

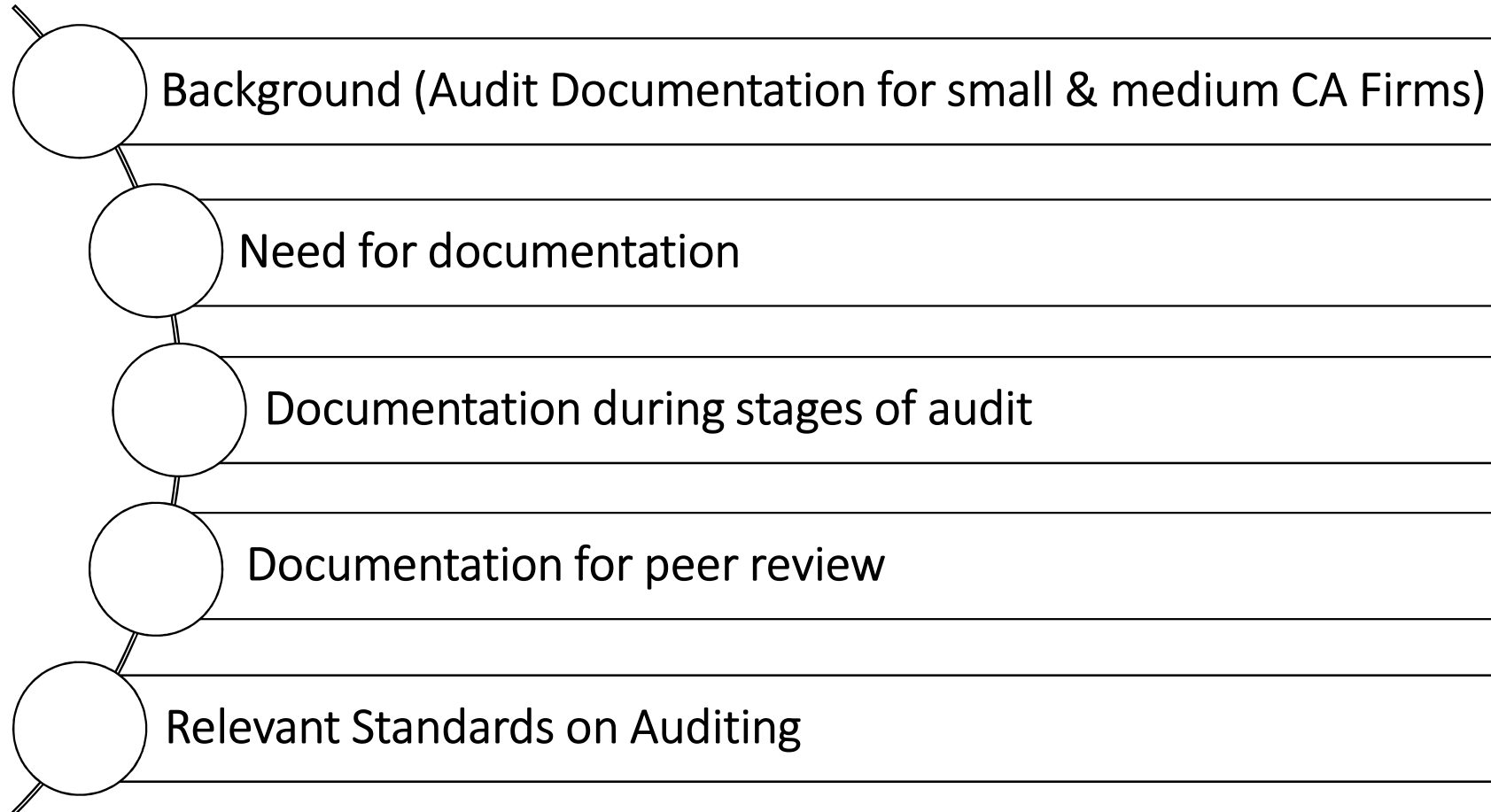
Audit Documentation – small & medium practitioners



C.A. Sandeep Shah
J. B. Nagar CPE Study Circle
16th April 2016

KNOWLEDGE THAT MATTERS. EXPERIENCE THAT COUNTS.

What are we covering today ?

- 
- Background (Audit Documentation for small & medium CA Firms)
 - Need for documentation
 - Documentation during stages of audit
 - Documentation for peer review
 - Relevant Standards on Auditing

Background

How many more documents do you think we need to create



Why is this topic relevant ?

- “WORK NOT DOCUMENTED = WORK NOT DONE”
- Poor documentation depicts poor performance in audit
- Significant responsibility cast on auditors under regulatory framework
- When things go wrong the onus is on auditors to “prove” that he / she was not professionally negligent in performing his duties
- Auditing Standards neither favour nor discriminate based on size of the practitioner

Resources

- ICAI through 'Committee for Capacity Building of Members in Practice' has issued the following publications for the benefit of small and medium practitioner CA firms
 - ✓ Implementation Guide on Audit Documentation. It contains:
 - 38 FAQ
 - 16 case studies
 - ✓ Practitioner Guide to Audit of Small Entities. It contains:
 - Templates of audit program
 - Checklist for compliance with auditing and accounting standards

What is Audit Documentation

The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as “working papers” or “work papers” are also sometimes used).

Case study

Questions raised in audit committee meeting

In ACM, independent directors raised questions on reasons for decrease in salary growth in actuarial valuation

CFO could not answer on spot and hence raised to auditor

Audit file did not document the reasons though discussed orally by audit team, hence Auditor couldn't respond

Audit documentation was not proper

Above lapse in documentation resulted into Board assuming that audit quality is not upto mark

Case Study

Facts of the case

Audit team member has taken the entire dump from ERP in excel and taken screen shots of ERP sample pages to explain a point

Consequences

Consequently, the file size significantly increased and included unwanted data.

