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Sonargaon University (SU)
সোনারগাঁও ইউনিভার্সিটি (এসইউ)

An Internship Report on

External Audit Procedure: Evidence on Small and Medium Enterprise in Bangladesh

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External Audit Procedure:
Evidence on Small and Medium Enterprise in Bangladesh

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In partial fulfillment for the degree of
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Letter of Transmittal

30 November 2022

Farjana Yeasmin Chowdhury
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Subject: Submission of Internship/Thesis Report.

Dear Sir,

It is my utmost pleasure to present my internship report on "**External Audit Procedure: Evidence on Small and Medium Enterprise in Bangladesh**". The report is a prerequisite for completing my Bachelor of Business Administration at Sonargaon University. The need to familiarize the readers of this report with the audit procedure followed in Bangladesh followed by a chartered accountant firm for a small and medium enterprise is the aim of this report. Attempts of the utmost level were taken to gather relevant information and make this report as analytical and reliable as possible. The internship program has allowed me to explore and comprehend the work and difficulties auditors face in their line of work.

I, therefore, would be grateful if you can enlighten me with your perspective on the report and assess my report while keeping the limitations in mind. I would also like to thank you for your continuous guidance and support.

Yours Sincerely,

Md. Abu Bakker Siddque
ID: BBA 2003021054
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Certificate of Supervisor

This is to certify that the thesis paper "**External Audit Procedure: Evidence on Small and Medium Enterprise in Bangladesh**" has been prepared as a part of completion of the BBA program from Department of Business Administration, Sonargaon University (SU), carried out by Md. Abu Bakker Siddque, bearing ID: BBA 2003021054 under my supervision. The report or the information will not be used for any other purposes.

I wish him every success in life.

…….. ……

Farjana Yeasmin Chowdhury
Lecturer
Department of Business Administration
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Declaration

I, Md. Abu Bakker Siddque, the student of Bachelor of Business Administration, bearing the ID: BBA 2003021054, would like to declare that the internship report titled "**External Audit Procedure: Evidence on Small and Medium Enterprise in Bangladesh**" has been prepared solely by me under the supervision of my supervisor, Farjana Yeasmin Chowdhury (Lecturer), Department of Business Administration, after the completion of the internship program at Mahfel Huq & Co. Chartered Accountants. I further affirm that the work reported in this report is original and no misinformation has been submitted anywhere for any purpose.

The report has been prepared and submitted for academic purposes only and it is a requisite for the completion of a Bachelor of Business Administration at Sonargaon University.

Preparing the report has enriched my knowledge on a professional level and has allowed me to relate the theoretical aspects to practical ways of doing things. I express my sincerest gratitude for having been allowed to prepare this report and I enjoyed doing so.

Letter of Authorization

I Farjana Yeasmin Chowdhury authorize you for your internship report course INT431. I have chosen your topic based on the major side of your BBA program, which is "**External Audit Procedure: Evidence on Small and Medium Enterprise in Bangladesh**". I also wanted to thank Mahfel Huq & Co. Chartered Accountants to allow me to do the internship program in their organization.

……

Farjana Yeasmin Chowdhury
Lecturer
Department of Business Administration
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Acknowledgment

On the very first note, I would like to express my gratitude to Allah for the special blessings in completing the report.

It has been an honor to work with a group of highly enthusiastic people, who have contributed something of theirs to this paper. There are certainly some special ones who cannot go without mention.

Firstly, I express my humble gratitude and indebtedness to my respected internship supervisor, Farjana Yeasmin Chowdhury, Lecturer, Department of Business Administration, Sonargaon University for her guidance, suggestions, encouragement, and cooperation during the internship period and preparation of this report. I also thank her in advance for sparing her valuable time to read this paper.

Furthermore, I want to thank my organizational supervisor, Mr. Md. Abdus Satter Sarker, Partner, Mahfel Huq & Co. Chartered Accountants; for giving me the required information and also for permitting me to work with the statutory audit team and for their constant supervision and constructive opinions that have augmented my learning and enriched this report. They have devoted a mentionable amount of time to guide me all through. Without their help and support, this paper might not have been a comprehensive one.

