



**Centre for Financial Reporting Reform Governance
Global Practice**

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The Audit Pack for SMEs

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Audit Pack for SMEs



The « Audit Pack for Small- and Medium-Sized Entities », or « Pack SMEs »

Coming from ?

France CNCC in cooperation with the IRE - IBR

What for ?

A set of tools designed to enable the auditor to **plan** and **perform** audit procedures and to structure the approach on SME audit, in accordance with **International Standards on Auditing (ISAs)**.

The « Pack SMEs »



These tools have been prepared to **save you time** grouped in two categories:

« **structuring tools** »: considered to be essential to the audit approach, they should be used in all cases;

« **other tools** »: considered to be useful to the audit approach, they are selected depending on the situation, on the basis of the auditor's judgment.

This pack is not intended to be complete.

Phase 1 – Engagement acceptance



Before accepting an audit engagement, the auditor **assesses whether he can perform the engagement**, in compliance with :

- laws and regulations
- the Code of Ethics for Professional Accountants,
- the International Standard on Quality Control (ISQC1) and International Standards on Auditing (ISAs).

This pack is not intended to be complete.

Phase 1 – Engagement acceptance



In the context of Small- and Medium-Sized Entities, completing a **short questionnaire** facilitates the identification of the main risk areas that would call into question the engagement acceptance :

⇒ the **audit engagement check-list**

⇒ The auditor **meets** with the entity management

⇒ **Proposal for audit services** to document the matters discussed

Phase 1 – Engagement acceptance



With the predecessor auditor, requesting details about the end of his engagement and the obstacles encountered, if any, in performing his engagement.

>> Tools : Letter to the predecessor auditor



Phase 1 – Engagement acceptance



- with the client**, specifying the terms of the engagement
- > **the objective** and scope of the audit of the financial statements,
 - > the responsibilities of the **auditor**
 - > the responsibilities of **management**,
 - > identification of the **applicable reporting** framework used to prepare the financial statements,
 - > expected form and content of the **auditor's report**,
 - > **fees...**

Phase 1 – Engagement acceptance



With the predecessor auditor, requesting details about the end of his engagement and the **obstacles encountered**, if any, in performing his engagement.

With the audit team members, acknowledgement of independence

>> Tools : Engagement letter
acknowledgement of **independence**



Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning

The auditor obtains an understanding of the entity, including the **entity's internal control** to identify and assess the risks of material misstatements in the financial statements => consisting of two components: **inherent risks** and **control risks**.

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning

As a first step, the auditor performs the analysis :

-> at the overall financial statement level,

-> then at the audit cycle level for those cycles considered as material.

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning



Furthermore, in the **audit planning phase** and **throughout the audit**, the auditor considers :

- > the possibility that a **fraud** could exist

and

-> the risk of the **entity's ability not to continue as a going concern.**

For those purposes, he explains and documents those considerations within the entity in order to establish the audit plan.

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning



The required understanding to assess **inherent risks** includes:

- entity's industry, regulatory environment and other external factors,
- nature of the entity (operations, ownership, governance structure, types of investments, the way the entity is structured and how it is financed),

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning

- entity's selection and application of accounting policies,
- measurement and review of the entity's financial performance.

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning

The required understanding to assess **control risks** covers the internal controls relevant to the audit.

For each assertion

For each class of transaction,

For each account balance

For each disclosure in the financial statements, if considered as material, the auditor:

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning

- Identifies the **potential material misstatements**,
- searches for the **entity's controls** that can **prevent or detect those misstatements**, and consequently assesses **the risks of material misstatements**.

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning



In the context of Small- and Medium-Sized Entities, the assessment of the risks of material misstatements **is performed according to the entity's size** and the extent of **involvement of management** in the decision and control process.

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning

The appropriate tools for identifying and assessing the risks of material misstatements :

>> Preliminary analytical review

A preliminary analytical review used as a procedure to assess risks enables the auditor to identify **unusual transactions or events, amounts or trends** that might reveal risks of material misstatements or matters having an effect on the audit.

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning



To document the assessment of risks of material misstatements the auditor is provided with a structuring tool called « **Overall audit strategy and audit plan** ».

