Anatomy of a 12-Hour ISA Audit:

An Assurance Specialty Service

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June 2010

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From bruised ego to trusted adviser

The culture shock was instantaneous. Literally overnight I went from managing the audits of two of Canada's largest companies to auditing some of Canada's smallest organizations. I switched, by choice, from an office of over 1,400 professionals to one with 2½. Talk about a fish out of water. I will never forget my embarrassment in that first week when a colleague dropped by unexpectedly at my new office and found me pouring over bank statements, certainly not the work of a professional accountant with 12 years' experience.

It took a while, but I slowly started to appreciate the change in professional environment. After the first few months the phone started ringing regularly (no Internet or e-mail back in those days): clients asking how to interpret financial statements, how to control transactions and inventory, how to handle board or management relations. Somehow I had transitioned from professional manager to trusted adviser. I loved my new role. And it didn't hurt that my income doubled in my first year.

That transition was 25 years ago. I have since come to understand that auditing a micro-entity[1] efficiently and effectively is truly a specialty in its own right. Many auditors could no more deliver the service in a cost-effective and timely manner than I could carry out the duties of an engagement partner on a listed-entity audit. Both require a special set of skills.

Pressure affecting audits of micro-entities

The audit of the micro-entity is currently under siege from two sides. There is pressure from regulators and financial statement users looking for cost-effective levels of assurance. Some are questioning the value of an audit of financial statements in accordance with International Standards on Auditing (the ISAs)[2] for micro-entities in relation to the cost. This is reducing the demand in some countries for audits. At the same time, many auditors are leaving the field of auditing altogether for supposedly greener (read: more profitable) pastures, thus creating a shortage of auditors. The combination of reduced demand for audits of micro-entities combined with fewer auditors to provide the service could sound the death knell for what in my experience is a valuable service for users and a potentially lucrative one for auditors.

Much has been written about the benefit of an audit for entities of all sizes. Just some of the benefits that are commonly cited are measurable decreases in cost of capital, increased efficiency

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[1] "Micro-entity" is defined for purposes of this paper in the definitions section, paragraph 6 of the following section.

[2] The ISAs are issued by the International Auditing and Assurance Standards Board (IAASB) and published in the "Handbook of International Standards on Auditing and Quality Control" by the International Federation of Accountants (IFAC). This publication may be downloaded free-of-charge from the IFAC website http://www.ifac.org/publications.

of social capital and providing assurance to trustees exercising fiduciary duty.[3] However, little has been written for the guidance and encouragement of auditors wanting to provide the service in a cost-effective manner. If there are too few trained auditors willing to perform audits of micro-entities, it doesn't matter how valuable the service is to users: it cannot be delivered.

I know from 25 years' experience not only that audits of micro-entities are a valuable service and definitely in the public interest, but also that they can be done efficiently and profitably. Statement users, regulators, management and auditors all benefit.

Evolution of professional standards

Another serious challenge facing auditors today is the massive change in professional standards that is just beginning to come into effect. In Canada, new financial reporting frameworks, such as International Financial Reporting Standards (IFRS) and Canadian Accounting Standards for Private Enterprises, will come on stream in 2011, new auditing standards will be effective December 15, 2010, and there is the possibility of an overhaul of ethical standards. Professionals are going to have to develop methods for incorporating the new standards into their engagements and for documenting conformity with them. The cost of retooling audit engagements will be significant.

Faced with such wholesale changes, auditors will likely do one of two things: invest significant time and effort in retooling or give up and move on to provide alternative services. Auditors will embrace the standards and retool their practices only if they know they can provide the audit service at a reasonable rate of return. If many professional auditors leave the field of auditing micro-entities, those entities will have difficulty obtaining the requisite assurance from an independent accountant on their statements. This will drive up the cost of assurance and result in economic inefficiencies.

This article provides guidance and encouragement to auditors who are considering entering the field of auditing micro-entities and those who want to increase their current engagement efficiency. The premise is that auditing micro-entities is a specialty in itself and not something just anyone trained in auditing can do efficiently. In short, this service is not for the "hobby auditor". I am speaking particularly to seasoned practitioners with good communication skills who are willing to invest time up-front to obtain a thorough understanding of the new audit standards. Knowing how to use the new standards effectively and combining this knowledge with industry specialization, practice automation and sector-appropriate staffing will result in greater efficiencies in performing audits.

[3] See for example Pitcher Partners, " The Value of an Audit to Small and Medium Sized Businesses", May 2010 http://tinyurl.com/2aowf98

Providing assurance services to the micro-entity sector is not for everyone, but I know from personal experience that those who choose to invest the time and effort can create a practice that is both rewarding in terms of client service and adequately compensates the auditor.