I am affluent that I received sincere guidance, supervision, and cooperation from various respected people during preparing this report.

Finally, I would like to thank Sonargaon University for allowing experience self-development through practical experience.

Executive Summary

The report titled "**External Audit Procedure: Evidence on Small and Medium Enterprise in Bangladesh**" is the accumulation of the experience during the internship period. This report aims to showcase the procedures and processes that are followed by auditors during an external audit and procedures followed by Mahfel Huq & Co. Chartered Accountants, where the internship had taken place. The report has been segmented into eight different chapters.

Chapter 1 covers the purpose and the reasons for which the report has been prepared and covers the difficulties that were faced when preparing this report. It also covers the sources of information that were made used to complete the report.

Chapter 2 covers the methodology followed for the collection of data and information and the basis of report preparation. The approaches and functioning processes considered in conducting this study.

Chapter 3 is the culmination of my four years of theoretical knowledge at Sonargaon University. It represents the accumulated knowledge that was earned about auditing of SMEs during the times spent at Mahfel Huq & Co. for internship.

In **chapter 4**, the procedures for engaging in an audit of SMEs in Bangladesh are discussed in detail. This chapter discussed what and how an audit procedure should be conducted for SMEs and the steps to be followed during an audit until a reasonable conclusion is reached.

Chapter 5 discusses the problems that are involved when conducting an audit and the difficulties that auditors face during the audit. Few findings were discovered as the allotted time was not enough and due to other difficulties mentioned in the limitations part of chapter 1.

Chapter 6 discusses the possible solution to some of the problems through recommendations, included in this chapter. The profession of chartered accountants is noble and daunting and given the current development of Bangladesh, their numbers will hopefully grow in the days to come which may facilitate the audit procedure for SMEs.

List of Acronyms

BBA	:	Bachelor of Business Administration
INT	:	Internship
SME	:	Small and Medium Enterprise
FCA	:	Fellow Chartered Accountant
ICS	:	Internal Control System
ICAB	:	Institute of Chartered Accountants of Bangladesh
GAPP	:	Generally Accepted Accounting Principles
CAATTs	:	Computer Assisted Tools and Techniques
IFAC	:	International Federation of Accountants
CA	:	Chartered Accountant
BSEC	:	Bangladesh Securities and Exchange Commission
ASB	:	Auditing Standards Board
APM	:	Audit Practice Manual
ISA	:	International Standards on Auditing
IAS	:	International Accounting Standards
IFRS	:	International Financial Reporting Standards
IESBA	:	International Ethics Standards Board for Accountants
VAT	:	Value Added Tax
EBITDA	:	Earnings before Interest, Taxes, Depreciation, and Amortization
IT	:	Information Technology
FS	:	Financial Statement
PIE	:	Public Interest Entity

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Chapter 01: Introduction

1.1 Introduction

In today's world, academic education is not adequate to enable a student to complete with confidence and reach his/her goal without having experience with the outside world. To have an idea and gain experience, we, the students of the Faculty of Business Administration, Sonargaon University have to undertake a four-week internship program at any organization.

As a part of my BBA program, the four weeks internship program allowed me to have a piece of practical knowledge on the auditing procedure of an SME organization. The assignment was on how a chartered accountancy firm performs an audit and also to gain knowledge and practical experience on how audit work is performed in SME organizations.

To face a much more complex and challenging business world in challenging business areas, practical knowledge is essential to expand our theoretical base. To gather this practical knowledge, we were forwarded to different organizations after completing BBA Program. As I have an intention to become a chartered accountant, I was forwarded to Mahfel Huq & Co. Chartered Accountants, a prominent chartered accountancy firm in Dhaka.

The study allowed me to observe and perform real-world knowledge about the audit procedure, which is followed by the chartered accountancy firm. During the internship period, I could relate the theoretical knowledge of auditing to practical exposure.

Although audits are generally considered stressful events, a lot of valuable information can be gained from these financial exercises. Internal and external audits are performed for a variety of reasons. Both can help pinpoint areas where a small business is lacking in internal controls, operational efficiency, or regulatory compliance.