It is a multi-year tool to update **engagement** acceptance, and to complete in connection with the **risk analysis matrix** of material misstatements **per cycle** and **per assertion**

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning

Materiality and performance materiality

To put into practice the materiality concept appropriately when planning and performing the audit, the auditor **documents materiality** and **performance materiality adopted** for the audit:

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning

>> Risk analysis matrix



The risk analysis matrix is conducted in successive steps with **automatic transfer** of results as the analysis progresses: assessment of **inherent risks**, **internal control** and **tests of controls considerations...**

The **audit program** which provides **the link** between **identified material misstatements per assertion** and **planned audit procedures**.

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning



Illustrative examples are provided in the input boxes for each step: inherent risks, internal controls, substantive procedures. These examples should be tailored and supplemented according to the features and characteristics of the audit engagement

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning



In order to manage the engagement in the best possible way, and to confirm his initial assessment, the auditor

- **schedules the audit work,**
- **plans** the nature and extent of resources necessary to perform the engagement
- **monitors** time spent

>> **Audit scheduling**



Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning



To help documenting tests of controls, **tailored working papers** are offered to the auditor

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning

At the end of the phase of **identification and assessment of material misstatements**, the auditor **meets** with entity's management

- to present the risk analysis,
- to inform him of internal control strengths and deficiencies
- and present his recommendations.

Phase 2 - Identifying and assessing the risks of material misstatements & Audit planning



The report, **intended for the entity's management**, makes it easier to conduct the meeting:

Preliminary report on risks and entity's controls
(PowerPoint and Word versions)

Phase 3 – Risk response & Obtaining audit evidence



The auditor exercises **professional judgment** to assess whether sufficient appropriate audit evidence has been obtained, in order to obtain **reasonable assurance** that the financial statements are **free from material misstatement**.

Phase 3 – Risk response & Obtaining audit evidence

During the course of the audit, he considers whether he has to **revise** the nature, **timing** or **extent** of planned audit procedures, based on the **evidence obtained**.

In the context of Small- and Medium-Sized Entities, **lead sheets** provide an **essential link** between

- the audited financial statements

And

- the audit procedures performed.

>> Lead sheets

Phase 3 – Risk response & Obtaining audit evidence



To perform those audit procedures, the auditor is provided with various audit techniques, including:

external confirmations:

=> **Processing of confirmations** (*trade creditors (trade debtors, bank, lawyers;...*)

=> **Attendance at physical inventory counting questionnaire**

Phase 3 – Risk response & Obtaining audit evidence

The auditor is also provided with **tailored working papers** to design and document the audit field work and to highlight audit issues and misstatements identified

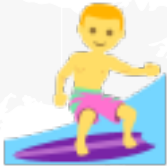
Phase 3 – Risk response & Obtaining audit evidence

=> Key ratios monitoring allows the auditor to ensure the consistency between **trends and evidence** obtained throughout the audit **regarding the entity** and the **relevant industry**

Phase 4 – Summary of the engagement and reporting the opinion

On the basis of the **evidence obtained** including the **results of the tests of controls** and the **substantive procedures performed**, the auditor prepares a **summary of audit conclusions** aimed at reaching a conclusion and **substantiating his opinion**.

Phase 4 – Summary of the engagement and reporting the opinion



In the context of Small- and Medium-Sized Entities, conducting this verification with a **tailored questionnaire** should allow the auditor :

-> to **check compliance**

-> to **document the approach on going concern,** subsequent events and communication with those charged with governance. .

Phase 4 – Summary of the engagement and reporting the opinion

>> **Completion questionnaire** *(including going concern, subsequent events and communication with those charged with governance)*



Phase 4 – Summary of the engagement and reporting the opinion



The auditor meets with the audit client on completion of the engagement to present the conclusions reached. The following report, intended for the entity's management, makes it easier to conduct the meeting:

>> Audit findings report (*PowerPoint and Word versions*)



Phase 4 – Summary of the engagement and reporting the opinion

The preparation of a **summary memorandum additional** to the audit findings report allows the auditor to decide

not only upon the opinion he will express

but also

upon the **engagement continuance** for the next period:

>> **Additional summary memorandum**



Phase 4 – Summary of the engagement and reporting the opinion

Before preparing the auditor's report on the financial statements, the auditor **obtains written representations** from his client **confirming** that he believes he has fulfilled his responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor,