Empirical evidence not yet available

This article is based on my professional experience auditing micro-entities for the past 25 years, first-hand detailed knowledge of the clarified ISAs and conversations with practitioners from many countries and cultures over the past five years.[4] At the time of writing there is no empirical evidence to demonstrate whether or not practitioners have had difficulties implementing the ISAs or what those difficulties might be.[5] However, there is much anecdotal evidence from International Federation of Accountants (IFAC) member bodies that practitioners are concerned about the sheer volume of the new standards, many of which are new even for those who have based their audits on the pre-clarity ISAs up to now. The process of implementation should be fertile ground for academic research for some time to come.

[4] I have been the Canadian nominee member of the International Audit and Assurance Standards Board since 2006 and, by virtue of being the only full-time practitioner in a small firm on the Board for much of that time, have unofficially become the Small and Medium Practices (SMP) special-interest member.
[5] The clarified ISAs are effective internationally for full years beginning on or after December 15, 2009. Reliable information on implementation issues faced by users and auditors will likely not be available until 2013 at the earliest.

Performing a 12-hour ISA Audit Efficiently and Effectively

Introduction

Purpose and scope of this proposal

1. The purpose of this proposal is to provide guidance and encouragement to auditors considering performing audits of micro-entities in accordance with the ISAs. The guidance, adapted as necessary, may also be useful for audits of other entities. (Ref: Paras. A1-A2)

Effective Date

2. As soon as the auditor acquires a complete knowledge and understanding of all the clarified ISAs. (Ref: Para. A8)

Objectives of the Auditor of a Micro-entity

"Overall objectives of the auditor

3. In conducting an audit of financial statements, the overall objectives of the auditor are:

   (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

   (b) To report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings.

4. In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient in the circumstances for purposes of reporting to the intended users of the financial statements, the ISAs require that the auditor disclaim an opinion or withdraw (or resign) from the engagement, where withdrawal is possible under applicable law or regulation."[6] (Ref: Para. A3)

Specific objective of the auditor of a micro entity

5. The audit is intended to be completed in 12 hours or less. (Ref: Paras. A4-A6)

[6] These are the overall objectives of the auditor as stated in ISA 200.11 and 200.12.

Definitions

6. Micro-entity: an entity with the following characteristics
   - There is no position of Chief Financial Officer and often no full-time bookkeeper
   - Either those charged with governance or management are involved in running the entity on a day-to-day basis
   - The auditor has a role in assisting management to prepare financial statements
   - The engagement is not classified by the auditor as high risk and therefore does not require an engagement quality control review
   - The auditor will typically not place reliance on the entity's internal controls
   - Turnover is under US$1 million and there are 10 or fewer staff. (Ref: Para. A7)

Requirements

Preconditions for a 12-hour audit

7. The auditor shall obtain a complete knowledge and understanding of all the clarified ISAs before undertaking a 12-hour audit in accordance with those standards. (Ref: Para. A8-A19)

8. The auditor shall develop a practice specialty. (Ref: Para. A20-A25)

9. The auditor shall automate the audit practice. (Ref: Para. A26-A27)

Performing the 12-hour audit

10. The audit shall be performed by a senior assurance professional with experience in auditing micro-entities. (Ref: Para. A28-A32)

11. The auditor shall conduct the audit at the client's place of business unless impracticable. (Ref: Para. A33-A36)

12. The auditor shall communicate with the client at every opportunity. (Ref: Para. A37-A39)

13. The auditor shall use checklists in every audit. These checklists shall be customized to suit the engagement and reflect the experience of the staff conducting the engagement. (Ref: Para. A40-A46)

14. The auditor shall bill for all time incurred on the engagement at standard firm rates. (Ref: Paras. A47-A48)

Application and other explanatory material

Format and scope of the proposal (Ref: Para. 1)

A1. Performing a 12-hour Audit Efficiently and Effectively is written in the form of a clarified ISA. Readers finding this style of composition confusing are encouraged to read requirement #1, "*The auditor shall obtain a complete knowledge and understanding of all the clarified ISAs before undertaking a 12-hour audit in accordance with those standards.*" Of course that knowledge includes familiarity with the format of the ISAs.

A2. Much of the guidance extolling the benefits of specialization and automation in a practice is far from new. However, given that auditors must retool their audit methodology to fit the new standards, now is a good time to consider maximizing engagement efficiency by incorporating these ideas.

The objectives of the auditor auditing a micro-entity (Ref: Paras. 3-5)

A3. The overall objectives of an auditor in the audit of a micro-entity are the same as those of any auditor for an audit of any entity regardless of its size or nature; that is, to obtain reasonable assurance sufficient to report in accordance with the ISAs.

