SME, unlike larger enterprise.
- SA 315 & SA 330 (risk based), absence of formal risk assessment process
E.g. In case of SME, test of details would have more preference rather than control
- SA 540 (Estimates), Estimates enable in opting for choice of responses to assessed risks
- SA 550 (Related parties), inspection of records or documents – Auditor to rely *more on enquiry, inspection & observation rather than mere scrutiny of financial transactions* .

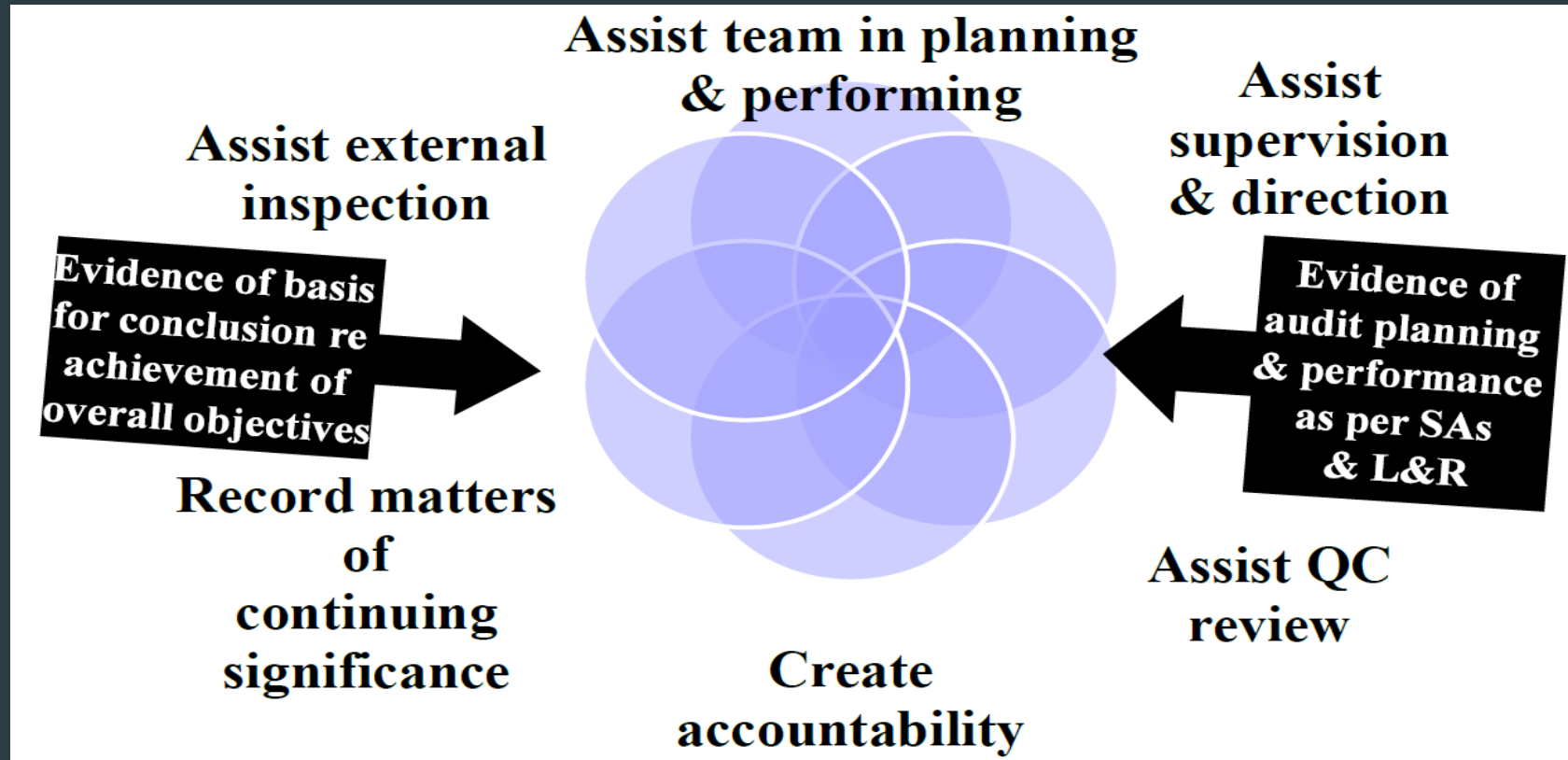
▶ Through the application material:

- Many considerations specific to smaller entities
- Other guidance, e.g. form and focus of communication with TCWG

Is compliance with all SAs required?