Conclusion

Remove unwanted columns, unwanted rows.
Reduce the image sizes when you copy screen shots into a file

Case Study

Case

- Following points were highlighted by a reviewer during peer review of an audit firm:
 - Cutoffs not documented
 - Going concern test not supported with projections
 - IT controls not documented

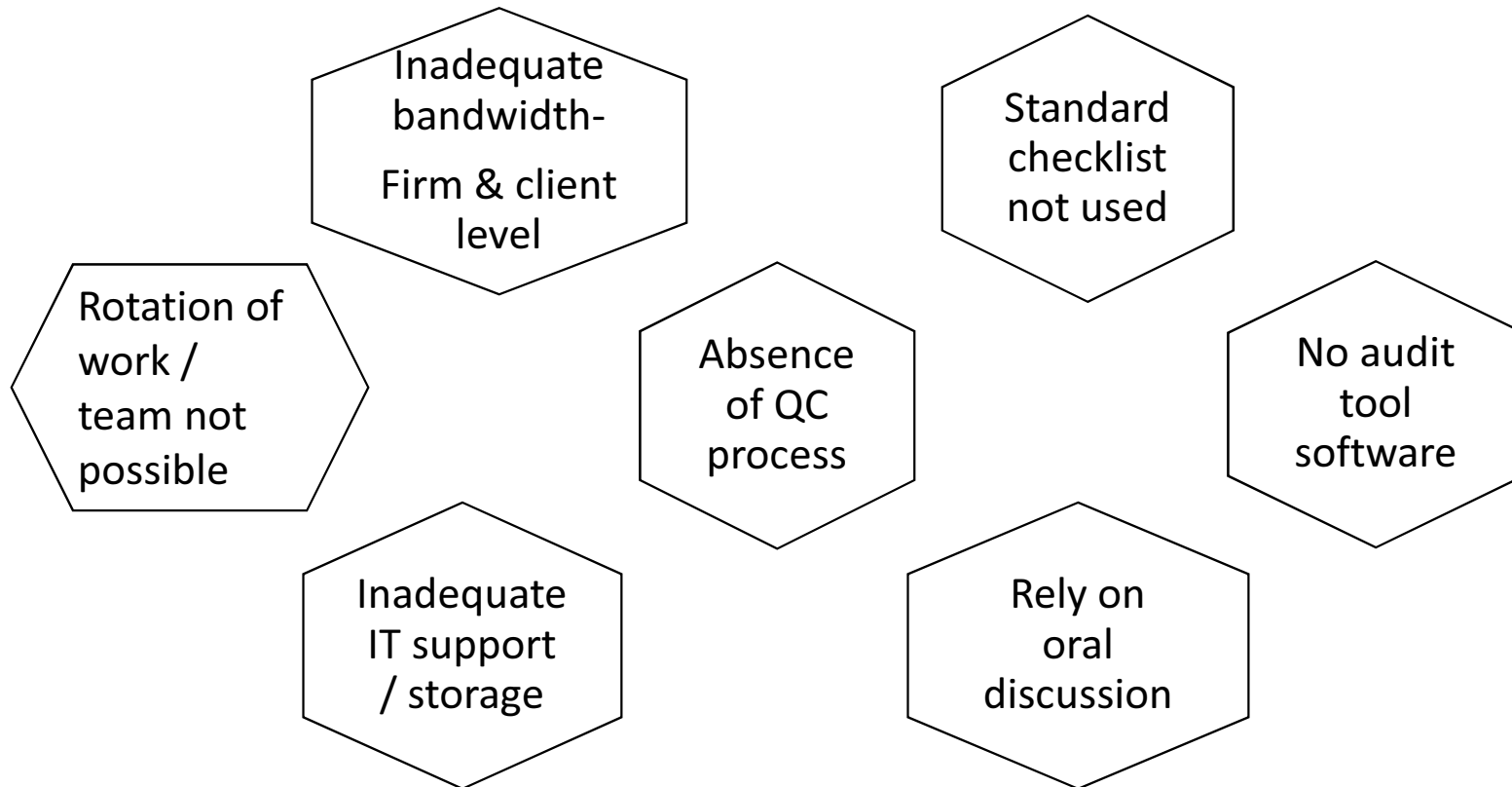
Answers

- No cutoff is applicable
- Projected sales not provided
- Company uses tally which has no control