=> **Management's representations**



Phase 4 – Summary of the engagement and reporting the opinion

Once those verifications have been obtained, the auditor decides how to report his opinion and prepares his report on the financial statements

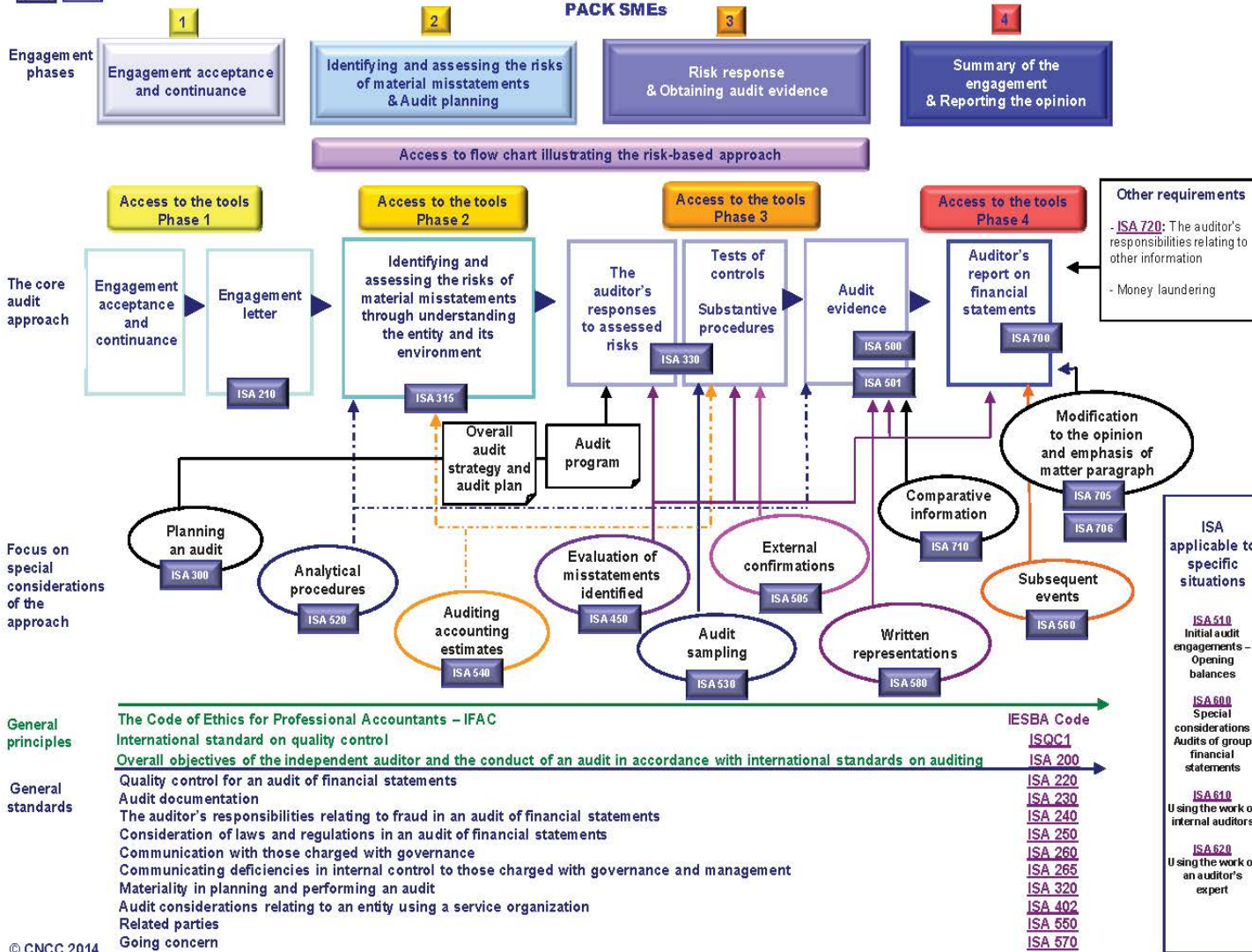
>> **Questionnaire to prepare the auditor's report on the financial statements**

>> **Auditor's reports on financial statements**



APPROACH TO AUDITING FINANCIAL STATEMENTS IN SMALL-AND-MEDIUM-SIZED ENTITIES

ISA version - March 2014



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