

# CHAMBER OF TAX CONSULTANT'S STUDENT COMMITTEE

Presentation on

AUDIT AROUND THE COMPUTER  
INCLUDING AUDIT  
DOCUMENTATION

by

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08<sup>TH</sup> JUNE 2018

# DEFINITION OF AUDIT

An **audit** is a systematic and independent examination of books, accounts, statutory records, documents and vouchers of an organization to ascertain how far the financial statements as well as non-financial disclosures present a true and fair view of the concern.

A historical black and white illustration of a large, multi-story industrial building, likely a cotton mill, with a prominent chimney. The building has many windows and a classic architectural style. In the foreground, there is a cobblestone street with a low wall or fence on the left side. A few figures are visible walking on the street. The sky is overcast.

**The Kingston Cotton Mill Co.,  
Ltd, 1896 :**

**AUDITOR IS WATCHDOG  
&  
NOT BLOODHOUND**

## Background of the case

- The auditors accepted an inventory certificate from a manager of the company.
- They only checked the details of the certificate to the inventory records without attending any physical inventory count.
- The inventories were overstated.
- However, the auditors were held not to be liable on that matter.
- The judge had made a famous remark of “He is a watchdog, not a bloodhound.”



# **QUALITIES TO PERFORM AUDIT SUCCESSFULLY**



# TEAMWORK



**HARD WORK**

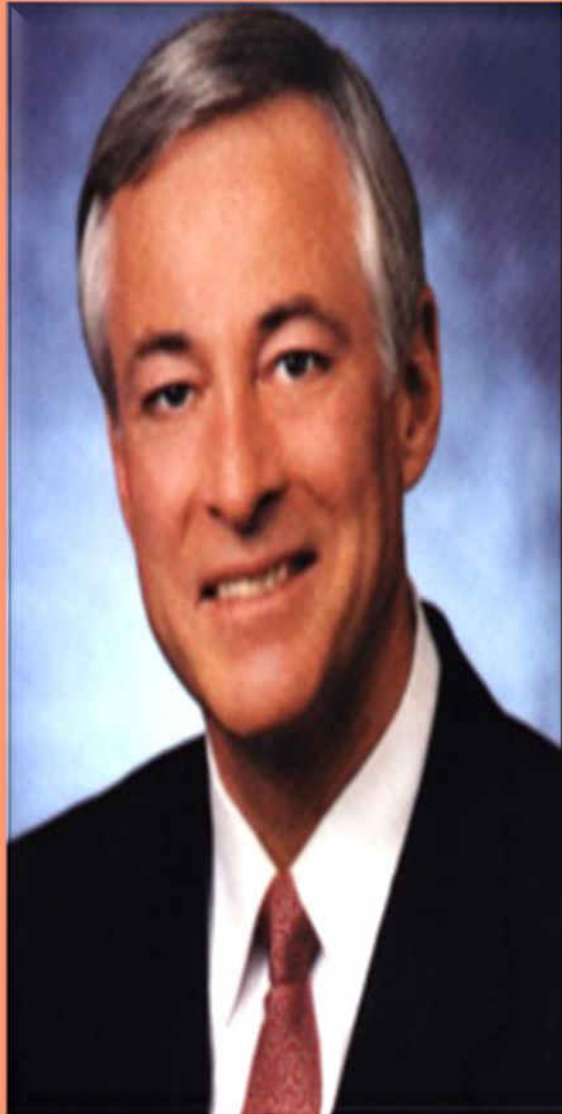
**beats talent**

**when talent**

**doesn't**

**WORK HARD**

[TheMindsJournal.com](http://TheMindsJournal.com)



Continuous learning is the minimum requirement for success in any field.

— *Brian Tracy* —

AZ QUOTES





1. What is difference between Accounting Standards and Auditing Standards ???
2. Difference



## Accounting Standards

## Auditing Standards

1. It Means maintaining books of Alcs systematically & Preparing financial statements at year end following accounting standards so notified.