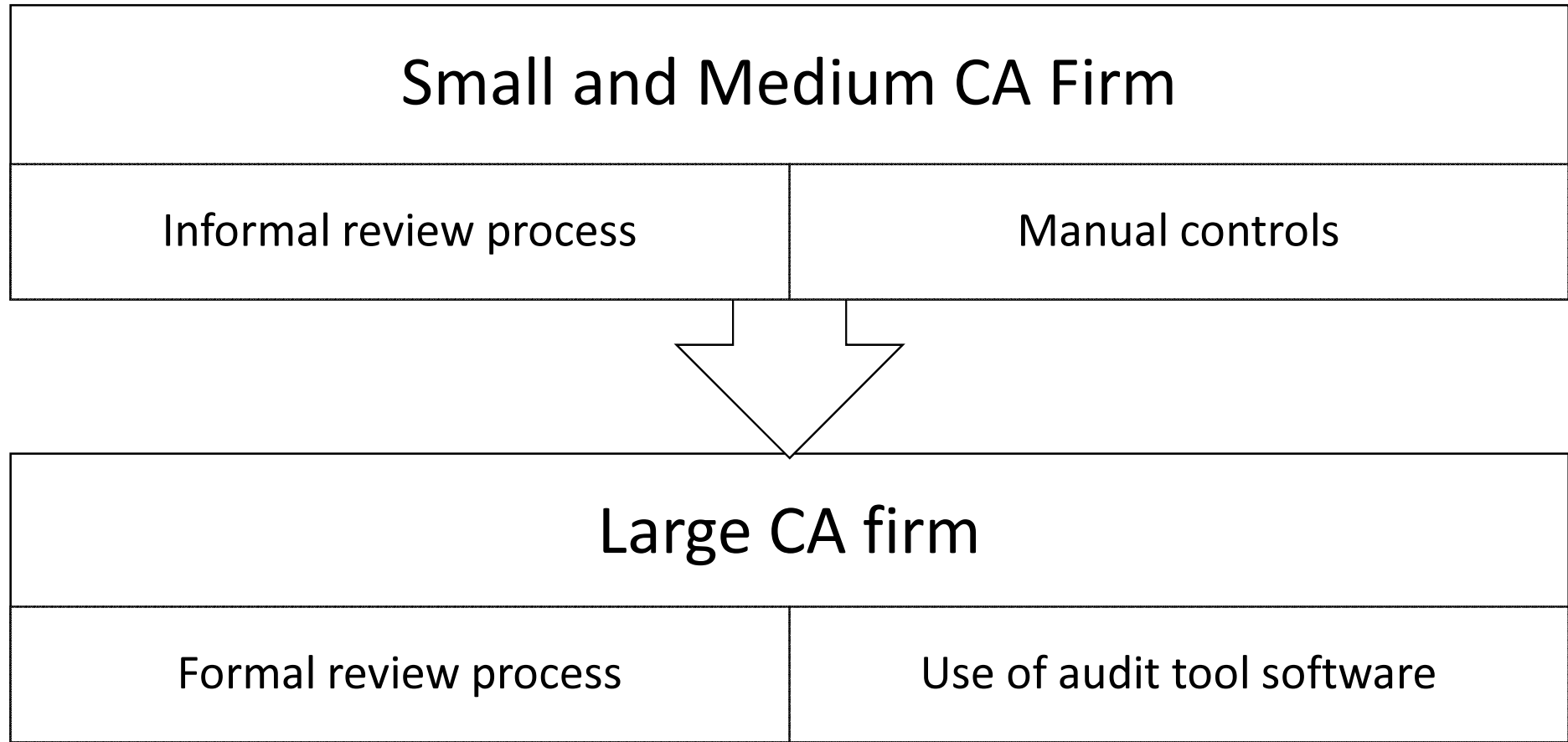
Analysis /
Conclusion

- There is no company where cut off is not applicable for revenue
- Projections to be formally documented
- IT controls related to financial statements should be documented

Concerns of CA Firms (small & medium)

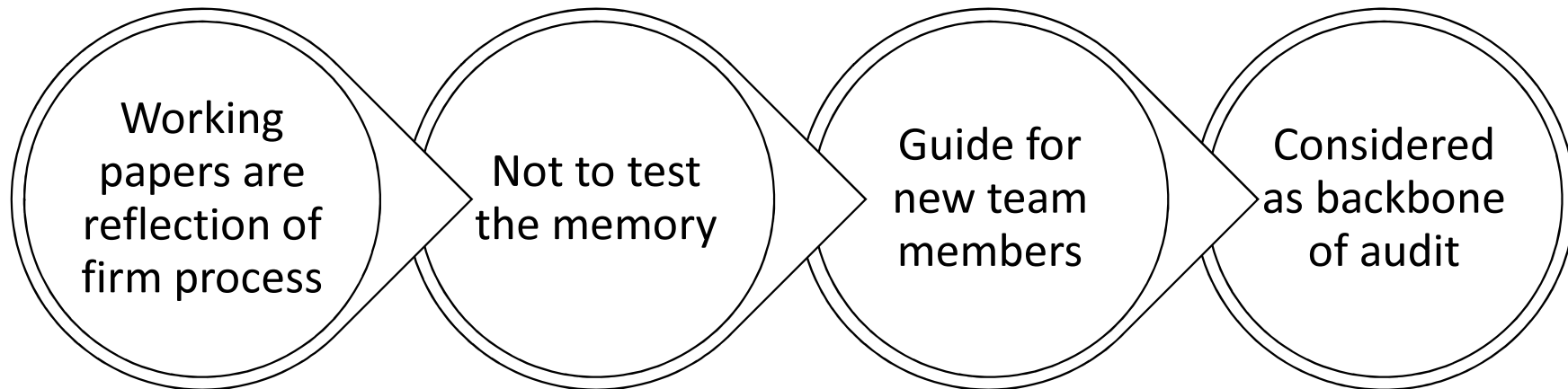


S & M vs Large Firms



Need for Documentation

Essence of documentation



Regulatory requirements

Mandatory reporting in audit report

- Compliance with Auditing Standards is mandatory u/s 143 (10) of Companies Act 2013.
- National Financial Reporting Authority to have powers to recommend Standards on Auditing (section 132)

Class action suit under Companies Act, 2013

- Class action suit on auditor / audit firm
- To prove innocence the auditor requires proper documentation

Quality assurance of audit

- To ensure that the audit complies with the professional standards as provided by SQC – 1

