Standards on Auditing for smaller entities and tax audit

Presentation at the CPE Seminar organized by the Kozhikode Branch of SIRC of ICAI on 19 August 2022

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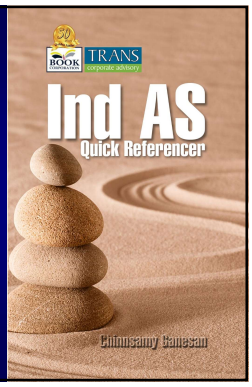


Structure of the discussion

- Whether Audit is really mandated for Smaller entities?
- Applicability of Standards on Auditing
- Key Standards and audit process

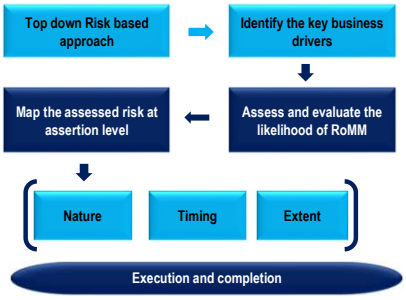
The driving factors

- Size should not influence the engagement (Audit is an audit anyway!)
- Audit of smaller entities may be mandatory under various situations
- Smaller entities may have complex transactions too
- Complete guidance to avoid litigations is provided by SAs

What services are provided to Smaller Entities

Nature of Service	Audit	Review	Agreed Upon Procedures	Compilation
Level of assurance provided by auditor	High but not absolute assurance	Moderate assurance	No assurance	No assurance
Report provided by auditor	Positive assurance on assertions and other specific reporting requirement	Negative assurance on assertions and other specific reporting requirement	Factual findings of procedures performed as agreed	Identification of information compiled

A simplified audit approach



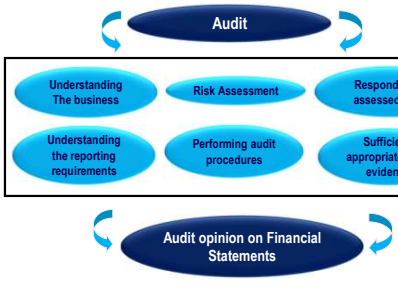
Special considerations

- Objectives of an audit of Smaller entities
- Audit Vs Taxation considerations
- Recent economic/ accounting developments
- Related Party Transactions
- Professional Scepticism
- Fraud risk and management override
- Laws and regulations impacting the client's business
- Sufficient, appropriate audit evidence
- External Confirmations
- Subsequent events

What may be the key requirements of Smaller entities?

- Audit of financial statements for smaller companies and for submission to banks and financial institutions for NCEs
- Audit under the Income Tax Act, 1961 for SMCs and SMEs
- Ensuring compliance with Income Computation and Disclosure Standards for SMCs and SMEs

What may be the key requirements of Smaller entities?



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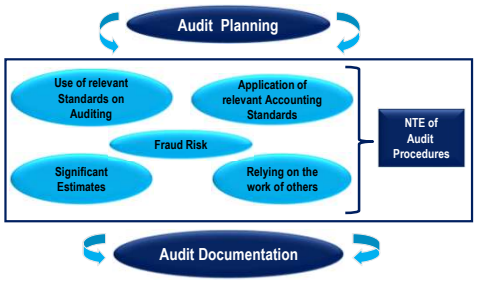


Test objectives – Assets and Liabilities

- **Existence** – does this account really exist?
- **Rights and obligations** – does account represent true ownership/liability?
- **Completeness** – is anything missing?
- **Accuracy, valuation and allocation** – is the information accurate?
- **Classification** – is the account correctly classified?
- **Presentation** – does it is fairly presented?

Test objectives – Transaction level

- **Occurrence** – did it really happen?
- **Completeness** – is anything missing?
- **Accuracy** – is the information accurate?
- **Cut off** – are the transactions have been recorded in the correct accounting period?
- **Classification** – is the transaction in the correct account?
- **Presentation** – is the transaction fairly presented?

Test objectives – Disclosures

- **Occurrence and rights and obligations** – did it really happen, and did it create true ownership/liability?
- **Completeness** – is anything missing?
- **Classification and understandability** – is the classification correct and is the meaning clear?
- **Valuation and allocation** – do all accounts reflect the appropriate amounts?

Key Standards on Auditing – Planning phase

- Agreeing the terms of audit engagements (SA 210)
- Consideration of laws and regulations (SA 250)
- Planning an audit (SA 300)
- Materiality in planning and performing an audit (SA 320)
- Preliminary analytics (SA 520)

Materiality

Overall materiality	Materiality fixed at the entity level to decide on material misstatement
Component level materiality	Materiality fixed at financial statement line items level
Materiality for trivial items	Materiality fixed to avoid aggregation risk

Materiality

- Often totally ignored concept in audit of private limited companies
- Audit opinion focusses on material misstatements only
- Accounting Standards are also driven by materiality
- If properly applied, will result of effective and efficient audit

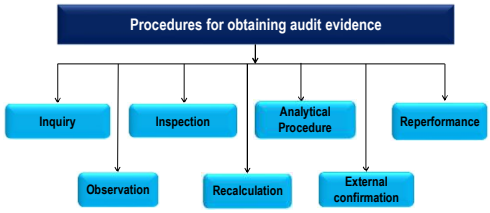
Key Standards on Auditing – Execution phase