A4. The budget of 12 hours is not entirely arbitrary. It assumes that the field-work will be completed in one full day and that approximately two hours will be spent beforehand in planning and two hours for forming an opinion, final communication with the client and billing. This budget also assumes that this is not an initial engagement, which usually requires special one-time audit procedures, gaining knowledge and understanding of the client for the first time and preparing documentation that will be used in the initial and subsequent engagements.

A5. The budget of a recurring engagement might look something like this:

File roll forward, import trial balance, assist in drafting statements	1 hr
Communication with client[7], set audit date	1
Fieldwork on site, including:	
– Updating knowledge and understanding	
– Risk assessment and planning the response	
– Substantive testing and documentation	8
Financial statement review (forming the opinion)	1
Communication with client, billing, file assembly	1

[7] Client communication includes agreeing the terms of engagement, explaining the audit strategy and requesting preparation and assembly of information needed for the audit.

A6. This budget assumes dedicated on-site time by the auditor. It excludes time spent on-site on the Internet and making phone calls not related to that client.

Defining the term micro-entity (Ref: Para. 6)

A7. There is no international consensus on a definition of a micro-entity. A good starting point is the definition of *smaller entity* in the "Glossary of Terms" in the IAASB Handbook.[8] For purposes of this paper, the characteristics of a micro-entity include the following:

- There is no Chief Financial Officer position and often no full time bookkeeper
- Notwithstanding management's acknowledgment of responsibility for financial reporting, the auditor is usually requested to provide assistance with presentation of financial information in accordance with the applicable financial reporting framework. (i.e., the accountant has a role in drafting the financial statements)
- Either those charged with governance or management are involved in running the entity on a day-to-day basis
- As the engagement is by definition not a high-risk audit engagement, it will not require an engagement quality control review
- Turnover is under US$1 million and there are 10 or fewer staff. This is a somewhat arbitrary threshold, but in my experience, audits of clients with turnover greater than US$1 million and more than 10 staff generally cannot be performed in 12 hours or less.

[8] The definition reads as follows:

Smaller entity – An entity which typically possesses qualitative characteristics such as:

(a) Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and

(b) One or more of the following:

(i) Straightforward or uncomplicated transactions;
(ii) Simple record-keeping;
(iii) Few lines of business and few products within business lines;
(iv) Few internal controls;
(v) Few levels of management with responsibility for a broad range of controls; or
(vi) Few personnel, many having a wide range of duties.

These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.

Why you need to read and understand all the clarified ISAs (Ref: Paras. 2, 7)

A8. This requirement is not an option; it is fundamental. While it may seem obvious, its application is not. There are 630 requirement paragraphs in the ISAs and ISQC1 (I know because I have counted them). Many of these paragraphs themselves are compound requirements with the result that there are between 1,000 and 2,000 actual requirements in the ISAs. That intimidating number makes the process of "reading" the handbook daunting. But as explained below, the task can be made palatable.

A9. The ISAs have been written to cover the audit of financial statements and certain other financial information of all reporting entities regardless of size. Audits of micro-entities have many characteristics that differ from audits of, for example, large public companies. Does an auditor *really* have to read and comply with every ISA requirement in every audit? The correct answer is a conditional yes, but in practice, with some up-front work, this need not be nearly as onerous as it sounds.[9]

A10. Two examples will illustrate the point. First, several of the ISAs will probably not be relevant in almost all audits of a micro-entity. Examples are ISA 402, "Audit Considerations Relating to an Entity Using a Service Organization"; ISA 610, "Using the Work of Internal Auditors"; and ISA 600, "Special Considerations – Audits of Group Financial Statements". Second, many of the requirements in ISAs relevant to an audit of a micro-entity can probably be considered once, and if the conclusion is that they are not relevant to either the entity or relevant in the entity's jurisdiction, then they can be put to one side in future. Examples of requirements that are likely to be rarely relevant in audits of micro-entitles are:

- requirements covering non–ISA-compliant reports specified by law or regulation for entities requiring ISA-compliant audits (ISA 210.21);
- requirements to test the expectation that controls are operating effectively (ISA 330.08); and
- requirements when an engagement needs an engagement quality control review (ISA 220.19-21).[10]

A11. In summary, several of the 36 ISAs will not be relevant to the audit of a micro-entity and many requirements in relevant ISAs may need only the briefest consideration.

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[9] The standards are very clear. ISA 200.18 states: "The auditor shall comply with all ISAs relevant to the audit." Furthermore, ISA 200.22 states: "…the auditor shall comply with each requirement of an ISA unless…the requirement is conditional and the condition does not exist".