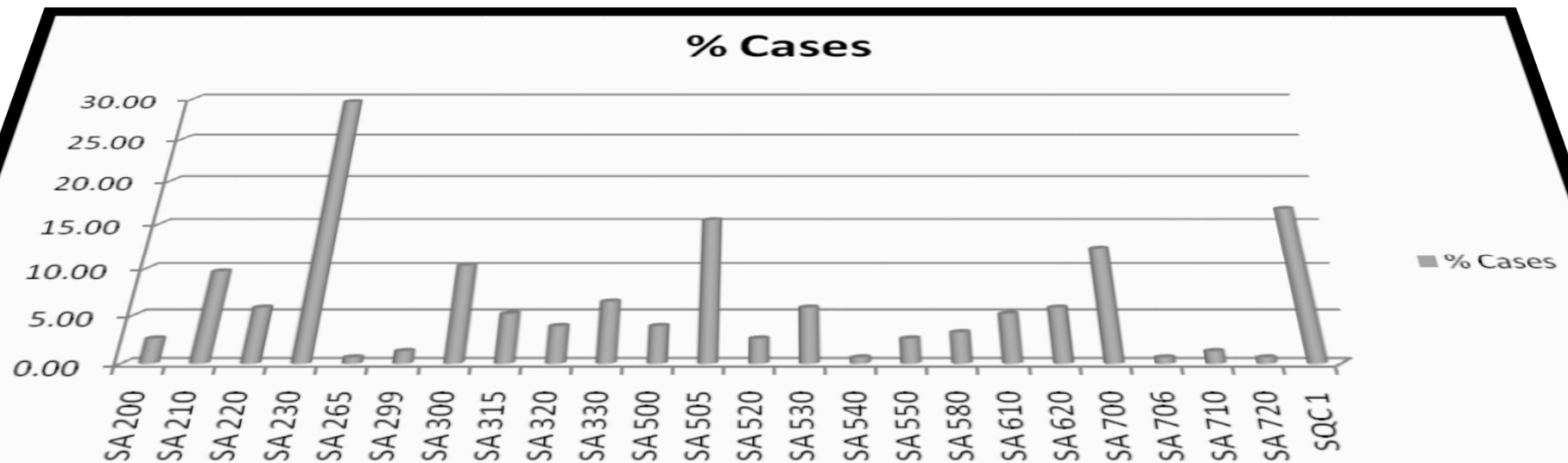
Audit of listed entities

- Peer review certificate is must for audit of listed entity under SEBI Regulation

GAP in Documentation

'Quality Review Board' (QRB) reviews:

- 29% of observations are on account of non-compliance with SA 230 – Audit Documentation (source: activity report of QRB for the period 2012-2015). The key points raised are given in next slide.



Key points identified by QRB (SA 230)

Significant observations without reference of source documents

Improper / no linking of documents

Unsatisfactory documentation of audit plan, nature, timing, etc.

No documentation for verification of key management estimated

Lack of proper segregation and indexation of working papers

Lack of documents to ensure that firm adhered with the ethical standards laid down by ICAI

Documents prepared for certain areas only

Contingent liability disclosed does not reconcile with work papers

No back up / mismatch for comments given in CARO

Key points identified by QRB (SQC 1)

Firm policies not
communicated to
employees

Integrity and Objectivity
of firm / team not
ensured

QC review partner and
partner-in-charge were
same

No documents for c/f
points to be checked in
subsequent audits

No proper training to
team members / partners

Assignment executed by
articles and reviewed by
partners (without
rotation)

Documentation during stages of audit

Before audit

Independence of firm

- Obtain independence declaration from all partners / relevant personnel

Client acceptance

- Ensure integrity of client
- If there was any issue, how the issue was resolved should be documented

Formal communications

- Offer letter
- Acceptance letters
- Engagement letters
- Continuance form

Planning stage

- Materiality level computation
- Budget or work allocation amongst the peers
- Analysis of financial and non-financial information

During audit

IFC over Financial Reporting

- Understand & document significant business processes
- Document the walkthroughs performed
- Document the inherent risks & internal controls

Professional ethics

- Policies & procedures adopted during the audit to ensure adherence to the ethical standards outlined by the ICAI

Design further audit procedures

- Document the detailed audit plan
- Lead schedules
- Checking notes with review points
- Document the audit evidences collected during the audit

Compliance related

- Documents ensuring compliance with various laws
- Checklists for recognition, measurement, disclosures

After audit

**Documents
required for
proper reporting**

- Signed financial statements and audit reports
- Updated trial balance

**Documents
required on
completion**

- Completion memorandum
- Management representation letter (LOR)
- Issue documents and how they were resolved

Audit Files



Permanent Audit Files

- Section flaps (for arrangement of papers)
- Client information
- Process related to key areas (including IFC)
- Financial ratios & financial statement including audit reports of last 3 years
- Secretarial records and agreements



Current Audit Files

- Section flaps
- Area wise checklist including compliance with AS, CARO, Companies Act, 2013 etc.
- Sampling size and materiality
- Management letter (key points)
- Letter of representation from management
- Review sheets of seniors including remarks for matters resolved

Documentation for Peer review

Why peer review ?

To ensure that in carrying out the assurance service assignments, the members of the Institute

(a) comply with Technical, Professional and Ethical Standards

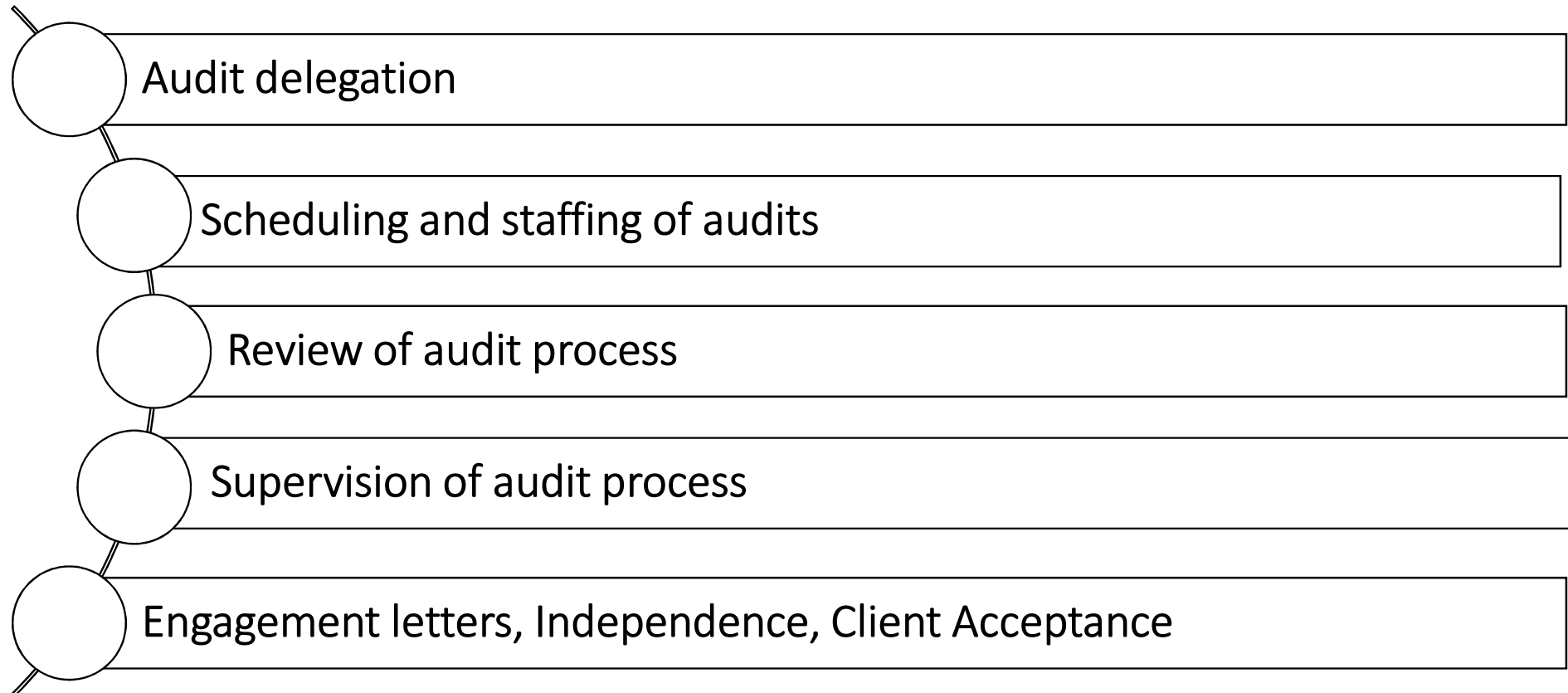
(b) have in place proper systems including documentation thereof, to amply demonstrate the quality of the assurance services.