Small and Medium Enterprises can gain a lot from having a better understanding of their financial position. Benefits of regular audits include improved interest rates, increased protection from risk and legal liabilities, and access to more capital. A financial review or audit can also give a business owner a better understanding of how their business operates, uses cash, and assumes the risk.

An external audit is an independent examination of a company's financial statements. Audits assure financial stakeholders that the company's financial statements are free from material errors. Information obtained during an audit can be used to help strengthen and grow the business.

External audits are required to be undertaken by registered companies and conducted by an auditor who is independent of the business. The auditor reviews the business' financial statements to draw an opinion on whether it is prepared and presented in accordance with applicable financial reporting standards and to give a true and fair view. Other reasons for audits include suspected fraud, employee theft, and operating inefficiencies.

A clean audit opinion from a qualified external auditor can help SME businesses gain the confidence of investors, customers, and business partners.

1.2 Background of the Study

The BBA program has equipped students with the theoretical knowledge that a business graduate should know, however, the scenario at the workplace can be very different than those described in textbooks. Work experience is vital to bringing that knowledge to completion and that is why an internship is requisite for the completion of our undergraduate program. The goal of placement is:

- To learn how chartered accountancy firms operate an audit.
- To acquire extensive knowledge about the audit practices followed by SMEs.
- Learn how the audit procedure is formulated and how it is implemented.
- Achieving versatility.
- Learn about the performance of fieldwork during the audit.

1.3 Origin of the Study

The internship is one of the main courses at Sonargaon University. To become a graduate of Sonargaon University, Bangladesh, a student must complete his internship course. Generally, the program requires all students to attend an internship under a firm, organization, institution, or multinational company to get familiar with and skilled in the real professional world. The course as a whole provides students a realistic capability where theoretically gained information could be employed and become familiar with the professional atmosphere of any industry that makes individuals a handy self-confident to enter professional life and construct the groundwork of their carrier.

An internship report is a prerequisite for the finishing point of the BBA degree. The principal goal of the placement was to deliver an on-the-job experience to the student and a prospect for interpretation of theoretical ideas into real-life circumstances. To fulfill this requirement, I was sent to Mahfel Huq & Co. Chartered Accountants to perform my internship under the mentorship of two highly qualified mentors. A teacher is selected from the institution internally and another one is from the internship firm or company for four months.

My report is the outcome of the internship effort and understanding gathered during the time of my working at Mahfel Huq & Co. Chartered Accountants in the Audit and Assurance department. The study was focused on External Audit Procedure: Evidence on Small and Medium Enterprise in Bangladesh. Based on my working experience during this period, I have prepared my internship report under the supervision and guidance of Farjana Yeasmin Chowdhury, Lecturer, Department of Business Administration, Sonargaon University.

1.4 Rational of the Study

This report has been prepared as a requirement of the internship program after completing the BBA program at Sonargaon University. I could relate the processes with the classroom knowledge and was also introduce to different practices yet to know. On the other hand, the University Internship program is an integral part of the BBA program. To minimize the gap

between theoretical knowledge & practical one is required to work on a specific topic acquired during the internship program. This report is on the Audit Procedure for SME organizations applicable and practiced by Mahfel Huq & Co. Chartered Accountants where, I, Md. Abu Bakker Siddque was engaged in completing the internship program under the guidance of my faculty supervisor Farjana Yeasmin Chowdhury and organization mentor Md. Abdus Satter Sarkar, FCA.

It is obligatory to undertake such a task for the students who want to complete their BBA degree successfully. The importance of this issue and the requirement of my course completion lead me to conduct this.

1.5 Objectives of the Study

1.5.1 General Objective

The general objective of the assignment is to

- Carry out of partial requirement of the degree of Bachelors of Business Administration.
- Provide knowledge regarding procedural and functional activities performed in various areas of organization.
- Enable the students to compare theoretical ideas learned in the class room within the work of corporate world experiences.
- Enhance students' intelligence and competence skills concerning solving the Complex and difficult problems relating to their areas of interest.