[10] See the IAASB staff publication, *Applying ISAs Proportionately with the Size and Complexity of an Entity*, which highlights how the design of the ISAs issued under the Clarity Project enables them to be applied in a manner proportionate with the size and complexity of an entity. http://web.ifac.org/clarity-center/support-and-guidance IAASB (August 2009)

Once they have been considered and determined not to be relevant, they can be ignored year after year unless engagement circumstances change.

A12. So why must the practitioner have a complete knowledge and understanding of all 630 requirement paragraphs in the ISAs before undertaking a 12-hour audit? The reason is that you cannot make a professional judgment as to what to leave out if you don't know what is in the standards in the first place. The question now becomes how best to obtain that knowledge.

Customizing the ISAs to fit your practice

A13. Many professional organizations, including my own, have instituted mandatory professional development for their members. Our firm of eight professionals usually attends two four-hour sessions a year on changes to audit standards. Is eight hours enough to acquire a complete knowledge and understanding of the newly adopted ISAs? No. It's not even close to being enough, especially since presenters often present their own methods of standards compliance and do not focus on the original wording of the standards. This will not give a complete knowledge or understanding of the actual requirements and the result could be inefficient and ineffective audits.

A14. In addition, many small and medium-sized firms base their audit methodologies on off-the-shelf third-party models. These generic models are often well put together but are designed for a wide variety of audit engagements. They are not customized for your clients, your culture or your style. Many also provide generic checklists that, while based on the ISA requirements, are often interpretations of the requirements as opposed to being the requirements themselves. Unless you have a complete knowledge and understanding of the standards themselves, how do you decide what parts of the programs and what checklists to include in your firm's audit methodology and, just as important, what to leave out?

A15. You need a very sharp focus to do the audit of a micro-entity efficiently and effectively. Unnecessary procedures add time that may not be recovered and can distract you from important issues. Ten unnecessary procedures in an audit with 100 procedures can result in a considerable amount of unproductive time. To develop a sharp focus you must first know the standards, and I cannot see how this can be done without a determined effort to actually read them. Would you commission a firm of architects to design your house if you knew no one in the firm had ever taken the time to read the actual building code but was just relying on the interpretive material of another professional? I think not. I contend that you cannot benefit from audit refresher survey courses or customize generic audit programs without first having read the standards themselves. The investment in time will pay off in efficiency of your audits.

Ways to read and understand the ISAs

A16. So how do you actually "read" the new standards? Volume 1 of the *2010 Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements* is a full 806 pages, and even to the initiated it is a tome[11]. Somehow you have to get through it. The standards were rewritten as part of the Clarity Project specifically to be easier to read. While the standards clearly state, "The auditor shall have an understanding of the entire text of an ISA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly" (ISA 200.19), the meat of the standards is in the requirements, which are only a fraction of the total material. You could start there. Let's take an example.

A17. ISA 210, "Agreeing the Terms of Audit Engagements", is 58 paragraphs long excluding the two appendices. However, only 16 of those 58 paragraphs are requirements. Let's look a little closer with an audit of a micro-entity in Canada in mind:

- Para. 6, agreeing the terms of engagement with management, is important and will be applicable in every engagement. For example, ISA 210.06(a) requires you to consider if the financial reporting framework is acceptable; this will always be relevant. If, however, you are using a generally accepted financial accounting framework, then the requirement will almost always be non-controversial.

- Reminding management of their responsibility for the preparation of statements and selection of accounting policies, etc. is also crucial; therefore 210.06(b) must be adhered to in every engagement.

- Paragraphs 210.07 and 210.08 deal with an imposed scope limitation and the situation where the ISA 210 preconditions do not exist. It is important to know what the requirements are in these situations; however, these situations are also likely to be few and far between for most audits of micro-entities.

- Paragraphs 210.09 and 210.10 require you to communicate the terms of engagement to management in a letter. Unless circumstances change from one

[11] You can download the original text of the ISA in the *2010 Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements* from the IAASB website at http://web.ifac.org/publications

year to another you only need to send this letter every year if you choose to (Para. 210.13).

- The rest of the section deals with changes to the terms of engagement in mid-audit (210.14 to 210.17) and the situation where laws and regulations supersede the ISAs (210.11, 210.12, 210.18-210.21). It is important to know that these requirements exist, but they are not likely to be relevant in most audits of micro-entities in Canada.

A18. To summarize, of the 16 requirements in 58 paragraphs in ISA 210, paragraphs .06, .09, .10 and .13 are essential, will apply in every engagement and should be in your audit methodology and incorporated into every audit. It is a lot less daunting to know you have to deal with four requirements out of 16 rather than with all 16 every time.