Policies
&
procedures

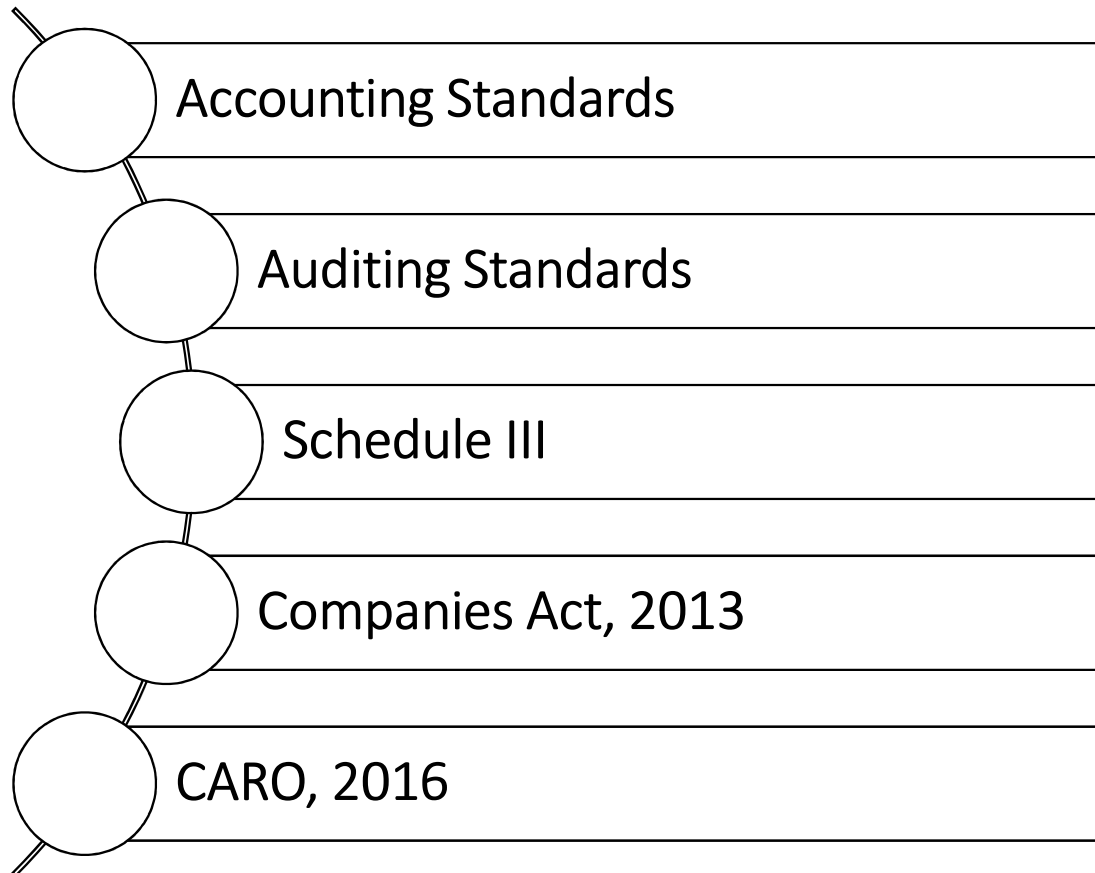
Checklists

Other
relevant
work
papers

Policies and procedures



Checklists / checking notes



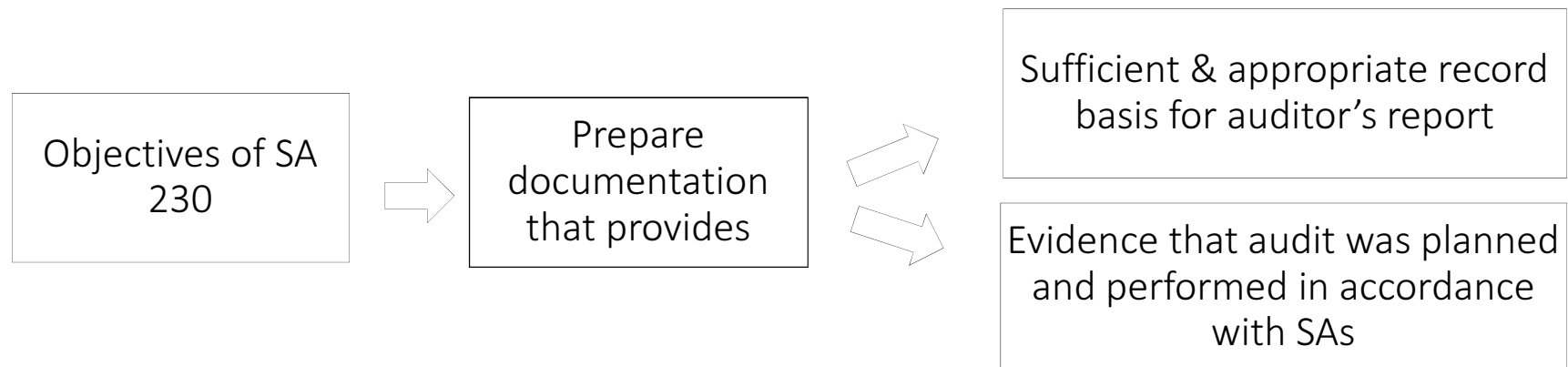
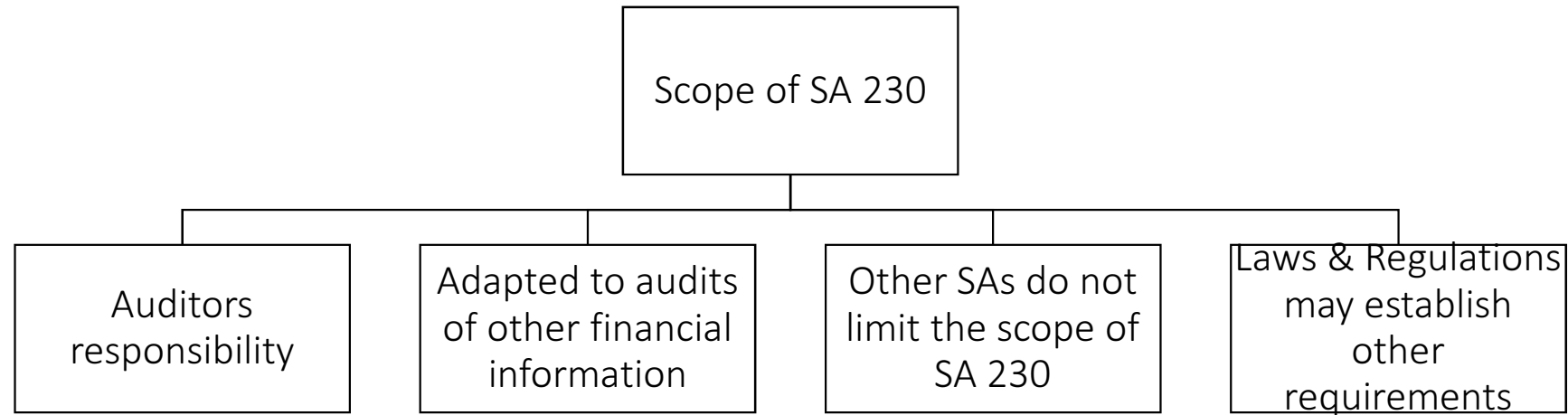
Documents provided by clients but not supported by checking notes are not considered as work papers

Basic concepts of SA 230 & SQC 1

Standard on Auditing ... Guides the Auditor



Scope and Objectives of SA 230



Nature and Purpose of SA 230



Purpose and objective of SQC 1

Quality control for firms that perform audits and reviews of historical financial information and other assurances and related service engagements