- Audit evidence (SA 500)
- External confirmations (SA 505)
- Analytical procedures (SA 520)
- Audit Sampling (SA 530)

Key Standards on Auditing – Execution phase

- Auditing accounting estimates (SA 540)
- Related Party Transactions (SA 550)
- Subsequent events (SA 560)
- Using the work of experts (SA 620)

Evidence gathering procedures



Key Standards on Auditing – Completion phase

- Letter of representation (SA 580)
- Communication to those charged with governance (SA 260)
- Final analytics (SA 520)
- Forming an opinion and reporting (SA 700, 705 and 706)

Tax Audit and Standards on Auditing

- All key standards will apply
- Planning, execution and completion phases will be based on test objectives
- Focused both on financial statements and particulars to be given in Form 3CD

Tax Audit and Standards on Auditing

- Can I apply the concept of materiality in tax audits?
- Can I apply the concept of test check in tax audits?
- Whether letter of engagement is really required?
- Whether Form 3CA or Form 3CD needs modification as per SA 700?

Important clauses and their linkage with SA2

Clause 17 [Sec 43CA or 50C]	Clause 19 [Sec 32AC to Sec 35E]	Clause 20 [Sec 36 (1)]
Clause 21 [Sec 40 (a)]	Clause 21 [Sec 40 (b)]	Clause 21 [Sec 40 A (3)]
Clause 23 [Sec 40 A 2 (b)]	Clause 26 [Section 43B]	Clause 27 [CENVAT/ VAT/ GST]
Clause 31 [Section 269SS and 269ST]	Clause 34 [Chapter XVIIB]	Clause 40 (Ratios)

Clause 17

Where any land and building or both is transferred during the previous year for a consideration less than the value adopted or assessed or assessable by any authority of a State government referred to in Section 43CA or 50C.

Audit Considerations

- Obtain list of all properties held and transferred during the year
- Reconcile the amount of consideration received or receivable with the books and financials
- Copy of registered deed or lawyer representation (if not registered)

Clause 19

Covers Sections 32AC, 33AB, 33ABA, Sec 35, Sec 35AC, Sec 35AD, Sec 35CCA, Section 35CCB, Section 35CCC, Section 35CCD, Section 35D, Section 35DD, Section 35DDA, Section 35E

Audit Considerations

- Applicability Checklist
- Map the possible accounts in which the expenditure is booked in the accounts
- Specific Audit Procedures (Target test beyond a threshold limit)

Clause 20

Section 36(1)(ii) – provides for deduction of any sum paid to an employee as bonus / commission for services rendered where such sum would not have been otherwise payable to him as profit / dividend

Section 36(1)(va) – permits deduction of any sum received by the assessee from his employees to which provisions of sec 2(24)(x) are applicable, if it is credited to the account of employees on or before the due date

Clause 21

Clause 21

Use of data analytics using Excel or Tally based audit

Cash Payments
(No disclaimer is possible)

Bank Payments
(Refer Guidance note on tax Audit issued by ICAI)

Whether test check is still possible?

Clause 23

Clause 26

In respect of any sum referred to in clauses (a), (b), (c), (d), (e), (f) or (g) of Sec.43B

- Map the accounts which may have items covered u/s 43B
- Get the schedule of outstanding liabilities and review items for 43B
- Verify and document the subsequent payments
- Identify and document the date of payment and eligible claims during the year
- Document verification of pre-existed liabilities and the eligible claims during the year
- Document and reconcile the pre-exiting and current year outstanding with Financials

Clause 31

Section 269SS and Section 269T

- Map all accounts which may have impacted by Sec 269SS and Sec 269T
- Use of data analytics using Excel or Tally based audit
- Cash Payments (No disclaimer is possible)
- Bank Payments (Refer Guidance note on tax Audit issued by ICAI)
- Obtain the ledgers for loans or deposit taken and trace the date, transaction amount and maximum outstanding
- Reconcile the opening and closing balance to the financials

Clause 34

Chapter XVIIB and XVIIBB

- Map all accounts which may have impacted by TDS provisions
- Obtain and verify reconciliation with T... already ...
- ...d verify the ...or lower or Nil ...on for the payee
- Carryout ... document the ... performed
- ...ing in the audit report/ respective clauses the required disclaimers

The work has direct impact with items to be disallowed u/s 40 (a) (i) and 40 (a) (ia)

Please note that this information is already available with the department

Clause 40

Ratios

- For a non-company assessee, information may be available directly in the financials
- For a company assessee, we may have to prepare an analytical profit and loss
- Compare with the previous year ratios and check reasons for major variances
- If client uses retail method of inventory valuation, cross check the margins applied

Best practices

- Permanent and temporary files
- Use of checklists
- Training the audit team
- Consult, consult, consult
- Work paper review by senior partner

Checklists

- Accounting Standards Checklist
- Standards on Auditing Checklist
- Schedule III Checklist
- ICDS Checklist
- Tax Audit Checklist

Questions?

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Thank you

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