A19. In our firm, one person has been assigned to go through the ISAs in depth once to highlight those requirements we are likely to have to incorporate into our audit methodology in every case. That person will then hold a series of guided information sessions for all staff to pass on this information, referring at all times directly to the ISAs (12 one-hour sessions over the next six months – think of it as audit therapy). A Herculean task has all of a sudden become manageable.

Benefits of developing a practice specialty (Ref: Para. 8)

A20. Performing an audit on any set of financial statements requires an in-depth knowledge and understanding of the entity, its environment and the applicable framework for financial reporting. An auditor must invest significant time and effort to obtain and document this understanding when auditing any entity for the first time, regardless of its size. This is especially so when the new client is in an industry with which the auditor is not familiar. The efficiencies from developing an industry specialty seem obvious.

A21. For example, in Canada social agencies that provide services in the fields of childcare, social housing and immigrant settlement have much in common. Day-to-day expenses are largely related to personnel, and funding comes primarily from a single government source. In these fields, annual audits are generally mandatory in order for these organizations to secure funding. That, however, is where the similarities end. Each sector is governed by a different set of funding rules and regulations. Each government department has a different set of reporting regulations, and the politics of the day can have a significant impact on the future prospects of a sector. Finally, the assets and liabilities of organizations in the three sectors typically vary dramatically. Doing an audit in each sector requires three quite different approaches, and opportunities for efficiencies are reduced. But some of those inefficiencies can be overcome by concentrating on one sector.

A22. A practitioner with 20 audit clients in 20 industries is likely to spend more time on each audit than a practitioner with 20 clients in one industry. The 12-hour audit is predicated on not having to reinvent the wheel every time you open a file. Knowing the industry allows the practitioner to minimize the time needed to determine the areas where material misstatements are likely to occur and to focus audit procedures quickly on those areas. For example, knowing that no significant policy changes have occurred in social housing in the past year or, if they have, knowing what they are in advance, allows the auditor to focus both internal and external inquiries and substantive testing on entity-specific issues right away.

A23. Having a practice specialty also allows the practitioner to draw on his or her experience to design effective and efficient substantive tests in advance. Substantive analytical tests, such as grant funding per housing unit or parent fees per child, can be designed based on pre-test expectations to provide maximum evidential value.

A24. Finally, the days when a practitioner was able to have only one or two audit clients are rapidly coming to a close. The time and effort needed to comply with the new standards is likely to be too great to warrant the investment by "hobby auditors".

A25. Of course, the benefits of developing a specialty are not new. It is just that with the need to retool audit methodologies, the benefits are more apparent. Specialization makes more sense now than ever.

Benefits of automating your audit practice (Ref: Para. 9)

A26. The 12-hour audit cannot be achieved without automating your practice. By automation I mean using some form of usually commercial audit software that allows you to set up audit files easily or roll them over from the previous year, import trial balances directly to the software and generate financial statements to help management discharge its financial reporting responsibility.

A27. Again, the benefits of automation are not new. Automation has resulted in the biggest increase in efficiency in my audit practice over the past 15 years. Forty per cent of the total time needed to conduct the audit of a micro-entity used to be taken up by such tasks as creating lead sheets and entering a trial balance on 11-column sheets of paper by hand and copying carry-forward documentation from prior years' files. Now, with the use of audit software it is possible, often in less than half an hour, to roll last year's file forward, import the trial balance, and, after a telephone discussion with the client, issue the engagement letter and audit strategy letter electronically. Last year's documentation of the auditor's understanding of the industry, the entity's control environment, internal control relevant to the audit and identification of areas of likely material misstatement are rolled forward as part of the automated file set-up and are ready to be updated. In short, clerical preparation can be reduced to a very modest amount of time. This is an absolute time saving for the auditor.

Benefits of using the most senior assurance professionals available to audit micro-entities (Ref: Para. 10)

A28. Performing an audit in 12-hours requires that the auditor minimize the time needed to make professional judgments. Most decisions in the audit of a micro-entity can be made on the spot provided those qualified to make those decisions are there when the decisions need to be made. Of course some judgments will likely need more time for consideration. The flatter the hierarchy of the audit team, the more efficient both the making and the documenting of those judgments will be. For example, if the engagement partner does the fieldwork then most decisions can be made and documented once and usually need not be revisited. If a junior staff person does the fieldwork and reports to a manager, decisions big and small will need to go up and down the chain of command: from junior staff to manager to partner; back down to manager and junior staff for clarification; back up the chain again for approval. We have all known that to happen. In my experience, having more than two people involved in the audit of a micro-entity means the audit cannot be carried out efficiently. Having two professionals involved can be efficient if both are experienced, especially if they have worked together before. Having one person do all the work, preferably the engagement partner, is optimal.

