

Documentation under various Audits

A professional office scene where a man in a white shirt and glasses is leaning over a desk, pointing at documents. Two women, one in a purple shirt and one in a pink shirt, are seated at the desk, looking at the documents. The background shows a modern office with wood paneling and a window with blinds.

17 June 2017

Presenter: Hemlata Jhawar, Chartered Accountant

What does audit documentation do?

- ü Evidence that work was done
- ü Sufficient support for our audit opinion, conclusions and judgments
- ü Evidence for supervisory review
 - ü Evidence that standards of fieldwork observed
 - ü Aid in the conduct and supervision of the engagement
 - ü Ease the internal review work of senior colleagues
 - ü Provide information for subsequent audits
 - ü Are useful in potential external reviews by third parties for actions such as litigations, inspections, due diligence, etc.

If it is not documented it is not done

SA -230- Audit Documentation

Definition:

“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)”.

Functions of audit documentation

ü Primary functions:

- Support the auditors' compliance with auditing standards
- Support the auditors' opinion

ü Secondary functions:

- Assist continuing and new audit team members in planning and performing the audit
- Serves as a record of matters of continuing audit interest
- Assists in supervision and review of the audit
- Demonstrates the accountability of team members
- Assists internal reviewers, external peer reviewers, PCAOB inspectors, and successor auditors in performing their roles

Sufficiency of audit documentation

- ü Audit documentation should be sufficient to:
 - Indicate the audit was adequately planned and supervised
 - a sufficient understanding of internal control was obtained
 - sufficient and competent evidence was obtained to support work performed and the significant conclusions reached
 - who performed and reviewed the audit work
 - that accounting records agree/reconcile to the Financial Statements

- ü Audit documentation should include all significant audit findings and the actions taken to address them

Types and form of documentation

Electronic/Non-electronic

- ü Audit administrative working papers
- ü PY and CY reports,
- ü Working trial balance
- ü spreadsheets, memos
- ü Lead and supporting schedules
- ü Adjusting journal entries and reclassification entries
- ü Analysis of a ledger account
- ü Reconciliations
- ü Computational working papers
- ü Corroborating documents, etc.