1.5.2 Specific Objectives

The internship project sought to accomplish the following specific objectives –

- To obtain an understanding what audit procedures should be applied to operate an audit.
- To obtain widespread knowledge about the audit standards applicable to auditing an SME organization's financial statements.
- Identify the ethical principle required to conduct an audit procedure.
- Responsibilities of the auditors regarding financial statements and auditing.
- How do the outcomes of the audit procedures translate into auditors' opinions?
- Develops transversal behavioral skills such as interpersonal relationships, self-confidence, self-restraint, working approaches, capacity to meet deadlines and schedules, ability to take part in organization values, groups, and work teams.

1.6 Limitations of the Study

This study is conducted with the view of identifying the complete external audit procedure of an SME entity's financial statements. Not only did I get many opportunities but also faced some obstacles during my assignment. The limitations of the study I realized during my journey were as follows:

a. As a matter of fact three months is too short after that I had tried to give best effort to my learning purpose. Time constraints restrict the organization of audit procedures practically followed.
b. Confidentiality creates obstacles to disclosing several information.
c. Difficulties face to identify some procedures as there is some conflict between standards and legal framework.
d. It is quite difficult to accumulate all procedures in one report as they are so widespread to some extent.
e. Understandability is another constriction as there are so much jargons used in standards
f. Information about audit practices of firms regarding SME organization are limited because many of the information are confidential.

1.7 Methodology

The Study I was to undertake was both descriptive and explanatory type of study. This is because the study aims not only to provide descriptive information on the structure of external audit procedures for SMEs but also intends to explain the extent this system is effective in relation to standards and principles.

This report has been prepared on the basis of experience gathered during the period of internship and my own learn and understanding. The entire process has been made by collecting secondary data which played a vital role and easy to write down the report and was needed for supportive structured buildup to the report.

1.8 Source of the Information

Information has been collected from secondary sources such as International Standards on Auditing (ISA), International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), Audit Practice Manual (APM) ICAB, various books, published journals, articles, research paper, internet website, audit reports, Policy and Procedures, and Annual report of companies.

Chapter 02: Profile of SME

2. Profile of SME

The existing definition of SME is recommended by Better Business Forum and accepted as a uniform one by the Ministry of Industry and Bangladesh Bank. Criteria of the definition of SME are given below:

2.1 Definition of Small Enterprise:

Small Enterprise refers to the firm/business which is not a public limited company and complies with the following criteria:

Serial No.	Sector	Fixed Asset other than Land and Building (Tk.)	Employed Manpower (not above)
01.	Service	50,000-5,000,000	25
02.	Business	50,000-5,000,000	25
03.	Industrial	50,000-15,000,000	50

2.2 Definition of Medium Enterprise:

Medium Enterprise refers to the establishment/firm which is not a public limited company and complies with the following criteria:

Serial No.	Sector	Land and Building (Tk.) Fixed Asset other than	Employed Manpower (not above)
01.	Service	5,000,000-100,000,000	50
02.	Business	5,000,000-100,000,000	50
03.	Industrial	15,000,000-200,000,000	150

Today, SMEs play a significant role in the national economy. Roughly 80% of industrial employment, 90% of all industrial units, about 45% of manufacturing value addition and about 25% of the labor force are all accounted for by them. Their overall contribution to export revenue ranges from 75% to 80%. The majority of the SMEs that make up the industrial sector, which accounts for 31% of the country's GDP, are small and medium-sized businesses.

According to estimates, Bangladesh has 7,900,000 small and medium-sized businesses. 93.6 percent of them are little, and 6.4 percent are medium-sized. There are, according to the 2003 Private Sector Survey, about 6 million micro, small, and medium-sized businesses with fewer than 100 employees. The majority of SMEs—60 to 65 percent—are dispersed throughout regions other than Chittagong and Dhaka.