A29. Now comes the question of the auditor's ego, and it is a very big issue. Many of us received our audit training in a hierarchical environment. As we were promoted, our responsibilities increased and our day-to-day tasks changed from the gathering of evidence to the evaluation and management of the evidence. Having the engagement partner do all the fieldwork, including examination of source documents such as bank reconciliations and invoices, will be viewed by many as regressive and possibly even demeaning. However, let's look at the audit of a micro-entity from the client's perspective.

A30. The objectives of an audit are clearly defined. Having said that, an audit of a micro-entity gives management of that entity an opportunity to obtain more than an opinion on a set of financial statements. I frequently arrive to perform an audit and am greeted by management with enthusiasm and a list of questions covering a myriad of areas that may or may not involve the audit directly. The usually brief conversation that follows provides an opportunity to answer those questions while allowing me to update my knowledge and understanding of the business, identify new areas of audit risk and generally focus my attention on what needs to be done over the day. Management gets a chance to go over issues on their mind and also concentrate on obtaining information needed for preparing financial statements.

A31. This direct communication is lost if there are two or more layers of auditors between the client and the engagement partner. The more direct the lines of communication, the more effective and efficient the audit will be. The question is, can an experienced audit professional accept the loss of status from having to do what was previously considered "junior accountant" work? Where this is possible the engagement can be carried out with maximum efficiency since decisions are made on the spot, and the service offered to the client can be maximized because senior professionals are there to answer questions.

A32. In some countries or firms it may be culturally unacceptable for an engagement partner to perform fieldwork directly[12]. The client's staff may also feel uncomfortable having such a senior person directly involved. When that is the case, the engagement partner should nevertheless attempt to keep the audit hierarchy as flat as is feasible given the culture of the client.

Benefits of performing the audit at the client's place of business (Ref: Para. 11)

A33. The audit of a micro-entity is still called a "shoe box audit" in many quarters. The client boxes up all the records and ships them to an auditor, who gets to them whenever there is nothing more pressing to do. The client gets a signed statement back with its box of documents. I maintain you can no longer do an audit in accordance with the ISAs in this manner.

A34. The standards have many requirements to communicate either in writing or orally with management and those charged with governance. Agreeing the terms of engagement, explaining the audit strategy, making inquiries to obtain knowledge and understanding of the entity and its environment, identifying controls relevant to the audit and understanding managements judgments, discussing audit adjustment and findings and reporting any deficiencies deemed noteworthy are just some of the requirements that involve actually communicating with your client. It's no longer enough just to put your head in a box of documents and come up with an audit report.

[12] For a discussion of cultural challenges in attempting to introduce non-hierarchical structures into hierarchical cultures, see: Geert Hofstede and Jan Hofstede, *Culture and Organizations: Software of the Mind* (New York: McGraw Hill, 2005).

A35. Doing the work at the client's office, especially if it is done by an experienced professional, allows for communication to be immediate, direct and effective. The alternative with the practitioner doing the work off site can result in delays, extensive emails and phone tag at best and miscommunication at worst. If the work is done on site and if it is done by the engagement partner or senior staff, you can create opportunities for serious efficiencies.

A36. Again, having senior staff doing the work on site may require a significant shift in style for many an auditors and in some cases may just not be culturally acceptable.

Benefits of communicating with your client at every opportunity (Ref: Para. 12)

A37. In the end, the audit of a micro-entity is as much about the people as it is about the numbers and notes. Financial statement users want assurance that the statements are presented fairly, but management is also usually looking for an interpretation of what the statements say about performance, as well as for constructive criticism on internal controls and any other matters the auditor deems significant. This other advice may or may not be directly related to the audit. It is these discussions and sharing of knowledge that is the cornerstone of client service to micro-entities.

A38. As mentioned above, the standards are at every turn full of the need to communicate, either in writing or orally, with management and those charged with governance. For many micro-entities the audit visit is one of the few opportunities in a year that management and those charged with governance will have to talk to a professional accountant experienced in their specific sector. The auditor is a valuable resource to the micro-entity. This is value added in any annual audit of financial statements.

A39. For this communication to be most meaningful, it needs to be direct (i.e., one-to-one) and timely. As mentioned above, the most efficient way for this to happen is to have the engagement partner perform the audit on site.