2. Work is performed by accountant of the entity

3. Accounting starts where book keeping ends

4. Accounting is continuous process i.e day to day recording of transactions.

Accounting is governed by Accounting Standards

1. It means inspection of books of accounts and financial statement of an entity.

2. Work performed by auditors so appointed by the entity

3. Auditing starts where accounting ends.

4. Auditing is periodic process can be continuous too.

5. Auditing is governed by Standards on Auditing



### ❶ Steps to initiate when an audit is allotted

- Study the Balance Sheet of previous year.
- Study the notes to accounts and working papers.
- Prepare list of preliminary documents from client.
- If possible study the industry in which the entity is engaged in.

# AUDIT AROUND THE COMPUTER



# EVOLUTION OF AUDIT AROUND THE COMPUTER

## **MANUAL BOOKS OF ACCOUNTS**

1. All transactions were checked 100%.
2. Verifying posting of entries from subsidiary books to primary books.
3. Verification of opening balances.
4. Verification of totaling of each page.
5. Manual preparation of Trial Balance.
6. Manual preparation of Balance Sheet.

Continued...

# COMPUTER RECORDS

1. Programs in COBOL (Used even today)
2. Simple softwares like Tally, Trio etc.
3. Upgradation of softwares giving MIS reports too.
4. ERP & SAP based softwares where security of data is given prominence and modifications are locked.
5. Industry specific softwares.



Continued...

# AUDITING APPROACHES

BLACK BOX APPROACH

WHITE BOX APPROACH

Continued...

# BLACK BOX APPROACH

- The auditor determines his audit procedure without taking into account the fact of use of computer for processing of information.
- In Black box approach, the auditor concentrate on input and output and ignores the procedure of how computer process the data or transaction.

Continued....



- The auditor carries out the audit **more or less in the same manner as in manual** system except that instead of handwritten books of account, he examines computer printouts.
- The auditor can usually audit around the computer in either of following situation
  - ➔ The system is simple
  - ➔ The system uses generalized software that is well tested and widely used by many institutions.

Continued....

# Advantage

Simplicity

Having little technical knowledge of computer and can be trained easily to perform the audit

# Disadvantage

Not beneficial for complex system

System follows the pattern of historical audit

# White Box Approach

- The auditor evaluates the internal controls relating to CIS and on the basis of this evaluation, determines the nature, timing and extent of his substantive procedures.
- The auditor can use the computer to test:
  - The logic and controls existing within the system
  - The records produced by the system

Continued....

- **Situation where it must be used**

- The computer processes a large volume of input and resultantly produce a large volume of output.
- The significant parts of the internal control system are embodied in the computer system itself.
- The logic of the system is complex.



Continued...

## Advantage

- Increase power to effectively test a computer system

## Disadvantage

- It needs extensive technical expertise

A stack of approximately 15 books of various colors (brown, green, red, white) is positioned on the left side of the slide, extending from the top to the bottom. The books are slightly offset, creating a sense of depth.

# **OVERVIEW OF FEW OF THE AUDITING STANDARDS**

# SA 200 Series

SA-200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing(Revised)
SA 210	Agreeing the Terms of Audit Engagements (Revised)
SA 220	Quality Control for an Audit of Financial Statements
SA 230	Audit Documentation (Revised)
SA 240	The Auditor's Responsibilities relating Fraud in an Audit of Financial Statements (Revised)
SA 250	Consideration of Laws and Regulations in an Audit of Financial Statements (Revised)
SA 260	Communication with Those Charged with Governance (Revised)
SA 265	Communicating Deficiencies in Internal Control to Those charged with Governance & Management
SA 299	Responsibility of Joint Auditors

# SA 200-OVERALL OBJECTIVES OF AN INDEPENDENT AUDITOR AND CONDUCT OF AN AUDIT IN ACCORDANCE WITH SAs



- To obtain reasonable assurance about whether F.S. as a whole are free from material misstatements, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the F.S. are prepared, in all material aspects and in accordance with the applicable FRF.