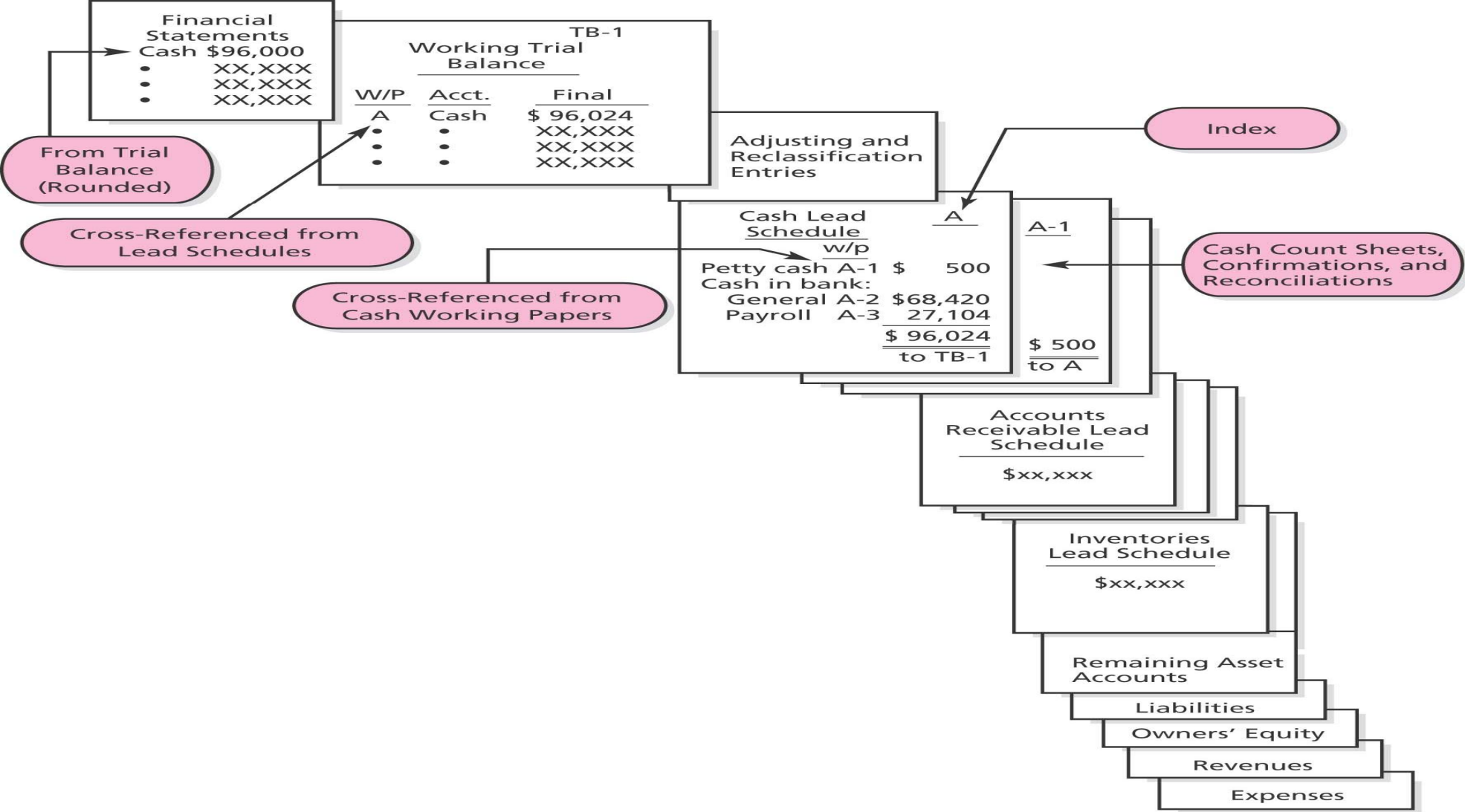
What affects the nature and extent of documentation

- ü Materiality of account
- ü Risk of material misstatement – Inherent risk x Control risk
- ü Extent of judgment
- ü Significance of evidence
- ü Nature and extent of exceptions

Characteristics of good audit documentation

- ü Heading which includes the client's name, explanatory title, and balance sheet date
- ü Initials of the auditor who prepared the documentation and date completed
- ü Initials of the reviewer and date review completed
- ü Description of the tests performed and the findings
- ü Assessment of tests which indicate material misstatement in an account
- ü Tick marks and legend indicating work performed by the auditor
- ü Index to identify the location of papers
- ü Cross-reference to related documentation

Examples of audit documentation



Examples of audit documentation (contd...)

Working Paper Heading	Reviewer's Initials and Date	Preparer's Initials and Date	Index
Maine Company, Inc. Allowance for Uncollectible Accounts March 31, 20X3			
Balance per ledger, Mar. 31, X2 Deduct: Write-offs during fiscal 20X3 June 18, X2 Morgan Desk Co. Feb. 12, X3 Baker Cabinet Co. Add: Provision for year ended Mar. 31, X3, based on aged trial balance of trade accounts receivable at Mar. 31, X3 Balance per ledger, Mar. 31, X2 A.J.E. 7 — to increase allowances based on tests of collectibility and analytical procedures on C-6 Adjusted balance Mar. 31, X3	V.M.A. May 6, X3	C-5 B.J.D. April 24, X3	22,881.75 ✓ 14,623.04 8,258.71 6,589.81 14,848.52 ✓ 5,151.48 to TB-5-2 <u>20,000.00</u> f to C
f Footed. n Examined Controller's authorization for write-off. x Agreed to general ledger.	Adjusting Entry Cross-Referenced to Adjusting Working Entries Working Paper (below)		"Tick Mark" Symbols
Auditors' Conclusion	Explanation of Audit Work Performed		Cross-Referenced to Accounts Receivable Lead Schedule
Based on the results of the tests of collectibility and analytical procedures on C-6, the adjusted balance of the allowance for uncollectible accounts appears to be adequate to value the accounts receivable at net realizable value.			
B.J.D. V.M.A.			