2.3 Adequate Accounting Records

To provide sufficient competent evidential matter, an entity’s accounting system should be designed to identify the types of transactions executed so that the transactions can be recorded in the appropriate amounts in the correct accounting period. Accounting records should include the following information:

- **Type of transaction:** Transactions should be described in sufficient detail to permit appropriate classification in the financial statements. Generally, accounting records need only indicate broad classes of transactions such as sales or payroll. In some circumstances, however, a more detailed description may be necessary, such as when payroll costs are to be allocated between inventory and expense. Identification of the type of transaction may be either explicit (for example, by using preprinted forms that describe the type of transaction, such as sales invoices) or implicit (for example, by using cash register tapes as a record of cash sales).

- **Size of transaction:** Transactions should be described in a manner that permits the recording of monetary value in the financial statements. Although accounting records generally include the dollar amount of transactions or the quantities involved and related unit prices, an indication of quantities only may be sufficient if the monetary value of transactions can be determined by reference to data such as price lists, wage rates, or contracts.

- **Period of time:** Accounting records should include the period in which the transactions occurred to permit the recording of transactions in the appropriate accounting period.

The form of accounting records maintained by the client and the detail in which they are prepared varies because of a number of factors, such as the nature of the client's business, its size, and its organizational structure. For a small business to be auditable there should exist adequate accounting records to identify the types of transactions executed and to record them at the appropriate amount in the correct accounting period.

Many small businesses do not have elaborate accounting systems. Likewise, most small businesses have neither adequate segregation of duties nor sophisticated internal control systems. Neither a formalized and complex accounting system nor a sophisticated control system is required for a small business to be auditable.

2.4 Audit of SME

Every SME company who is limited by shares have mandatory requirement for Audit in accordance of the Companies Act 1994. For SME an audit helps to improve the quality and reliability of information, giving investors faith in and improving the reputation of the market. Audit also creates others attributable for SME organizations as follows:

- Independent scrutiny and verification may be valuable to management.
- An audit may reduce the risk of management bias, fraud and error by acting as a deterrent.
- An audit enhances the credibility of the financial statements, e.g. for tax authorities/lenders.
- Deficiencies in the internal control system may be highlighted by the auditor.

Chapter 03: Theoretical Background

3. Theoretical Background

The theoretical framework defines key concepts, needed for the report, proposes a relation between them and why they are essential to the report, and discusses relevant theories and models based on a literature review.

3.1 Introduction

In what follows, a review of literature is provided on the issue of external audit in Bangladesh SMEs. This review is done to provide a theoretical framework that enables answering the research question in the subsequent analysis of the research paper i.e. To what extent does the external audit system of SMEs comply with the principles of effective audit procedure?

This section provides detailed guidance on the use of the documentation, including how the forms should be completed for the preparation of a well-documented audit file.

As discussed in the final section of this review, discussions of the issue of external audit, in the literature, do not specifically focus on SMEs in general or Bangladesh SMEs in particular. Therefore, an argumentative presentation of different views on the matter becomes difficult in such cases.

Therefore, the subsequent review will focus on setting a general theoretical background on which analysis of the research will be framed.

Traditionally the audit workings and activities, performed by the chartered accountancy firms are completed using Microsoft Excel or other software or manual labor, or a combination of all of them. The firms perform their task efficiently and with due diligence, both computerized and manual, however, the efficiency can be further improved by the use of audit software for audit purposes and by adding further value to the services they render.

3.2 Literature Review

3.2.1 Definition

Auditing

Auditing is a systematic and independent inspection and examination of books, accounts, statutory records, documents, and vouchers of the client and determines whether the financial statement and the non-financial disclosures have been prepared with a true and fair view or not. According to Alvin A. Arens, Randal J. Elder and Mark S. Beasley auditing can be defined as: “Auditing is the accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria. Auditing should be done by a competent, independent auditor.”