## Aspects to be covered while performing audit

1. • **ETHICAL REQUIREMENTS**
2. • **PROFESSIONAL SKEPTICISM**
3. • **PROFESSIONAL JUDGEMENT**
4. • **SUFFICIENT APPROPRIATE AUDIT EVIDENCE**
5. • **CONDUCT OF AUDIT IN ACCORDANCE WITH SAs**



# ETHICAL REQUIREMENTS

- He should be Independent :
  - i) Independence of mind
  - ii) Independence in appearance
- Ethical Requirements as per code of ethics issued by ICAI  
Fundamental principles of the Code of Ethics are as under :
  - 1) Integrity
  - 2) Objectivity
  - 3) Professional Competence and due care
  - 4) Confidentiality
  - 5) Professional Behaviour

# PROFESSIONAL SKEPTICISM

- Professional skepticism is a key element of a quality audit.
- **Professional skepticism means :**
  - ➔ Not accepting the evidence you have gathered at face value.
  - ➔ Continuing to pursue all avenues of inquiry on the topic at hand.
  - ➔ Critically assessing evidence without being overly suspicious or cynical.
  - ➔ Increasing your awareness of how supporting documentation is selected & the amount of documentation that is collected.

Continued....

➔ Corroborating management explanations or representations concerning material matters.

- **Your assessment should include whether :**

➔ Evidence may be misleading or incomplete .

➔ The person providing the evidence lacks subject matter competence or is motivated to provide evidence that is misleading or incomplete.

➔ All of us have a professional responsibility to ask more probing questions, critically analyze the answers & be sure we have used all of the evidences presented.

# PROFESSIONAL JUDGMENT

It is essential in particular in taking decisions on :

- ➔ Materiality and audit risk
- ➔ Nature, timing and extent of audit procedure to meet requirements of SAs and gather audit evidence
- ➔ Evaluating whether sufficient audit evidence is obtained and whether more needs to be done to achieve the objects of SAs and thereby achieve overall objectives of auditor.
- ➔ Evaluation of management's judgment
- ➔ Drawing of conclusions based on audit evidence obtained.

## SUFFICIENT APPROPRIATE AUDIT EVIDENCE

- ➔ Audit evidence is essential to support auditor's opinion and report.
- ➔ It is cumulative in nature derived either in the course of audit or from other sources.
- ➔ The entity's accounting records are important source of audit evidence.
- ➔ Report or work of an expert employed or engaged by the entity can be important audit evidence.
- ➔ Absence of information like management's refusal to share data can constitute audit evidence.

# SA 230 – AUDIT DOCUMENTATION



## Audit Documentation:

Means the record of audit procedures performed, relevant audit evidence obtained and conclusion the auditor reached.



## 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.



Continued....

## ❖ Audit Working Papers :

- ➔ The audit working papers constitute the link between the auditor's report and the client's records.
- ➔ Documentation refers to working paper kept by the auditor in connection with performance of his audit work.
- ➔ It is the records of planning, procedure performed, evidence obtained & conclusion drawn.
- ➔ It shows that audit work has been conducted as per requirement of SA 230.
- ➔ It is collected during course of audit.

Continued....



## Basic Requirements :

- ➔ WP should be designed and organized according to circumstances of each audit.
- ➔ As far as possible WP should be kept in standardized form.
- ➔ WP should be signed, complete and dated.
- ➔ If it is in electronic/magnetic media, he should take proper care for its storage & retrieval.
- ➔ He should maintain confidentiality.

Continued....



❖ **Audit documentation may be recorded on paper or on electronic or other media.**

**Example :**

- Audit programmes.
- Analyses.
- Issues memoranda.
- Summaries of significant matters.
- Letter of confirmation and presentation.
- Checklists.
- Correspondence (Including e-mail) concerning significant matters.

Continued....

❖ **Retention Period :**

7 Years from date of Audit Report.

❖ **Ownership :**

(a) Documentation is the property of the Auditor.

(b) May at his discretion make portions of or extracts from documentation available to client.

# SA 299- RESPONSIBILITY OF JOINT AUDITORS

1. DIVISION OF  
WORK

2. CO-  
ORDINATION

**JOINT  
AUDITORS**

3. RESPONSIBILITIES  
OF JOINT AUDITOR

Separate

Joint & Several

4. REPORTING

# SA 300– PLANNING AN AUDIT OF FINANCIAL STATEMENTS

- The objective of auditor is to plan the audit so that it will be performed in an effective manner.

