

Practitioner's Guide to Audit of Small Entities



The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

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FOREWORD

Audit of small entities is one of the very important areas of professional assignments taken up by the members. I view its importance from at least two perspectives. First is that the small entities by themselves are a very integral and crucial component of the socio economic fabric of our country. Second is that audit of small and tiny entities are more often than not handled by small and medium practitioners, who also offer them many other professional services, like tax audit advisory. In a country whose almost two third professional practice landscape is marked by the presence of small and medium practitioners, small entity clients indeed are important for the growth of the Profession.

In the above context, it is however, essential to note that despite the relative simplicity in audit of financial statements of smaller entities, an member cannot ignore the essential principles laid out in our auditing standards. Rather, these principles need to be scaled to match the smaller size of the auditee. While all the Standards on Auditing contain separate guidance on their applicability to the smaller entities, a need for more comprehensive and detailed guidance was always felt.

I am happy to note that the Auditing and Assurance Standards Board is bringing out this Practitioner's Guide to Audit of Small Entities (including tiny enterprises), authored by an eminent and a senior member of the profession. I am also happy to see that the Guide has been written in a very lucid and simple to understand language and format, providing a step by step approach to audit of smaller entities in accordance with the Standards on Auditing issued by the Institute. The audit programmes, templates and illustrative formats given in the Guide would provide a necessary hand holding to the members in ensuring not only appropriate planning and execution but also documentation of the audit engagement.

I take this opportunity to compliment CA. Abhijit Bandyopadhyay, Chairman, Auditing and Assurance Standards Board, who has again, through this Practitioner's Guide, proved his commitment to reach out to the members, one and all, and help them to not only understand and implement Standards on Auditing but also to provide quality services to their clients. Also my compliments to CA. Puja Wadhera, Secretary to AASB for the issuance of this guide.

I am sure that the Practitioner's Guide will prove to be a very useful publication for the members undertaking audits of small or tiny enterprises.

December 10, 2010
New Delhi

CA. AMARJIT CHOPRA
President, ICAI

PREFACE

Contribution of large corporates and other forms of enterprises to the Indian growth story does not need any reiteration. Understandably, they have been the centre of attention for one and all, be it the investors, the financial analysts, the environmentalists or the government agencies and the regulators. This notwithstanding, the role that small enterprises have played in the socio economic development of the country is unquestionable.

The small enterprises have contributed not only in terms of generating employment and ploughing in the capital and other resources at the micro level but are also an essential support system to the larger enterprises. Besides, the very fact that they form a significant part of bank borrowers, means that they have, although indirect, access to the public money. In addition, they are an important contributor to the Government kitty in terms of the direct and indirect taxes that they pay. Thus, in more than one way, their financial health does impact the “public interest”. It is therefore essential that these small enterprises too are subject to checks and balances, importantly, a financial statement audit.

Though the operations of a majority of these small entities would be marked by uncomplicated and simple transactions, with limited revenue streams, what makes the financial statement audit of these entities peculiar is their lack of an appropriate accounting and internal control system. Absence of segregation of duties, mix up of personal financial transactions of the owners with the business transactions, increased possibilities of management override of controls are some of the critical issues that an auditor would need to consider in planning and performing the audit.

This Practitioner’s Guide to Audit of Small Entities is a step by step approach to an audit of such smaller enterprises, starting from engagement acceptance to engagement planning to conduct of audit and reporting. The Guide contains ready to use audit programme templates for audit of common financial statement audits. This will not only help practitioners in ensuring that, to the extent possible, all important concern areas are covered but also help ensuring appropriate audit documentation. In addition, the Guide also contains a separate section devoted solely to audit of tiny enterprises. The Appendices contain several illustrative letters and communications made in the normal course of an audit as well as a checklist to verify compliance with auditing and disclosures under the accounting standards.

At this juncture, I wish to express my sincere thanks to CA. Amarjit Chopra, President, ICAI as well as CA. G Ramaswamy, Vice President, ICAI whose vision, guidance and support I have been privileged to receive in the activities of the Board. I also wish to place on record my heartfelt gratitude to CA. Bhavani Balasubramanian, Chennai, who is also a special invitee to the Board for authoring the Guide.