- ▶ Basic obligation is to **comply with all SAs** relevant to the audit
- ▶ Not all SAs may be relevant.
For example –
 - SA 402, if SME does not use a service organization
 - SA 501, if SME does not have any inventory
 - SA 600, if SME audit is not a group audit
 - SA 610, if SME has no internal audit function
- ▶ Conditional requirements need not be applied if conditions do not exist [SA 240]

SA 230: Documentation - Nature & Purpose



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

- Robert H Montgomery, Montgomery's Auditing, 1912

Documentation – Critical component of audit evidence

- ▶ Document is any material that provides evidence of work performed that enables the Auditor to satisfy himself
- ▶ Appropriate documentation need not be burdensome
- ▶ Reinforcing quality
- ▶ Be proportionate, efficient and effective
 - Experienced auditor test
 - Caution against checklist mentality
 - Importance of exercising professional judgment
 - Illustrations of how documentation can be done in efficient & effective manner

Objective

- ▶ To prepare documentation that provides –
 - Sufficient & appropriate record of the basis of the auditor's report.
 - Evidence that audit was planned & performed in accordance with SAs & Applicable Legal & Regulatory requirements

Definitions

- ▶ **Work papers – signed agreements – written representations – spreadsheets – videos – pictures – transcripts – correspondences – etc**
- ▶ **Audit documentation** – Record of audit procedures performed, relevant audit evidence obtained, & conclusions the auditor reached (terms such as “working papers” or “work-papers” are also sometimes used).
- ▶ **Audit file** – 1 or more folders or other storage media, in physical or electronic form, containing 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 & applicable legal - regulatory requirements;
 - Business environment in which the entity operates; and
 - Auditing & financial reporting issues relevant to the entity’s industry

Do we know what we do not know

▶ **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 - Quality control review

▶ **When to document?**

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

- Implementation Guide to SA 230 – March 2013 –
- 16 Case studies –
- Appendix containing Illustrative Working paper Format

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

Audit Documentation is not a substitute for the entity's accounting records

- ▶ Extent of Documentation depends on various factors such as Risk Assessment - sampling Methods used & Materiality
- ▶ Permanent Audit File / Current audit File
- ▶ Contains - Relevant risks & controls applicable to an area - assertions to be tested & satisfied - Substantive & analytical procedures performed
- ▶ Physical or Electronic Form - Hard or Soft copy
- ▶ Audit Plan / Engagement Letter / Qualified opinion -
- ▶ Documents relating to the use of professional judgment
- ▶ Deleting / Discarding old superseded information
- ▶ Retention of Records - 7 years as per SQC-1

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 presentations & management letters (retention of copy)

Documentations under other SAs (contd.)

▶ 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 (contd.)

▶ 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 (contd.)

▶ 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 (contd.)

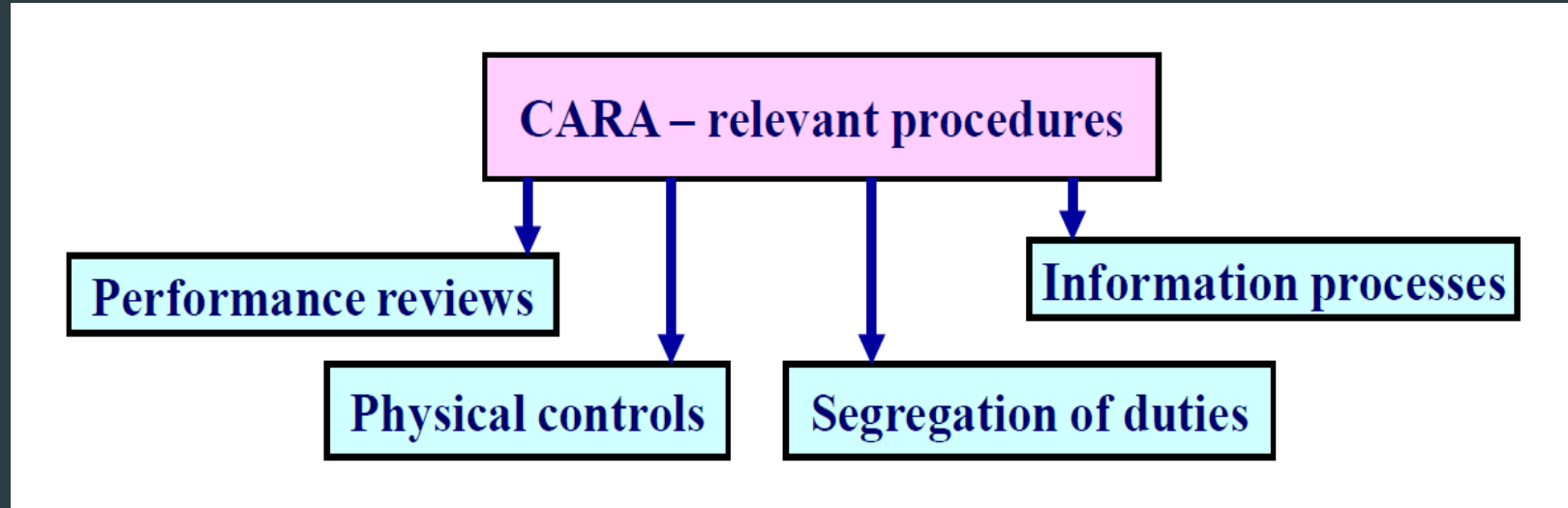
▶ SA 600: Using the work of Another Auditor

- 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

▶ 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

Control Activities Relevant to Audit (CARA)



Important:

Relevance to Auditors understanding – assessing risk & subsequent response –

i.e. SME considerations –

- Same concepts – less formal
- Some may not be relevant – direct owner oversight
- Relate mainly to transaction cycles