## Benefit of Planning an Audit

Proper Attention to Important Area

Identify Problem

Proper org. of Audit program

To Facilitate direction, Supervision, Co-ordination of Audit Team

Utilization of assistants/ Co-ordination of work

Nil Chance of duplication/ overlooking

Timely Completion of work



# Planning involves



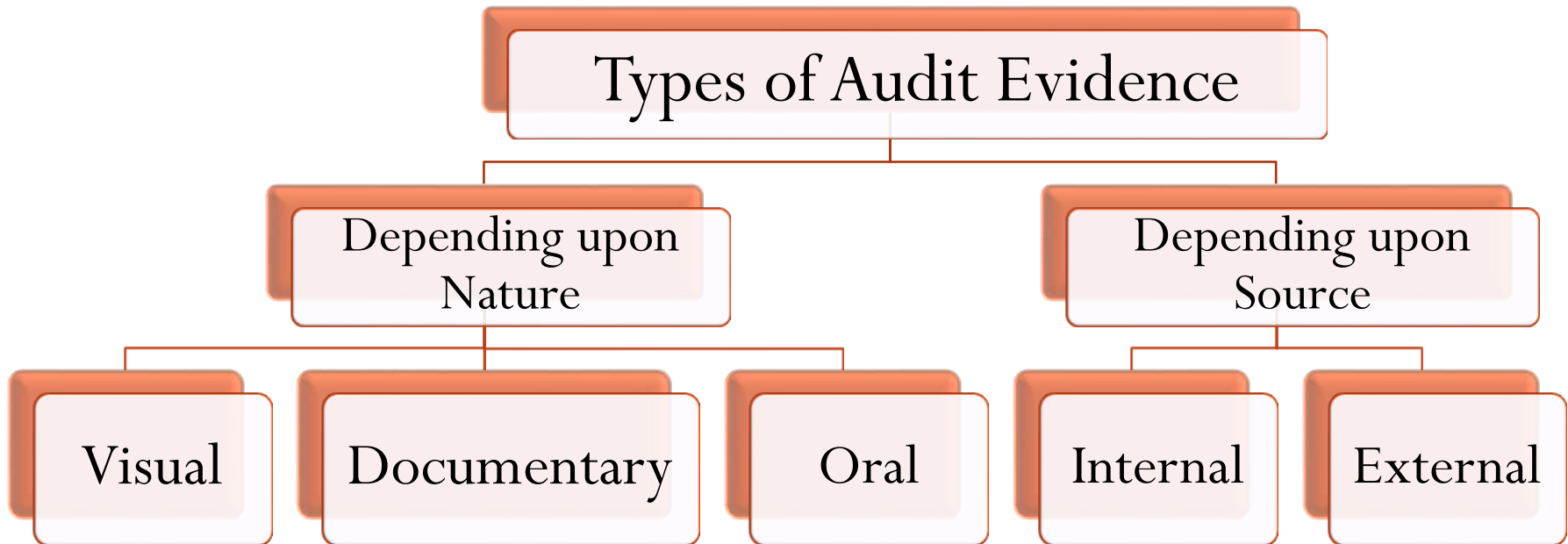
- Identifying the scope.
- Ascertain the reporting objective and engage team accordingly.
- Factors that gives significant direction to the team.
- Ascertain nature, timing and extent of resources necessary.
- Change or update audit strategy and audit plan if necessary during the course of audit.

## Documentation at the beginning of audit.

- ❖ The overall audit strategy
- ❖ The audit plan
- ❖ Significant changes to audit plan/strategy in the course of audit and record reasons
- ❖ Communicating with previous auditors, if any.

# SA 500: AUDIT EVIDENCE

- “Audit evidence” information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.



# Methods of Obtaining Audit Evidence

**Observation**

**External Confirmation**

**Analytical Procedure**

**Inquiry**

**Re-calculation**

**Physical Examination**



# Reliability of Audit Evidence

Observation



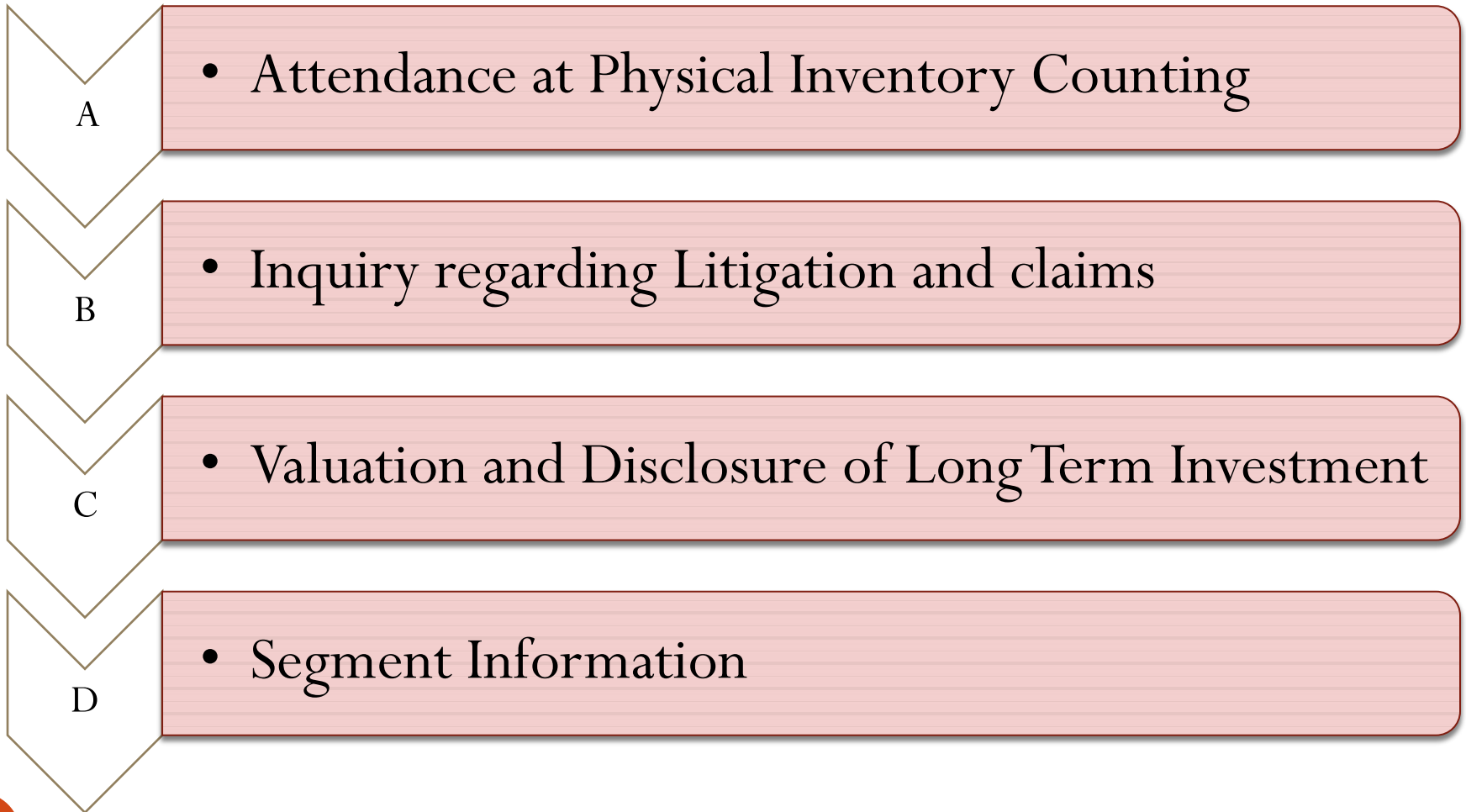
Orally



Documentary



# SA 501 : Audit Evidence-Additional Consideration for Specific Item



# SA 505-External Confirmation

- ❖ “External Confirmation” Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electric or other medium.
- ❖ The auditor should **determine** whether the use of external confirmation is necessary to obtain sufficient appropriate audit evidence to support certain financial statement assertions.
- ❖ Examples :
  - ➔ Bank balances and other information from bankers
  - ➔ Account receivables balances (Debtors)
  - ➔ Stock held by third parties
  - ➔ Account payable balance (Creditors)



# External Confirmation Procedures

- When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

1

• Determining the information to be confirmed or requested;

2

• Selecting the appropriate confirming party;

3

• Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and

4

• Sending the requests, including follow-up requests when applicable, to the confirming party.