Maine Company, Inc. Adjusting Journal Entries March 31, 20X3			TB-5-2 V. M. A 4/26/X3		
Working Paper Reference C-5	Account No. 524 126	Account Title and Explanation ⑦ Uncollectible Accounts Expenses Allowance for Uncollectible Accounts To increase the allowance for uncollectible accounts to amount considered necessary based on test work performed.	Dr. 5,151.48	Cr. 5,151.48	

Documentation – statutory audits

- ü **Pre- commencement documentation** such as – Letter of appointment with board resolution copy wherever applicable, NOCs, independence compliance procedures, signed ELs (defining management responsibility, auditors responsibility and scope of audit) etc.
- ü **Understanding the business** – checklist seeking key information about the client/ peculiar to industry and relevant for audits, key information technology systems used, findings of regulatory inspections, internal audit reports etc.
- ü List of various **documentation to be obtained** from the management e.g. various certificates (cash, stock), confirmations, reports, legal opinions sought etc.

Documentation – statutory audits (contd....)

- ü Detailed audit programs considering
 - § all material accounts and disclosure requirements,
 - § assessment of internal controls over financial reporting and
 - § addressing identified key risks
- ü Summary of all significant audit findings and the actions taken to address them
 - § adjusted/ unadjusted audit differences
 - § justification for audit qualifications
 - § expert/ legal opinions considered
- ü Ensure that the dates in all the documents and statements are prior to audit report date.
- ü Seeking management representation letter

Documentation - CARO

- ü If CARO is not applicable to a company, as a measure of prudence it is advisable to insert a comment such as “This report does not include a statement on the matters specified in the paragraph 4 of the Companies (Auditor’s Report) Order, 2003, issued by the Ministry of Companies Affairs, in terms of section 227 (4A) of the Companies Act, 1956, since in our opinion and according to the information and explanations given to us, the said Order is not applicable to the company”.
- ü In a situation where one or more of the clauses is not applicable it would be appropriate for the auditor to make suitable comment in his report bringing out the fact of non applicability of a particular clause rather than just not commenting upon it.

Documentation - CARO

(contd...)

- ü Management's explanation for any adverse comments; it is not necessary but may be advisable to make the comment to make it more meaningful or to convey how true fair view of the financial statement is not affected. For instance in case of undisputed statutory dues outstanding for more than six months on the balance sheet date, it would be fair to mention if the amounts were subsequently deposited by the company.
- ü If any information and explanation necessary for reporting is not received, he should mention that fact both while reporting on the specific question in the Order and also while reporting in terms of sub section (3) of section 227. Any adverse comment in the Order having impact on true and fair view may require modification in the audit report (AAS 28).

Documentation - certificates

- § Revised GN on Reports or Certificates for Special Purposes issued by the ICAI specifically deals with requirements on documentation, archival and retention of workpapers for engagements performed under the said GN.
- § Required to prepare and maintain documentation to provide a basis for opinion and evidence that work was performed in accordance with professional standards, legal and regulatory requirements.
- § Agree upon management and auditors responsibility and scope
- § Determine whether full/ limited assurance certificate required
- § Document nature, extent and timing of audit procedures performed
- § Document rational for selecting number and size of samples
- § Document management judgements and estimates relied upon
- § Document restriction of use and obtain LOR

Documentation - tax audit

- ü Seek following documentation from client before commencing the audit:
 - § Last year Tax Audit report and form 3CD with supporting schedules
 - § Financial statements with notes on accounts
 - § Supporting documents like VAT returns, TDS returns, Service Tax returns, Excise records, assessment orders, Fixed Assets Register, Stock Register and Books of Accounts.
 - § Form 3CD with all particulars duly filled with supporting schedules and documents like proof for payment of statutory dues, TDS remittances, related party payments, past year's tax returns etc.,
 - § Reconciliation of the figures as appearing in different documents like audited financial statements, tax computation, TP documentation, VAT returns, Service Tax returns, TDS returns etc.,
 - § Judicial pronouncements relies upon for inclusion / exclusion of any items