Many thanks are also due to my Council colleagues at the Board, viz., S/Shri Rajkumar S Adukia, Vice Chairman, Sumantra Guha, P. Rajendra Kumar, Jayant P Gokhale, Jaydeep N Shah, Sanjeev Maheshwari, S Santhanakrishnan, J Venkateswaralu, Pankaj Tyagee, Anuj Goyal and the Central Government nominees, Shri Prithvi Haldea and Smt. Usha Sankar and also to the co-opted members at the Board, viz., K. Rajasekhar, Ganesh Balakrishnan, Samir Shah, Harinderjit Singh and T.V. Balasubramanian, for their dedication and support in charting the work plan of the Board and bringing it to fruition. I also wish to place on record my thanks to the special invitees to the Board, viz., S/Shri Nilesh S. Vikamsey, Sanjay Vasudeva, Amit Roy, R. Narayanaswamy, Prof. Vipul and Jaideep Bhargava who have taken time out of their far more pressing commitments to devote time to the activities of the Board.

My deepest gratitude is also due to the members of the study groups constituted in the Southern Region (at Chennai, Ernakulam and Coimbatore under the convenorship of CA. P. Rajendra Kumar) and Kolkata (under the convenorship of CA. Sumantra Guha), viz., CA. S. Ramesh, CA. R. G. Rajan, CA. N. Venkat Krishnan, CA. N. Sathiamoorthy, CA. K. R. Sathianarayanan, CA. P. Uttam Chand Jain, CA. Mahaveer Munoth, CA. P. Ravindranath Naidu, CA. S. J. Padmini, CA. Gopala Krishna Raju, CA. P. R. Aruloli, CA. R. Sivakumar, CA. J. Purushothaman, CA. Thomson Thomas, CA. Ittyrah M P, CA. Mohanan A, CA. Jomon K George, CA. Veeramani P M, CA. Vinod Kamath V, CA. Vivek Krishna Govind, CA. Vijay Narayan Govind, CA. Sajeev P G, CA. Stephen C Peter, CA. Venugopal S, CA. Prasanth Srinivas, CA. Pramod S H, CA. Rema C R, CA. Parvathy Ammal K, CA. Saji Mathew, CA. Mathew Joseph, CA. Minu Mathew, CA. Lakshmi Menon V, CA. Suresh T N, CA. Babu Abraham Kallivayalil, CA. Jose V X, CA. Divya C V, CA. Shanmukha Sundaram K, CA. Ramachandran S, CA. Badri Narayanan K, CA. Anantha Krishnan G, CA. Ramani P J, CA. Panneerselvan M P, CA. Sreenivasa Rao N G, CA. Ravi K, CA. Gopalakrishnan S A, CA. Ramnath V, in the Southern Region and CA. Krishanu Bhattacharyya, CA. Barun Ghosh, CA. Debashis Mitra, CA. Kunjan Mehta, CA. Sunil Singhi, CA. Krishanu Murari Tapuriah, CA. Nirupam Haldar, Kolkata, respectively, for sparing time out of their other preoccupations to provide inputs that have gone a long way in making this Guide more comprehensive and useful for the common members. I am also thankful to CA. Ravi Bharathwaj, Chennai for his contribution in finalising the Practitioner's Guide.

At the end I, however, wish to caution the readers that this publication is not a substitute for the text of the authoritative Standards and other professional pronouncements of the Institute of Chartered Accountants of India, nor does it in any way exonerate the practitioners from using professional judgment, due care and professional skepticism in conduct of their engagements. I am sure that the Guide will receive a warm welcome among the practitioners.

December 09, 2010
Kolkata

CA. ABHIJIT BANDYOPADHYAY
Chairman
Auditing and Assurance Standards Board

DISCLAIMER

This Guide is not a substitute for the authoritative literature, including Standards on Auditing and other Engagement and Quality Controls Standards and Guidance Notes, issued by the Institute of Chartered Accountants of India in respect of audit of financial information. The practitioners using this Guide are, therefore, urged to separately ensure that they are compliant with the applicable Standards and other relevant applicable pronouncements of the Institute while carrying out the audits.

The Guide also does not claim to be absolute and comprehensive. The practitioners are therefore also requested to ensure that the procedures adopted by them are sufficient to achieve the objectives of the audit engagement. The Institute does not take any responsibility for any action taken by the readers on the basis of the contents of this Guide.

PURPOSE OF THIS GUIDE

The purpose of this Guide is to provide a practical approach to implementation of the Standards on Auditing that may be followed while carrying out audit of small entities. Since the Guide is in the form of a checklist, it is also hoped that by using that checklist, the practitioner would be able to maintain appropriate documentation of the audit work.

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SECTION I

**PRACTITIONER'S GUIDE TO AUDIT OF
SMALL ENTITIES**