

# ENHANCING AUDIT QUALITY

In continuation of the write-up of last issue we are herewith giving the observations of Peer Reviewers relating to compliance with Technical Standards by the Practice Units.

The observations of the Reviewers on Technical Standards are broadly covered under the following categories:

## 1. Record Administration

The Institute has issued the Auditing and Assurance Standard (AAS 3) on "Documentation". The mandatory nature of the standard implies that while discharging their attest function, it is the duty of the members of the Institute to ensure that the AASs are followed in the audit of financial information covered by their audit reports. If, for any reason, a member has not been able to perform an audit in accordance with the AASs, his report should draw attention to the material departures there from.

There should be procedures to ensure proper documentation (Members in smaller practices may find some of the documentation too elaborate for most of their clients and so should tailor their attestation services documentation to suit their particular circumstances with justification for doing so). Members are to issue engagement letters and to have appropriate procedures for planning engagements by making use of audit programmes. Principal requirements of documentation as envisaged in AAS-3 on "Documentation" are: Working papers should record the audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained. Working papers should be designed and properly organised to meet the circumstances of each audit and the auditor's needs in respect thereof. Working papers should be sufficiently complete and detailed for an auditor to obtain an overall understanding of the audit. All significant matters which require the exercise of judgment, together with the auditor's conclusion thereon, should be included in the working papers. The auditor should adopt reasonable procedures for custody and confidentiality of his working papers and should retain them for a period of time sufficient to meet the needs of his practice

and satisfy any pertinent legal or professional requirements of record retention.

The content of working papers be guided by amongst other factors, completeness and accuracy, clarity and understanding, and legibility and neatness. Generally, each individual assigned to an audit engagement should prepare working papers in such a manner that any professional not connected with the engagement may later examine such working papers and be able to determine that the work was performed in accordance with generally accepted auditing standards. The use of standardised working papers (for example, checklists, preprinted forms, questionnaires, specimen letters, and standard organisation of working papers) may improve the efficiency with which they are prepared and reviewed. There should have pre determined numbering system and section dividers for each item of financial statements to ensure uniformity of working papers.

All working papers must be prepared in a manner so that they clearly and logically show the schedule, results of test, etc. Working papers must depict the client's name, file number, accounting period, subject of working paper, reference of working paper with current or permanent file, initials of preparer and date of preparation and reviewer (principal or supervisor and the date of such review). The working papers may be classified as "permanent files" as distinct from "current files". It is not important that the classification of working papers is done on the basis of "Permanent vs. Current". The moot point is that the information is recorded somewhere.

It has been observed by the Reviewers that standardisation of working papers like checklists, specimen letters, standard organisation of working papers is missing in many of the PUs reviewed. Working papers need to be properly organised. Documentation of results of evaluation and testing the internal control to decide the extent of substantive procedure should be in place. Sufficient working papers and record of removal of queries raised to be kept. System of indexation and cross-referencing of the working papers in audit files of client companies should be introduced. Record of Audit plan, the nature, timing and

extent of Auditing procedures performed to be maintained. Letter(s) of reappointment to be kept on record. Working Papers i.e. copy of Audit Programme, particulars of audit test carried out to be kept in each Client's Record to support audit opinion including full information on work carried out. Working of estimates such as provisions for taxation and deferred tax calculation, evaluation of internal audit, expert opinion on labour liabilities etc have to be kept on record. The appointment letters from auditees, irrespective of cases of corporate/CAG audits/other clients be obtained. Acceptance letters to be sent to clients, including Tax audit clients. The letters of Preliminary Audit observations and comments/replies/final observations thereon, to be kept in respective file(s). Organisation chart of the client to be kept in file. The records should be maintained in such a manner so that these are easily retrievable, as and when required. Procedure of collection of audit evidence which is to be obtained directly from parties and business associates of the clients, for performing substantive test and results obtained thereat, be properly documented. Audit plan, nature of work, timing, extent of audit procedure performed and conclusion drawn thereon, be recorded. The work allocation, number of man days required and the management comment on Draft Audit Report should be documented.

## 2. Evaluation of System of Internal Controls

PU should obtain the knowledge of the business of the client and to evaluate the accounting and internal control systems of it. Reliance may be placed on internal controls, after performing compliance tests. It must assess the audit risk and its components—inherent risk, control risk and detection risk and may obtain an understanding of the control environment of the client by obtaining audit evidence to support any assessment of control risk which should be recorded properly.

Reviewers have observed that written statements in questionnaire form or flow chart form regarding internal control system was not in place in respect of a good number of PUs. It is also desired that review and evaluation of system of internal control in large audits to be documented. Review and reliance placed on work of an internal

auditor to be documented.

## 3. Financial Statements Presentation

All the PUs should have a system to ensure that disclosure requirements related to the attestation engagement have been fulfilled, they are required to make use of a checklist to ensure that pronouncements of the Institute to the extent it has effect on the Financial statements have been complied with. They must provide a description of the method used, must if any other method is followed and to verify the compliance with laws and regulations to the extent it has material effect on the financial statement. PUs should conduct the audit of specialised industries in accordance with the relevant Guidance Notes.

## 4. Audit Conclusions and Reporting

To document the basis for arriving at audit conclusions ensure that the reporting requirements related to the engagement are complied with the procedures followed, ensure that audit report is in accordance with the relevant authoritative requirements or technical standards, state the reasons wherever any qualified, adverse or disclaimer of opinion is given or the reservation on any matter is made.

Reviewers have also observed that disclosure in the Auditor's Report regarding non-compliance of AS-1 "Disclosure of Accounting Policies" was done only in corporate clients, not for the other clients, which should have been done in all cases of non-corporate clients also as AS-1 is mandatory for all the enterprises. In cases where the client does not disclose Accounting Policies at one place, the PU should disclose the fact in his audit report without necessarily making it subject matter of audit qualification as required vide AS-1. Valuation of Inventories to be mentioned in the Audit Report as per AS-2 and the basis of confirmation from outside parties viz., debtors, creditors etc. to be recorded. Qualifications in the Auditor's Report to the members of the company to be in accordance with the requirements of AAS 28. Use of short-term funds for acquisition of Fixed Assets to be highlighted in CARO Report. □