Key clauses - Form 3CD

- ü Clause 13a. Method of accounting employed in the PY
- ü Clause 13b. Any change in the method of accounting employed vis-à-vis the method employed in the immediately preceding PY;
Clause 13c. If answer to (b) is in the affirmative, give details of such change, and the effect thereof on the P/L
- ü Clause 13d. Whether any adjustment is required to be made to the P/L for complying with the provisions of ICDS notified under section 145(2)
- ü Clause 13e. If answer to (d) is in the affirmative give details of such adjustments; each ICDS wise increase/ decrease in profits and net effect thereof
- ü Clause 13f. Disclosure as per ICDS

Documentation - tax audit

(contd...)

- ü Clause 14a. Method of valuation of Closing stock employed in the PY; Refer the method of valuation in the significant accounting policies in the notes to accounts.
- ü Clause 14b. Details of deviation, if any, from the method of valuation prescribed under section 145A, and the effect thereof on the profit or loss (increase/ decrease)

- ü Clause 16. Amounts not credited to the P/L account, being :-
- a) The items falling within the scope of section 28
 - b) The proforma credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned
Examine all relevant correspondence, records and evidence in order to determine whether any claim has been admitted as due within the relevant previous year.
 - c) Escalations claims accepted during the previous year
 - d) Any other item of income which tax auditor considers as income based on verification of records, but not credited P/L account to be reported under this clause
 - e) Capital receipt, if any

- ü Clause no 17: Where any land or building or both is transferred during the previous year for a consideration less than value adopted or assessed or assessable by any authority of a State Government referred to in section 43CA or 50C, please furnish:
 - Details of property
 - Consideration received or accrued
 - Value adopted or assessed or assessable
- § Verify assessable value from the stamp duty documents and ensure that such value is less than the consideration received.
- § The consideration received or accrued should be verified using the sales agreement between the two parties.

Documentation - tax audit

(contd...)

- ü Clause 20a. Any sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend
- ü Clause 20b. Any sum received from employees towards contributions to any PF or superannuation fund or any other fund mentioned in section 2(24)(x); due date for payment and the actual date of payment to the concerned authorities
 - § Deduction of such sums received from the employees is allowed, if it is credited by assessee to the account of employees on or before the due date as per the applicable law.
 - § Otherwise, the same is treated as his income under Section 2(24)(x)
 - § Get a list of various contributions recovered from the employees and verify the actual payments from the evidence available.
 - § To report cases where the payment is beyond the due date

ü Clause 21a. Amounts debited to Profit and loss account, being in the nature of capital, personal, advertisement expenditure etc.:-

§ Expenditure of Capital nature

Srutinize records, obtain information and make necessary inquiries

- Capital expenditure, if any, debited to the profit and loss account to be disclosed stating the amounts under various heads separately
- Capital expenditure which are fully deductible in the computation of total income, maintain particulars regarding -
 - the nature of expenditure, the amount of expenditure incurred and the relevant provision under which the expenditure is admissible.

§ Expenditure of personal nature

- Scrutinize the ledger to verify whether any expenses of personal nature have been incurred by the assessee
- Check whether the personal expenses are covered by the contractual obligations or accepted business practices .
- Section 227(1A) requires the auditor to inquire whether personal expenses have been charged to the revenue A/c

§ Expenditure incurred at clubs - as entrance fees and subscriptions as cost for club services and facilities used

- may be incurred for directors, employees, partner, proprietors.
- whether they are of personal nature or incurred in the course of business should be ascertained and disclosed if of personal nature
- Make a close scrutiny of the ledgers in such cases
- All payments made through credit cards should be carefully scrutinized in order to determine any payments made to clubs.

- § Expenditure by way of penalty or fine for violation of any law for the time being in force
- § Any other penalty or fine
- § Expenditure incurred for any purpose which is an offence or which is prohibited by law
 - Obtain in writing the details of all payments made by way of penalty or fine from the assessee and how such amounts have been dealt in the books of accounts
 - Not required to express any opinion as to allow ability or otherwise of amount.
 - It does not cover payment for contractual breach.