Using customized checklists strategically (Ref: Para. 13)

A40. At the time of writing, the ISAs and ISQC1 have 630 requirement paragraphs, which contain over 1,000 individual requirements. Some argue that compliance with every requirement must be documented in every file. In short, they believe the ISAs are not scalable per se (i.e. the audit of a micro entity requires consideration of the same number of requirements as an audit of a much larger entity). ISA 200.22 does require compliance with each requirement in every relevant ISA unless that requirement is conditional and the condition does not exist. However, ISA 230.08 only requires documentation sufficient to enable an experienced auditor to understand the basis for the audit conclusion.[13]

A41. The auditor needs to focus on documentation of procedures performed, results and evidence obtained, significant matters arising, conclusions reached and significant professional judgments made (ISA 230.08). This blanket requirement for audit documentation leaves a lot of scope for common sense. In the audit of a micro-entity there are many aspects of the audit that require documentation every time. For example, documentation that the auditor has obtained a knowledge and understanding of internal controls relevant to the audit, that representations from management have been obtained and that the audit strategy has been communicated to those charged with governance will be required in every audit. Using a checklist to document that the most essential elements of every engagement have been completed is a far cry from using a checklist to document that each and every one of the 1,000 plus ISA requirements has been considered and that the auditor has complied with all of those which are relevant to the audit[14].

A42. Auditors generally have a lot of experience using checklists. The lists that smaller firms use are often generic checklists produced by third parties for use by auditors in a wide variety of audit engagements. Many of the checklists are designed to be completed by junior accountants and reviewed by more senior assurance professionals. It is not surprising that so many experienced auditors are frustrated with having to fill out these type of checklists on every audit when, in fact, many of the points are reminders of steps they perform instinctively. The key to maximum efficiency is to prepare customized checklists that suit your needs and jog your memory to ensure that in each engagement you have not missed any essential steps.

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[13] ISA 230.08 states: The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:
(a) The nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements:
(b) The results of the audit procedures performed, and the audit evidence obtained; and
(c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

[14] If an auditor is concerned that a regulator might find an audit of a micro-entity deficient without such a checklist, then the auditor could list all the requirements that are expected to be not-relevant in virtually all audits of micro-entities, list them on a single schedule marked as “not relevant” and include that schedule in the back of every file every year. But the preparation of such a schedule would appear to make sense only if the regulatory risk of not having it was considered significant to the auditor’s practice (i.e. The risk that its absence would be seen by the regulator as a failure of the auditor to comply with the requirement to document the ISAs in the eyes of an experienced auditor).

A43. For example, assume you are an auditor with 15 years' experience and that you are performing the audit of a client for which you have performed the audit for several years. The client uses one bank account for all cash transactions, and no new risks related to cash have been identified. Do you need to complete a 10-to-15 step (or more) bank reconciliation checklist? Or could you not just review the bank reconciliation, verify significant reconciling items, confirm the bank balance, document this and move on? An extensive generic checklist in this case seems both unnecessary and inefficient.

A44. Having said this, strategic customized checklists do have an important place in every audit. Even experienced professionals need reminders to ensure they have fulfilled the key requirements of every audit. These critical-step checklists will vary depending on the specifics of a practitioner's client base and industry specialization, and they must be designed accordingly[15]. The questions in the checklists must focus on essential steps only, must be concise and must be easy to complete. They are intended to be answered by professionals with a complete knowledge and understanding of the ISAs so that, if unusual circumstances occur in an engagement, the auditor can respond appropriately.

A45. The key is to know what to include and, just as important, what not to include, in these checklists. In order to design suitable checklists you will need to have a complete knowledge and understanding of all of the ISAs. (See Para. 7.)

A46. In my practice I have found that using three short checklists, one at the end of each of the planning, fieldwork and forming-an-opinion phases of every audit helps me ensure none of the steps crucial to every audit have been missed. I complete the checklists by hand to be sure I concentrate on answering the questions. I have included examples in the Appendix that follows.

Reasons for billing all professional time incurred at standard firm rates (Ref: Para. 14)

A47. Many auditors have the impression that micro-entities either cannot or do not want to pay for time spent in performing audit services. This has not been my experience for the past 25 years. In fact, bills submitted to my not-for-profit clients tend to get paid promptly because payment of annual audit fees is in the budget. Also, unlike some private companies where the owner's cash flow often takes precedence over creditors not considered essential to day-to-day operations, audit fees are paid along with those of all other creditors.

[15] For an excellent description of the need for and use of strategically designed checklists for professionals, see Atul Gawanda¸ *The Checklist Manifesto: How to Get Things Right* (New York: Macmillan, 2009).