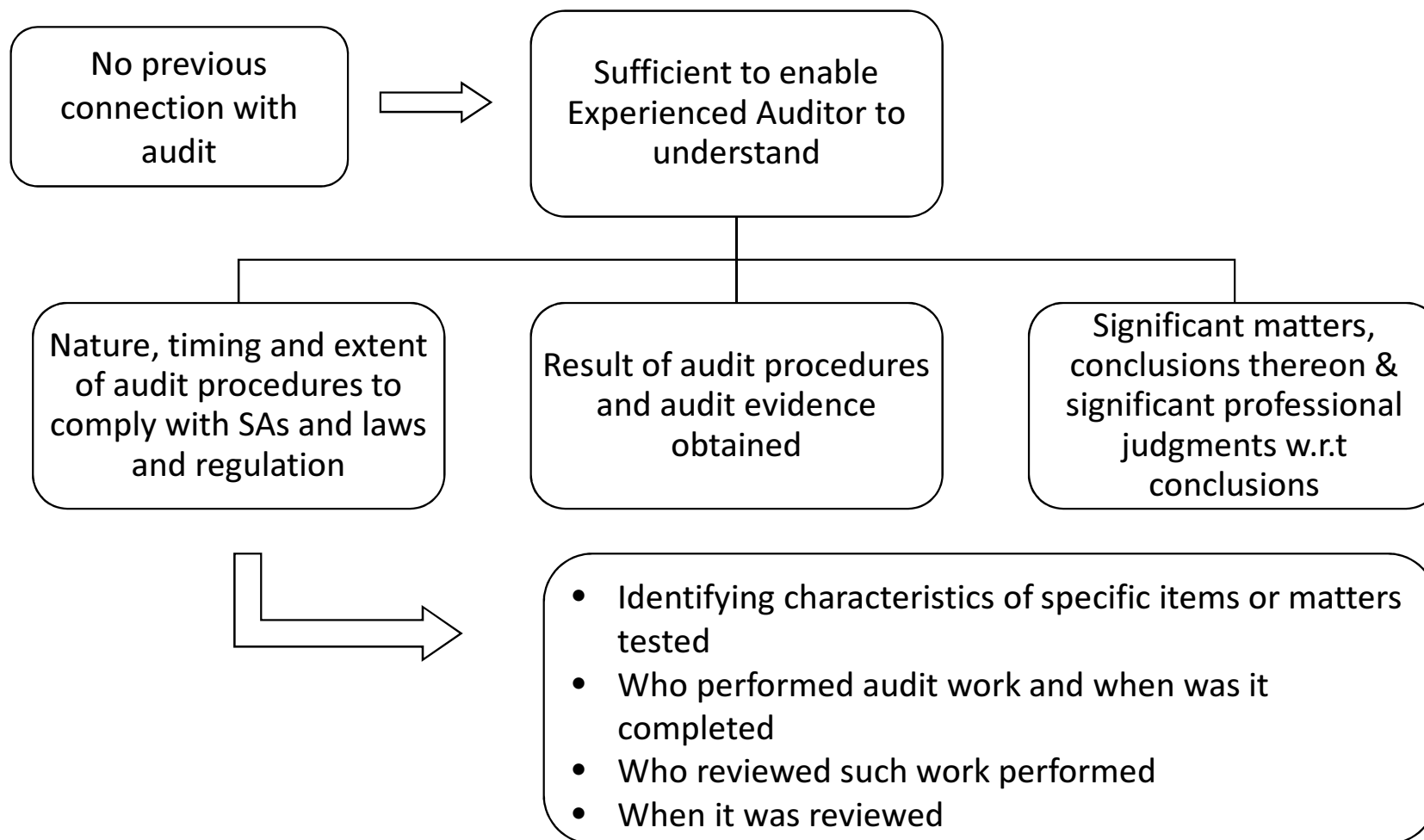
Purpose

- To assure that firms and personnel comply with the professional standards, regulatory and legal requirements

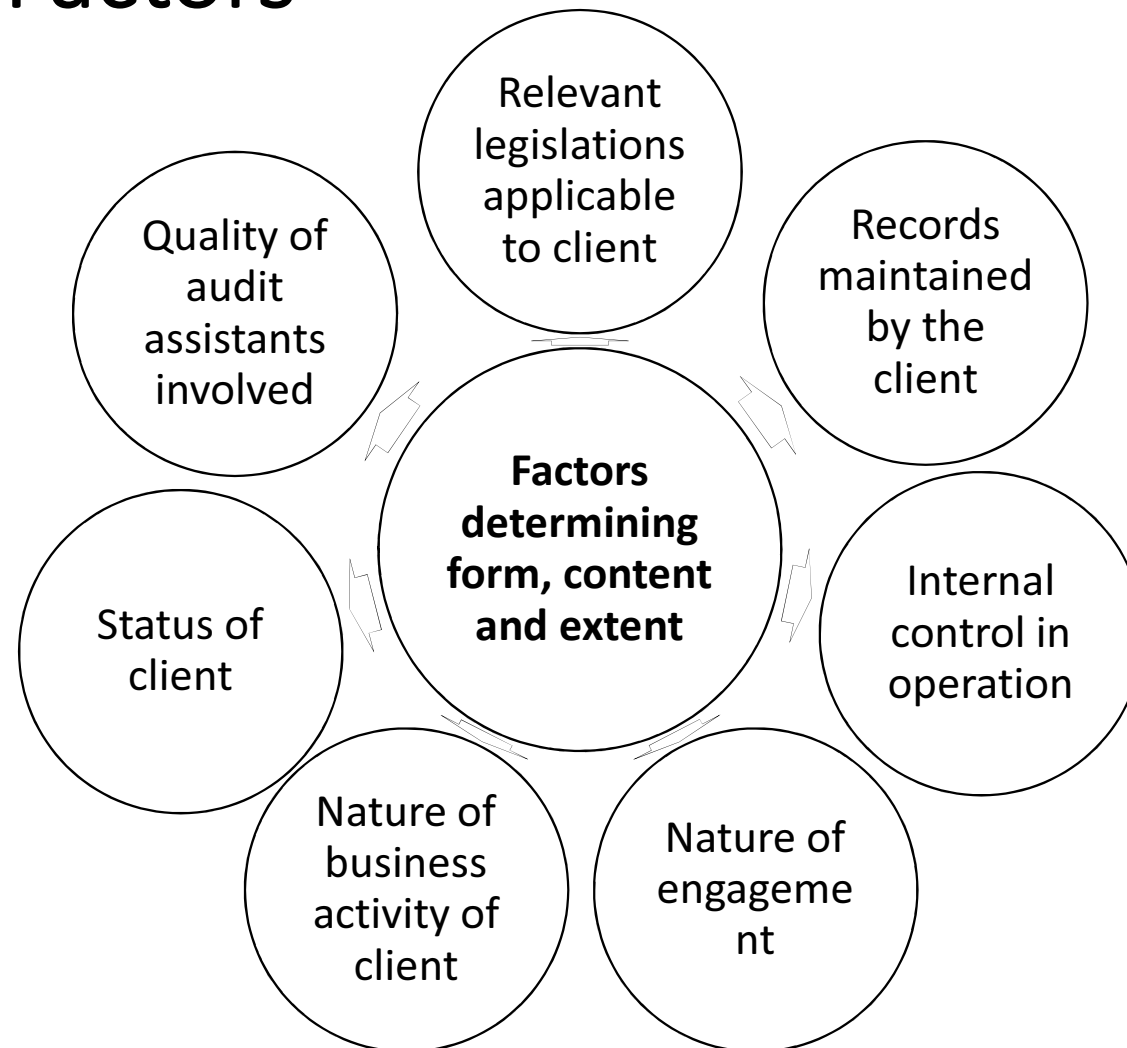
Objectives

- Establish standards and polices for firm in respect of quality and ethics

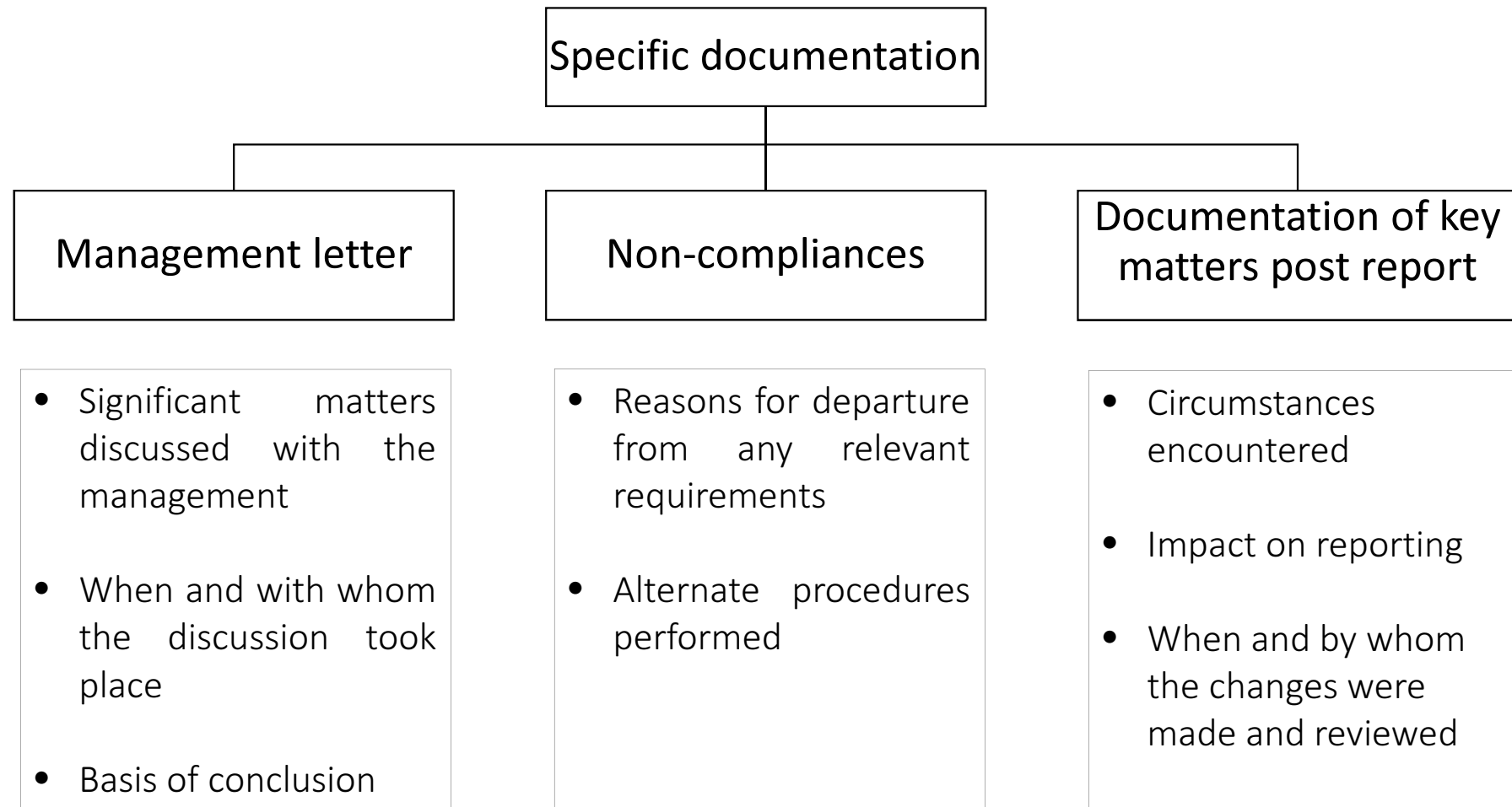
Form, content and extent of documentation



Relevant Factors

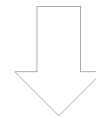


Specific documentation



Assembly and Retention

SQC-1 requires firm to establish policies and procedures for timely completion of assembly of audit files and retention of engagement documentation



If not prescribed under any law

Assembly

Should be completed in **not more than 60 days** in case of audit

Retention

In the specific case of audit engagements, period is **no shorter than seven years** from the date of report

Note: SA 230 provides retention period of **10 years**

“Reports on the Observance of Standards and Codes (ROSC)”

- An initiative of World Bank and the International Monetary Fund (IMF)
- Review of Accounting and Auditing (A&A) Practices which assesses the comparability of national accounting and auditing standards with IFRS and International Standards on Auditing (ISAs)
- To see degree of actual compliance with the standards applicable to the statutory financial statements of business entities.
- The assessment also focuses on the institutional arrangements that underpin the quality of accounting and auditing practices.

ROSC-India-Though the report is more than 10 years old, many of the things still holds true:

- India has not yet experienced large-scale litigation against audit practitioners, audit reports are signed in the name of a partner, although all partners have joint, several, and unlimited liability Professional indemnity insurance is not compulsory (para 27).
- The range and depth of practical knowledge gained by the trainee accountants significantly vary with the diversity in nature and size of accountancy firms that act as practical training providers in India.