- ü Clause 21b. Amounts inadmissible under section 40(a)
 - i) In case of payments made to non-residents u/s 40(a)(i)
 - Details of payment on which tax is not deducted
 - Details of payment on which tax has been deducted but not been paid during previous year / subsequent year before time prescribed u/s 200(1)
 - ii) In case of payments made to residents u/s 40(a)(ia)
 - Details of payment on which tax is not deducted
 - Details of payment on which tax has been deducted but not been paid on / before due date specified u/s 139(1)
 - iii) Details of payee (in receipt of salary outside India/ a non-resident) whose TDS not deducted/deposited (Sec 40(a)(iii))

ü Clause 21b. Amounts inadmissible under section 40(a)(i)

Defaults and possible consequences under this section can be classified as follows:

- § Tax not deducted
- § Tax deducted not deposited in current year
- § Tax deducted and deposited during the current financial year but after the due date specified in section 200 (1)
- § Tax is deducted during the current year. The last date of deposit falls in the next financial year. Tax is actually paid in the next financial year after the due date.

Documentation - tax audit

(contd...)

- a. Obtain a schedule from the client giving the following details:
- Name of Party
 - Amount of Invoice
 - Date of Credit/Payment whichever is earlier
 - Nature of Payment i.e. professional fees, interest, brokerage, contractor etc.
 - Amount of TDS
 - Rate of TDS
 - Date of TDS deduction
 - Date of Payment of TDS
 - Amount inadmissible under section 40(a)(ia)

Above schedule is an extract of the e- Form 26 of the Annual return

Documentation - tax audit

(contd...)

- Test check the details in the schedule with relevant supporting.
- Check that the total of expense as per schedule reconciles with amount as per P&L.
- Verify the TDS deducted with the entries in TDS ledger account and TDS annual return (Form 26).
- Verify the payments made with the TDS challan and TDS annual return.
- Ensure that the rate of TDS is correct (based on appropriate classification) and as per correct section
- In respect of matters where the remittance is made without deducting TDs and the auditor has a difference of opinion with the legal opinion obtained by the client then he must state both the facts in the form .

- b. In case of short deduction of TDS on account of applying a wrong (lower) rate of TDS, it would tantamount to default and therefore proportionate amount of expense to the extent of shortfall will be disallowed.
- c. Where there is a interpretation issue regarding classifying a particular expense under a particular head under which TDS should be deducted and because of which there is short deduction, than in such a case it can be argued that there is no default and hence no disallowance. Seek tax consultation.
- d. State following note in Form 3CD: "We have relied on management representation for the purpose of reporting under this clause".

- ü Clause 21c. Interest, salary, bonus, commission or remuneration admissible under section 40(b)/40(ba) and computation thereof
 - State the inadmissible amount under this clause after applying the conditions for allowance or disallowance and accordingly determine the prima facie inadmissibility of the deduction and also quantify the same

Conditions for admissibility:

- a. Remuneration to working partner
- b. Remuneration / interest is authorized by partnership deed
- c. The interest should not exceed 12% p.a. and the remuneration should not exceed the maximum permissible limits.
- d. The same should not pertain to a period prior to the date of partnership deed

- ü Clause 21d.(A). On the basis of the examination of books of account and other relevant documents/evidence, whether the expenditure covered under section 40A(3) read with rule 6DD were made by account payee cheque drawn on a bank or account payee bank draft. If not, please furnish the details.
- ü Clause 21d. (B) Deemed income under section 40A (3A).
In case of no proper evidence for verifying about the payment made by account payee Cheque / account payee bank draft is available, the following note may be inserted -
“It is not possible for us to verify whether the payments in excess of Rs.20,000 have been made otherwise than by account payee cheque or account payee bank draft as the necessary evidence is not in the possession of the assessee “

ü Clause 21(e). Provision for payment of gratuity not allowable under section 40A(7)

As per section 40A(7), deduction of any provision is allowable only if provision is made for contribution to any approved gratuity fund or the provision relates to the amount of gratuity which has become payable during the previous year.