A48. There are at least four compelling reasons for a practitioner to bill all time incurred:

1) You have invested the time and money necessary to develop a sound audit methodology, you are capable of providing efficient audits and auditing micro-entities is your specialty. Billing for that effort is your tangible reward for good client service. Are you more inclined to give prompt and efficient service to clients that pay for that service or to clients that do not pay full fare? Offering discounts can result in corners being cut so that the auditor can move on to recoverable work. There are not many corners to be cut in a 12-hour audit.

2) Billing for all time incurred (i.e. not allowing discounts) imposes both discipline and efficiency on a practice. If time on an audit was significantly over budget then there was either (i) a problem on the audit which, because a senior assurance professional performed the audit on site and communicated the problem to the client at the time, is fully billable; or (ii) there was a problem with your performance of the audit for which the client is not responsible; i.e. it is not billable time in the first place and ergo, all the billable time is billed.

3) Audits are scalable and so are audit fees. If you spend 120 hours on an audit, would you normally bill only 100 hours? If the answer is no, then why would you bill 10 hours for a 12-hour audit of a micro-entity?

4) Most important, look at what the micro-entity client has received in an efficiently run 12-hour audit: an opinion on its financial statements and likely some significant assistance with the preparation of those statements, an onsite visit from an assurance professional experienced in their field of operations, information about the audit and significant results noted in the process, probably some discussion of financial performance over the past year and a chance to ask finance questions along the way. Clients are willing to pay for this service. You should bill for it.

Appendix i

PRE-ENGAGEMENT CHECKLIST

Client:______________________________

Year end:________________________

Question	Audit procedure	Conclusion	File reference	ISA reference
1) Does client management understand and is it willing to accept its responsibility for statement preparation and internal control necessary to prepare those statements?	Engagement letter signed and obtained before or on the day of commence-mint of the engagement.			210.06(b)(i & ii) 300.06(c)
2) Is the financial reporting framework acceptable for purposes of the engagement?	Discuss with manage-ment the applicable financial reporting framework to be used.			210.6(a)
3) Is the turnaround time for the audit adequate to obtain sufficient appropriate audit evidence?	Determine turnaround time from availability of books and records to need for final statements.			
4) Do members of the engage-ment team collectively have sufficient expertise and time available to perform the audit?	List any special expertise required for the audit.			220.15 300.05
5) Have those charged with governance been advised who is responsible for the audit and been given an overview of the planned scope and timing of the engagement?	Audit strategy letter sent to those charged with governance prior to commencement of procedures.			260.14 300.07 300.08
6) In your opinion, (i) can you; and (ii) do you want to accept this audit engagement?				
Checklist prepared by:	Date:	Comments:		

Appendix ii

RISK ASSESSMENT AND RESPONSE CHECKLIST

Client:______________________________

Year end:________________________

Question	Audit procedure	Conclusion	File reference	ISA reference
1)Have results of initial enquiries of management and analytical procedures been factored into identification of areas of risk of material misstatement?				315.06
2) Have the actions decided by the team in discussions on planning and susceptibility to material misstatements and fraud been factored into the design of substantive audit procedures?				240.15 300.05 300.09 315.10
3) Were controls identified designed appropriately and implemented throughout the period of the audit?	Steps performed in addition to inquiry of management (walkthrough)			300.13
4) Have the results of evaluation of the control environment been adequately factored into the design of substantive audit procedures?				300.15
5) Have the controls over IT systems been considered?				300.21
6) Have further audit procedures been designed to address identified risks of material misstatements in general and significant risks, and revenue completeness specifically?				300.25
Checklist prepared by:	Date:	Comments:		

Appendix iii

FORMING AN OPINION CHECKLIST

Client:______________________________

Year end:_________________________

Question	Audit procedure	Conclusion	File reference	ISA reference
1) Are the results of the analytical procedures performed at the end of the engagement consistent with your understanding of the entity?	• Design end-of-engagement analytical procedures. • Evaluate consistency with understanding			520.06
2) Have you obtained significant appropriate audit evidence to support you conclusions for all identified significant risks, including completeness of revenue?	• For each significant risk, review the conclusions reached in light of the analytical review performed in (1)			700.11 315.27
3) Have all recorded and unrecorded adjustments been discussed with management?	• Document the results of the discussion.			700.11
4) Do the financial statements contain all disclosures required for fair presentation?	• Read the financial statements prior to finalization and consider whether they present fairly			700.14
5) Is the form of opinion appropriate in the circumstance of the engagement and the evidence obtained?	• Compare the opinion with the conclusions drawn in points 2-4			700.16-700.19
6) Have all items of significance identified in the audit been reported in writing to those charged with governance?	• Document in the file points communicated to management			265.9

Checklist prepared by:	Date:	Comments: