

## **TOPIC 7: AUDIT DOCUMENTATION (ISA 230)**

According to ISA 230, the auditor should adequately document all materials that are relevant to the audit in working papers.

Working papers refer to all the materials prepared, collected and retained by the auditor in connection with the audit.

The working papers may be in form of data stored on paper, electronic storage media or other storage media.

Audit documentation is the record of all the audit procedures performed, relevant audit evidence obtained and conclusions the auditor has reached.

### **Importance of audit documentation**

- 1) It provides evidence of the audit basis for a conclusion.
- 2) It provides evidence that the audit was planned and conducted in accordance with the ISA's
- 3) The working papers assist in providing direction and supervision to the staff.
- 4) It makes the staff accountable for the work they have performed.
- 5) It facilitates review of the work done.
- 6) The working papers can be used for training new recruits.
- 7) They are used to control the current year's audit.
- 8) The working papers can be used by the auditor as his defense in litigation against him.
- 9) Preparation of the working papers forces the auditor to adopt a systematic approach to the audit which enhances the quality of the audit.
- 10) The working papers can assist in investigations into the financial affairs of the client company.
- 11) The working papers can be sued as a basis for negotiating the audit fee.
- 12) It facilitates the subsequent years audit planning.
- 13) It retains a record of matters that may continue to be important in the future audits.

### **Qualities of good working papers**

- 1) They should be as complete as possible.
- 2) They should be properly indexed.
- 3) Any symbols used must be clearly explained.
- 4) They should be properly headed.
- 5) They should be properly bound.
- 6) They should be well secured under key and lock.
- 7) They should be prepared neatly and tidily so that they clearly and concisely and logically show the schedules, procedures, results of the tests
- 8) Any personal judgment must be clearly explained.
- 9) They should be kept for sufficient period.

### **Examples of Audit documentation**

Audit documentation may be recorded on paper, on electronic or other media. e.g.

- 1) Audit programs.
- 2) Analysis
- 3) Issues memorandum
- 4) Summary of significant matters.
- 5) Circularization letters and their responses
- 6) Checklists.
- 7) Correspondences including emails concerning significant matters.
- 8) Copies of entities records such as contracts and agreements etc.
- 9) Letters of representations, letters of internal weaknesses.

### **Methods of gathering the working paper**

- 1) Making copies of important documents.
- 2) Recording all the procedures and results obtained.
- 3) Recording all the questions raised and the responses obtained.
- 4) By taking notes on important areas of the client's entity.

- 5) Keeping copies of communication with the client.
- 6) Filling reports of experts.
- 7) Keeping responses obtained from 3rd parties.
- 8) Scanning important documents of the client.

Organization of working paper

The working papers are put in files which are classified into 2:

- 1) Permanent Audit file
- 2) Current Audit file

### **1. Permanent Audit File (PAF)**

This file is used for putting the working papers that are of long-term importance to the auditor i.e. their purpose may go beyond the current years in audit.

#### **Purpose**

- 1) To document information, which is of recurring value regarding appearing in the financial statement.
- 2) To document information of permanent nature regarding the client.
- 3) To give the audit staff who are auditing for the first time information regarding the client's affairs and the nature of the audit.

#### **Contents**

- 1) Copies of the client's statutory documents such as A.O.A and M.O.A, certificate of incorporation, list of shareholders.
- 2) Other statutory materials such as copies of the company act, NSE regulation.
- 3) Copies of documents of continuing importance and relevant to the auditor such as engagement letter.
- 4) The clients physical and postal address.
- 5) List of the company's lawyers, bankers, stock brokers, insurance broker and advisors.

6) The organizational structure showing the top management functions and division of responsibilities in the company.

7) A description of the entities business and its operations.

8) Copies of important client legal documents such as contracts, lease agreement.

9) A brief history of the company and a summary of the annual accounts.

2) Current Audit file

This file is used for putting the working papers that are of short importance to the auditor.

### **Purpose**

1) To provide a record of the work planed in the current years of audit.

2) To detail the work performed including the procedures followed, tests performed, information obtained and the conclusions reached.

3) To enable any person especially the audit reporting partner reviewing the audit to satisfy himself that an adequate examination of the financial statement has been carried out.

### **Contents of CAF**

1) Copies of the current year's financial statements duly signed.

2) A schedule of each item included in the income statement and comparative.

3) A schedule of each item included in the statement of financial position and comparatives.

4) The audit plan and audit programs.

5) A record of the questions raised and the answers obtained.

6) Internal control questionnaire.

7) A copy of the management letter.

8) The letter of representation.

9) Copies of circularization letters.

**Factors influencing forms and contents of working papers.**

1) The nature of the audit engagement.

2) Size and complexity of the entity.

3) The nature of audit procedures to be performed.

4) The identified risk of material misstatements.

5) Significance of audit evidence obtained.

6) The nature and extent of exceptions identified.

7) The specific audit methodology used.

8) The nature and condition of the client's ICS and accounting system.

9) The need in the particular circumstances for direction and review.

**Limitations of gathering work papers**

1) Lack of cooperation from the client staff and management.

2) Lack of cooperation from 3rd parties e.g. non-replies to circular letters.

3) It may be expensive and time consuming.

4) Technicality of the client's business.

5) Incomplete record.

6) Weaknesses in the client's systems such as supportive documents.

**Reasons why the Auditor may refer to the previous year's audit**

1) To obtain background knowledge about the client.

2) To establish the basis of planning the current year's audit.

3) To check the difficulties encountered in the previous year's audit.

4) To identify the queries that were raised and were not cleared the previous year.

5) To check the reporting framework applied by the client.

6) To confirm that the misstatements identified in the previous year's audit have been corrected.

7) To avoid bothering the client's management and staff with the issues that had already been represented to.

## **Types/classifications of working papers**

1) a) Standardized

b) Un-standardized

2) a) Automated

b) manual/physical working paper

1. Standardized working paper vs. un-standardized working paper

This is an approach where the auditor uses standardize pre-prepared audit manual developed by the audit firm to be used for all audits.

The manual will contain e.g.

a) Standardized audit programs

b) Standardized bank letters.

c) Standards internal control questionnaires

d) Standards debtor circularization letters etc.

## **2. Automated Audit files**

These are computer programs used by the auditor to make documentation easy and to assist in analyzing the client's records.

Such software assists the auditor in extracting data from the client's data base and analyzing such data.

### **Advantages**

1) They free up storage space in the audit firm's office.

2) They are safe/more secure as they are not subject to damage through wear and tear.

3) They can be transmitted electronically hence a high possibility of sharing work between people indifferent remote locations.

4) They are near and easy to review.

5) They are easy to update and edit.

- 6) They facilitate quick assessment of risk.
- 7) They guarantee a high level of accuracy.
- 8) Large amount of data can be scanned and tested.
- 9) They encourage uniformity of work since standard formats can be saved.
- 10) They facilitate faster communication of data.

### **Disadvantages/challenges**

- 1) Lack of computer knowledge.
- 2) Risk of data corruption by viruses.
- 3) The auditors' software may be incompatible with the client's software.
- 4) The computer software may be expensive to develop or purchase.
- 5) There is high risk of unauthorized data alteration.
- 6) The risk of loss of confidentiality as the data is transmitted electronically.
- 7) It requires a lot of computer time.
- 8) The audit software may become obsolete requiring constant updating which may be expensive.

### **Ownership and custody of working papers**

Initially the working papers were thought to belong to the client. However, a 1938 U.K case set a contrary precedence.

#### **Facts:**

The client was claiming custody over the working papers

- 1) The working papers were collected from the client company.
- 2) The client had paid the auditor for the service.
- 3) The auditor is an agent of the client.
- 4) The working papers contained the secrets of the client.

## **AUDIT QUALITY CONTROL (ISA 220) AND ISQC 1**

ISQC (1) – International standards for quality controls

When the auditor accepts appointment, he exposes himself to a number of risks.

- 1) The risk of giving an inappropriate opinion.
- 2) The risk of damages.
- 3) Risk of adverse publicity.
- 4) The risk of losing the client and future prospective clients.
- 5) Withdrawal of the practicing certificate.

To mitigate against the above risks ISA 220 requires the audit firm to implement quality control procedures at 2 levels.

- i) At the audit firm level.
- ii) At the individual audit engagement level.

Objectives of quality control procedures

- 1) To ensure that the audit report issued by the audit firm is appropriate in the circumstances.
- 2) To ensure that the audit firm and its personnel comply with the professional and technical standards and the applicable legal and regulatory requirements.

### **Quality control procedures at the individual audit engagement**

#### **level Nov. 2011 Q 1c**

- 1) Client's acceptance procedures.
- 2) The engagement team.
- 3) Direction.
- 4) Supervision.
- 5) Consultation.
- 6) Documentation.
- 7) Monitoring.

8) Review.

### **1. Clients Acceptance procedures**

The engagement partner should conclude on whether all the engagement procedures have been considered and finalized. This includes:

- a) Potential threat to independence has been considered.
- b) The management integrity has been considered.
- c) The auditor has ensured there is no conflict of interest.
- d) The audit firm has considered availability of resources to complete the audit.
- e) Clearance has been obtained from the predecessor auditor.
- f) Ethical requirements have been complied with.

### **2. The engagement team**

The engagement partners should ensure that the engagement team collectivity has the skills, competence and time to do the audit.

The engagement partner should assess the team for the following:

- a) Experience in similar audit assignments.
- b) Understanding of the professional technical standards and legal requirements.
- c) Ability to make professional judgment.
- d) Technical knowledge and expertise e.g. in I.T.
- e) Knowledge of the industry.
- f) Understanding of the audit firms' quality control procedures.

### **3. Direction**

The engagement team should be directed by the engagement partner and the audit senior.

An engagement planning meeting should take place in which the members of the team are informed of the following:

- a) Their responsibility including the need to comply with ethical requirements.
- b) The objectives of audit of financial statements.
- c) The objectives of the audit work to be performed.
- d) Risk related issues.
- e) The general audit methodology to be used.
- f) How to deal with the problems that may arise during the audit.

#### **4. Supervision**

Supervision should be continuous during the audit.

The senior members of the team should supervise the work of the junior members.

- a) To check whether they are following the audit programs.
- b) To track the progress of the audit.
- c) To address significant matters arising during the audit.
- d) To check whether the audit staffs are competent enough to carry out the work.
- e) To identify matters for further consultation.

#### **5. Consultation**

The engagement partners should arrange of consultation on difficult and contentious issues.

Some of the areas where consultation is required include:

- a) In application of a newly pronounced standard.
- b) When auditing organizations with complex reporting requirements.
- c) When there is disagreement with the management on accounting policy.
- d) When a qualified opinion is to be issued.

#### **6. Documentation**

All important aspects of the audit must be adequately documented i.e. the audit procedures carried out, the findings and the conclusions drawn.

In addition, areas where consultation was sought and the conclusions

arrived at should be well documented.

## **7. Monitoring**

This involves making a follow-up to check whether the quality control procedures are relevant and functioning effectively.

## **8. Review**

This is where working papers produced by the audit staff are checked by other members.

Types of quality control review

- 1) Hot review
- 2) Post-audit review
- 3) Second-partner review
- 4) Peer review

### 1. Hot review

This is regular review that takes as the audit is progressing where the working papers produced by the junior members of the audit team are checked by more senior members of the team e.g. audit manager.

#### **Purpose of the regular review**

- 1) To check whether the work has been performed in-accordance with the ISA's Audit plan and Audit programs.
- 2) To check whether the staffs are understanding the instructions.
- 3) To check whether the conclusions expressed are consistent with the findings.
- 4) To ensure that significant matters have been raised for consideration.
- 5) To check whether the staff are competent enough to continue with audit.
- 6) To check whether there is need to change the audit approach.

### 2. Post-Audit review

This is also as final review or overall review of the audit. This is the review that takes place after the audit has been completed but before the audit report is written and signed.

It is done by the engagement partner who has the ultimate responsibility for committing the audit firm when signing the audit report.

The engagement partner does the review in liaison with the audit manager.

### **Matters Considered During the Final Review**

- 1) Whether the financial statement comply with the relevant financial reporting framework.
- 2) Appropriateness of the accounting policies used.
- 3) Whether the presentation of the financial statement may have been influenced by the directors' desire to present the matters in a more favorable way.
- 4) The impact of the aggregate error.
- 5) The validity of the going concern assumption.
- 6) Significant subsequent events.
- 7) Other information in documents containing audited financial statements.
- 8) Consideration of whether the evidence gather in the course of the audit supports the audit opinion. This includes considering:
  - a) Whether all the planned procedures were completed.
  - b) Whether sufficient appropriate audit evidence has been gathered.
  - c) Whether the overall audit plan was followed.
  - d) Whether there were any consultations within and outside the firm and their outcome.
- 9) Performing final analytical review procedures.
- 10) Considering whether appropriate written management representations have been obtained.

### **3. Second partner review**

This is where an independent partner from the audit firm who did not take part in the audit is called upon to come and review the working papers and form an independent conclusion to see

#### **4. Peer review**

Peer review is an independent review of the audit firms auditing and accounting practices. It is classified into 2:

i) Internal peer review

ii) External peer review

##### **1) Internal peer review**

i) This is where a group of independent partners who did not take part in the audit will confirm that the quality control procedures were followed.

ii) Significant risks identified during the audit and the auditor's responses.

iii) Whether documentation reflects the work performed.

iv) Judgments with respect to materiality and risk.

v) Evaluation of the audit firms' independence towards the audit.

vi) Appropriateness of the proposed audit report.

##### **2) External peer review**

This is where another audit firm is engaged to check whether the audit firm in question follows quality control procedures and how relevant the procedures are.

#### **Objectives of peer review**

1) To promote compliance, with professional standards and other technical pronouncement.

2) To provide assurance to the users of the financial statement that professional standards have been followed in the performance of the audit.

3) To promote uniform application of professional practices.

- 4) To create a mechanism of continuous quality improvement in the professional practice.
- 5) To ensure that auditors are competent and independent.
- 6) To identify weaknesses in the audit processes and provide technical assistance for professional development.

### **Challenges faced by small firms of CPA's in implementing Quality control procedures**

#### **1. Consultation**

Small firms of CPA's may lack sufficient partners with sufficient experience for consultation.

Recommendation: make use of external consultation.

#### **2. Training**

Small firms of CPA's may not have sufficient resources to establish an in-house training function.

Recommendation: Sponsor the staff to attend external training programs.

#### **3. Competence and experience**

A small firm of CPA may lack the staff with the required competence and experience to carry out an audit engagement.

#### **4. Working papers**

A small firm of CPA may not have developed in-house set of audit manuals or working papers due to lack of resources.

**Recommendations:** Audit manual can be obtained from external firms or professional bodies.

Elements of a system of quality control as per ISQC 1

#### **1. Leadership responsibilities for qualities within the firm.**

The auditor firm should establish policies and procedures designed to promote an internal culture that recognizes the importance of quality in performing engagement.

The board of partners should assume the ultimate responsibility of the audit

firm's system of Q.C.

## 2. Relevant ethical requirements

The audit firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with the relevant ethical requirements which includes: confidentiality, objectivity, integrity, independence.

## 3. Acceptance and continuance of client relationship and specific engagements

The audit firm should establish policies and procedures for acceptance and continuance of client relationships and specific engagements designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagement where the firm:

- a) Is competent to perform engagement has the capacity, time and resources to do so.
- b) The firm can comply with the relevant ethical requirements.
- c) The firm has considered the integrity of the client.

## 4. Human resources

The audit firm should have policies and procedures designed to ensure that it has sufficient personnel with competence, capabilities and commitment to ethical principle.

In addition, the firm should assign responsibilities to those who are competent to perform it.

Examples of the procedures related to:

- ☐ Recruitment
- ☐ Performance evaluation
- ☐ Career development etc.

## 5. Engagement performance

The audit firm should establish policies and procedures to ensure

engagements are performed in accordance with the professional standards and the applicable legal and regulatory requirement and that the firm issues reports that are appropriate in the circumstances.

#### 6. Monitoring

The audit firm should establish policies and procedures to monitor the quality of the Q.C over time i.e. to check whether the quality controls are relevant, adequate and operating effectively.