Call for the order of Commissioner of I.T granting approval for gratuity fund, verify the date from which it is effective and also verify whether the provision has been made as provided in the trust deed.

In case the provision is made for payment of gratuity is not allowable under sec 40A(7) the same is to be stated under this sub clause.

ü Clause 21(f). Any sum paid by the assessee as an employer not allowable under section 40A(9)

Under section 40 A(9), any payments made by an employer towards the setting up or formation of or as contribution to any fund, trust, company, or other institutions (other than contributions to recognised provident fund or approved superannuation fund or approved gratuity fund)is not allowable.

ü Clause 21(g). Particulars of any liability of a contingent nature

Detailed scrutiny of account heads like outstanding liabilities, provision etc to be made to ascertain any such particulars of contingent nature debited to P/L account. Also check whether any contingent liability of the previous year has been provided for and whether the liability continues to be contingent innature. A suitable note may be given as to the non availability of such particulars relating to contingent liabilities.

- ü Clause 21(h). Amount of deduction inadmissible in terms of section 14A in respect of the expenditure incurred in relation to income which does not form part of the total income.:-
Verify the details furnished by the assessee and should satisfy himself that the inadmissible amounts have been worked out correctly.
- ü Clause 21(i). Amount inadmissible under the proviso to section 36(1)(iii)

ü Section 36(1)(iii) provides that interest on borrowed capital would be deductible only if :

- a) The assessee has borrowed money.
- b) It is used for the purpose of business and profession.
- c) Interest is paid/payable on such money.

The proviso to the above section requires that capital borrowed for acquisition of asset for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use shall not be allowed as a deduction

Need to report the amount inadmissible under the above proviso.

- ü Clause 22 – payment of interest under The MSME development act , 2006

Obtain and review full list of suppliers of the assessee which fall within the definition of “Supplier” under section 2(n) of the MSMED Act, 2006.

Verify from the books of account whether any interest payable or paid to the buyer has been debited to the books

Verify the interest payable on test basis

Verify additional information provided by the auditee.

If on the test check basis, the auditor is satisfied, then the amount so debited to the profit account should be reported

- ü Clause 23. Particulars of payments made to persons specified under section 40A(2)(b)
 - § Review transfer pricing report for compliance of these provisions
 - § Obtain a full list of specified persons as contemplated in this section and obtain details of expenditure / payments made to specified persons Tax auditor should scrutinize all items of payments to above persons
 - § Related Party schedule as disclosed in Notes to Accounts
 - § Disclosure made in Form 3CEB certification

- ü Clause 26:- In respect of any sum referred to in clause (a), (b), (c), (d), (e) or (f) of section 43B, the liability for which;
 - (A) pre-existed on the first day of the previous year but was not allowed in the assessment of any preceding previous year and was i) paid during the PY; ii) not paid during the PY;
 - (B) was incurred in the PY and was i) paid on or before the due date for furnishing the return of income of the previous year under section 139(1); ii) not paid on or before the aforesaid date

- ü Clause 27(a) Amount of Cenvat credits availed of or utilized during the previous year and its treatment in the profit and loss account and treatment of outstanding Modified Value Added Tax credits in the accounts.
- § This clause requires the factual reporting about the CENVAT credit availed and utilized during the year as well as its treatment in profit and loss account and treatment of outstanding Cenvat credits in the accounts
- § Verify that there is a proper reconciliation between balance of CENVAT credit in the accounts and relevant excise records.
- § Verify that the information furnished under this sub-clause is compatible with the information under clause 12(b)
- § Service tax credit also needs to be reported in this clause.

- § b) Particulars of income or expenditure of prior period credited or debited to the profit and loss account.

Information may be available from the annual accounts, where accounts of the assessee are audited under any other law

In other cases, scrutiny of the ledger in regard to the period for which expenditure or income is entered is required

Documentation - tax audit

(contd...)