- An ICAI review committee noted in 1992 that some students who prefer to train with small firms felt the main objective was passing the exams and the quality of training was secondary.

ROSC- India-contd

- Vague statements were noticed in financial statements that raise a question on the validity of the auditor's opinion on "true and fair view."
 - "the debtors, advances and creditors were subject to reconciliation/confirmation."
- The quality of audit practice differs significantly among audit firms mainly due because of inadequacy of quality control arrangements in most of the smaller audit firms.
- Most of these specialists were of the opinion that a majority of auditors use a traditional vouching-based audit approach focusing on transactions, as opposed to the modern risk-based approach focusing on critical assertions. In addition, most auditors focus their audit effort on financial reporting and compliance with provisions of statutes. (para 65)

ROSC-India-contd

- Improvements in audit quality can be achieved by the development and dissemination of practical guidelines on the implementation of auditing standards.
- A small proportion of audit firms use high-quality audit practice manuals.
- In the absence of proper guidance, auditors generally find it difficult to address important concepts, such as audit risk, audit planning, internal control, materiality, documentation, and quality control.
- Many stakeholders expressed their concern about close relationships between some auditors and their clients . In cases when auditors are defending the majority owners' interests as opposed to protecting the minority shareholder, this may cause undue influence on auditors, resulting in noncompliance with applicable auditing requirements. (para 66)



Thank You

C.A. Sandeep Shah

sandeep.shah@nashah.com