SA  
530

# Audit sampling: Meaning

Application of audit procedures to less than 100% of items within a population of audit relevance.

Such that all sampling units have a chance of selection.

To provide a reasonable basis on which to draw conclusions about entire population.

# Sampling Risk

Risk that auditor's conclusion based on sample may be different from the conclusion if the entire population were subjected to the same audit procedure

Leads to 2 types of erroneous conclusions

Good Items

Test of Controls – More effective than they actually are

Test of Details – Material Misstatement does exist but not detected in samples selected.

Leads to inappropriate audit opinion

Bad Items

Test of Controls – Less effective than they actually are

Test of Details – Material Misstatement exists when in fact it does not

Leads to additional work

# Requirements

## Step 1

- Sample Design, Size and Selection of Items for Testing

## Step 2

- Performing Audit Procedures

## Step 3

- Communicating Misstatements

## Step 4

- Adjustments of misstatements identified

# Example

## Population

- Total Sales by the Company during the year = Rs. 500 crores
- Total Sales transactions = 10,000 transactions

## Samples selected

- Total Sample size = Rs. 50 crores consisting of 500 transactions.

## Misstatements identified in Sample = Rs. 20 lacs

- Therefore, Projected misstatement = 20 lacs X {500 crores/50 crores} = Rs. 200 lacs.



# Audit Sampling has not provided a reasonable basis for conclusions

If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:

(1) Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. In our above example, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

(2) Request management to investigate misstatements that have been identified and evaluate the potential for further misstatements and make necessary adjustments.

# Sampling Methods

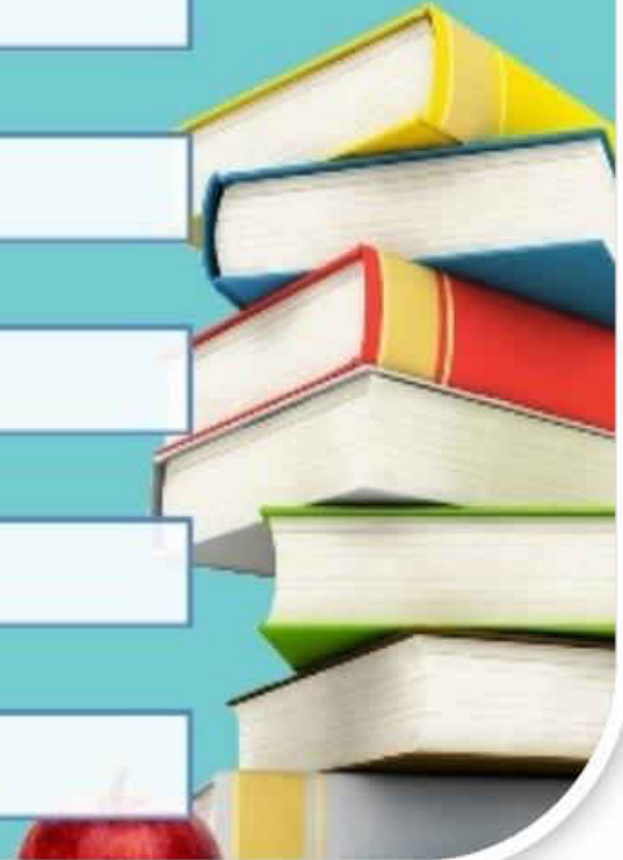
random selection

systematic selection

monetary unit sampling

haphazard selection

block selection.



# SA 570- GOING CONCERN

## ➔ MEANING :

An entity is said to be a GOING CONCERN if it is likely to be in existence for a foreseeable future time, generally extending beyond a period of one year.