ü Clause 34 a: Details of TDS and TCS

A table has been prescribed listing the following reporting:

1	Tax deduction and collection Account Number (TAN)	6	Total amount on which tax was deducted or collected at specified rate out of (5)
2	Section	7	Amount of tax deducted or collected out of (6)
3	Nature of payment	8	Total amount on which tax was deducted or collected at less than specified rate out of (7)
4	Total amount of payment or receipt of the nature specified in column (3)	9	Amount of tax deducted or collected on (8)
5	Total amount on which tax was required to be deducted or collected out of (4)	10	Amount of tax deducted or collected not deposited to the credit of the Central Government out of (6) and (8)

ü Clause 34b: Whether the assessee has furnished the statement of tax deducted or tax collected within the prescribed time. If not, please furnish the details:

- 1) Tax deduction and collection Account Number (TAN)
- 2) Type of Form
- 3) Due date for furnishing
- 4) Date of furnishing, if furnished
- 5) Whether the statement of tax deducted or collected contains information about all transactions which are required to be reported

Management to prepare a statement in this regard and ensure that the actual date is compared with the statutory due date

- § Verify the returns filed by the assessee and compare the actual date of filing with the statutory deadline.
- § Check that any delays noted are reported under this clause.
- ü Clause no 34c: Whether the assessee is liable to pay interest under section 201(1A) or section 206C(7). If yes, please furnish:
 - 1) Tax deduction and collection Account Number (TAN)
 - 2) Amount of interest under section 201(1A)/206C(7) is payable
 - 3) Amount paid out of column (2) along with date of payment.
- § Verify the calculation of the interest amount payable by the assessee.
- § Verify the amount of interest actually paid from the challan along with the date of payment.

- ü Clause 36. In the case of a domestic company, details of tax on distributed profits under section 115-O in the following form:—
 - a) Total amount of distributed profits; b) Total tax paid thereon;
 - c) Dates of payment with amounts.
 - d) Amounts set off as per section 115-O(1A) for determining dividend distribution tax payable is required to be disclosed
- § Verify the statutory records/minutes to ascertain the amount of profits distributed
- § Verify the tax paid thereon and the date of payment, on the basis of duly received challan and books of account.
- § Verify the amount of dividends received from the subsidiary companies and ensure that the same has been adequately disclosed here.

- ü 38. Whether any audit was conducted under the Central Excise Act, 1944, if yes, enclose a copy of the report of such audit.
 - § Ascertain from the management whether an audit was carried out and if yes enclose a copy of the report of such audit.
 - § Where an audit may have been ordered and is not completed by the time of issue of report, he has to state the same in his report.
 - § Not required to make nay detailed study of such report, however make a note of any material observation which may have relevance to the tax audit.

Documentation - tax audit

(contd...)

- ü Clause no 39: Whether any audit was conducted under section 72A of the Finance Act, 1994 in relation to valuation of taxable services, Finance Act, 1994, if yes, give the details, if any, of disqualification or disagreement on any matter/item/value/quantity as may be reported/identified by the auditor.
- § Verify if any audit under section 72A of the Finance Act, 1994 in relation to valuation of taxable services was conducted.
- § Review the audit report and furnish the details of disqualification or disagreement on any matter/item/value/quantity as reported/identified and reported in the audit report.

- ü 40. Accounting ratios with calculations as follows :—
 - a) Total Turnover b) Gross profit/Turnover; c) Net profit/Turnover;
 - d) Stock-in-trade/Turnover; e) Material consumed/Finished goods produced.
- § Verify the total turnover with the audited financial statements.
- § Ensure that the comparative numbers of the previous year is also reported.
- § Verify the comparative numbers from the previous year's tax audit report.

- ü Clause no 41: Please furnish the details of demand raised or refund issued during the previous year under any tax laws other than Income Tax Act, 1961 and Wealth tax Act, 1957 along with details of relevant proceedings.
- § Obtain a listing of all the assessment years for which the assessment by the assessing officer has been closed.
- § Review the assessment order and verify the amount of demand raised or the refund issued from these orders.
- § Ensure consistency with the year end audit working papers and our conclusions at the time of finalisation of audits.
- § Get a specific LOR from the company regarding the completeness of data.

Questions





Thank You!