**1. Management is responsible for  
Going Concern.**

**2. Should be in accordance with the Fundamental Assumptions as  
per AS-1.**

## ➔ AUDIT CONCLUSION & REPORTING :

Conclude whether Going Concern assumption is valid or not.

If not, then the F/S would be misleading; the auditor should express an Adverse Opinion.

# NEGATIVE INDICATORS OF GOING CONCERN

## FINANCIAL

Negative Working Capital

Substantial Operating Losses

Arrears of Dividends

Inability to pay creditors on due dates

Adverse Key financial ratios

## OPERATING

Labor difficulties

Shortages of imp supplies

Loss of major market , license, key customers etc.

Emergence of a highly successful competitor

Loss of key management without replacement

## OTHERS

Non-compliance of statutory requirements

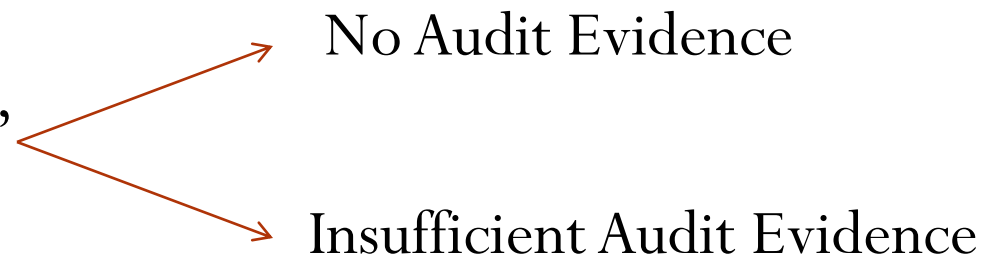
Pending Legal proceedings

Changes in govt. policies

# SA 580- Written Representation

Written representation is a statement provided by mgt to Auditor to confirm certain matters or to support other Audit evidence.

- ✓ Does not include “Fs” and not a substitute for Audit Evidence
- ✓ Mgt responsibility to prepare and present “Fs” as per “FRF”

“Why WR”    
No Audit Evidence   
Insufficient Audit Evidence

- ✓ WR issued by Authorised person ( M.D., BOD, WTD)

# SA 700 : FORMING AN OPINION & REPORTING ON FINANCIAL STATEMENT

## Auditor's Report – Basic Elements

- a) Title
- b) Addressee
- c) Introductory Paragraph
- d) Management's Responsibility for the financial Statements
- e) Auditor's Responsibility
- f) Auditor's Opinion
- g) Emphasis of Matter Paragraph (If Needed)
- h) Other Matter Paragraph (If Needed)
- i) Going Concern (If Needed)
- j) Report on Other Legal and Regulatory Requirement
- k) Signature of the Auditor
- l) Place of Signature
- m) Date of the Auditor's Report



Microsoft Office  
Word Document

# SA 705- MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

## Types of modifications

### Qualified Opinion

- Where the auditor, either on basis of evidence obtained or otherwise, concludes that misstatement are **MATERIAL BUT NOT PERVASIVE** to the financial statements

### Adverse Opinion

- The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatement, are **BOTH MATERIAL AND PERVASIVE** to the financial statements.

### Disclaimer Opinion

- The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion and the auditor concludes that possible effects of such undetected misstatements, if any, on the financial statements could be **BOTH MATERIAL AND PERVASIVE**.

# SA 706 : EMPHASIS OF MATTER PARAGRAPH AND OTHER MATTER PARAGRAPH IN THE INDEPENDENT AUDITOR'S REPORT

Objective

Draw User's attention by way of clear additional communication in auditor's report.

Emphasis of  
Matter  
Paragraph

- A matter although appropriately presented or disclosed in Financial Statements which is of such importance that it is fundamental to user's understanding of Financial Information.

Other Matter  
Paragraph

- As appropriate, any other matter that is relevant to user's understanding of the audit, the auditors responsibilities or the Auditors Report.



# Circumstances in which Emphasis of matter paragraph is necessary

1

- An uncertainty relating to the Future outcome of an Exceptional Litigation or regulatory action.

2

- Early application (wherever permitted) of a new accounting standard that has pervasive effect.



# THANK YOU

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