Independence

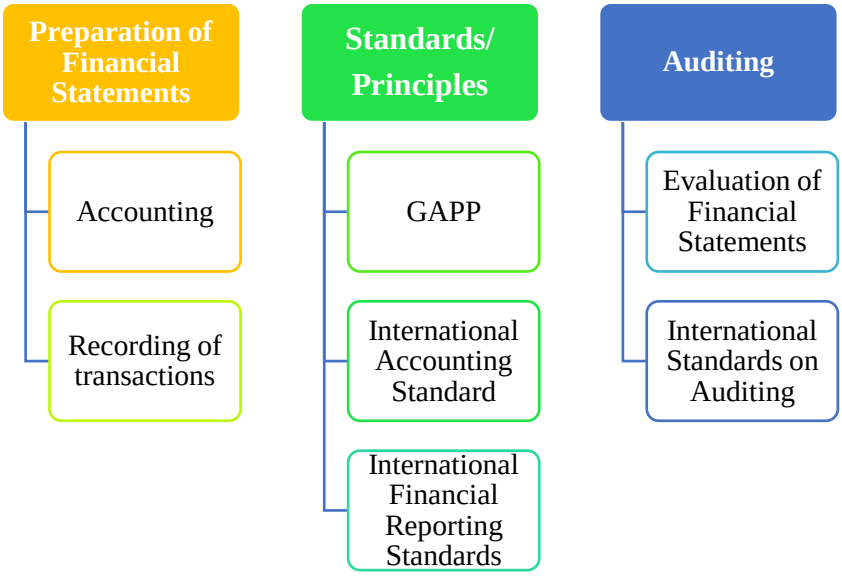
Independence of mind: The state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional scepticism. (IESBA *Code*: para. 290.6)

Independence in appearance: The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, knowing all relevant information, including safeguards applied, would reasonably conclude that a firm's, or a member of the assurance team's, integrity, objectivity or professional scepticism had been compromised. (IESBA *Code*: para. 290.6)

Professional scepticism: An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. (ISA 200: para. 13)

3.3 Difference between Auditing and Accounting

Since the majority of the auditing process revolves around accounting numbers, quantities, balances, and disclosures and the auditors have experience dealing with those data and information, the general public frequently conflates auditing with accounting. The fundamental procedures of accounting and auditing are similar in that they are both carried out by a person with proper accounting knowledge employing bookkeeping, computer, and analysis methods and techniques. The main distinction is that auditing begins where accounting concludes in order to ascertain the truthful and fair perspective of the books of accounts.



3.4 International Standards on Auditing (ISA)

International Standards on Auditing (ISA) are professional standards for the auditing of financial information. These standards are issued by the International Auditing and Assurance Standards Board (IAASB). According to Olung M (CAO - L), ISA guides the auditor to add value to the assignment hence building confidence of investors. Standards designed to enhance auditor's reports for investors and other users of financial statements, as well as changes to other International Standards on Auditing to address the auditor's responsibilities in relation to going concern, financial statement disclosures, and other information.

The standards cover various areas of auditing, including respective responsibilities, audit planning, Internal Control, audit evidence, using the work of other experts, audit conclusions and audit reports, and standards for specialized areas which are also applicable for SMEs.

Currently, International Standards on Auditing have 36 and 1 Quality Control Standard.

The key standards issued by the ISA include:

- Respective responsibilities
- Audit planning
- Internal control
- Audit evidence
- Using work of other experts
- Audit conclusions and audit report
- Specialized areas

3.5 The ISAs for SME

A suite of standards applicable to all audits including SMEs

- Can be applied in a manner appropriate to the size and complexity of any entity
- Designed to achieve reasonable assurance on all audits, regardless of the size and complexity of an entity
- Recognize that the characteristics of SMEs differ significantly from those of larger, more complex entities
- Responds to a need for practical support in implementing the ISAs on SME Audits
- Helps Firms apply the ISAs Appropriately and Efficiently on SME Audits

3.6 Ethics and Acceptance

Professional accountants have a responsibility to act in the public interest.

The purpose of assurance engagements is to increase the confidence of the intended users; therefore the users need to trust the professional who is providing the assurance.

In order to be trusted the assurance provider needs to be independent of their client. Independence can be defined as having 'freedom from situations and relationships where objectivity would be perceived to be impaired by a reasonable and informed third party.'

Therefore, assurance providers need to and must operate (and be perceived to operate) in accordance with an accepted code of ethics.

3.7 The Fundamental Principles

The formal definitions of the fundamental principles are as follows:

- **Objectivity**: Members should not allow bias, conflicts of interest or undue influence of others to override professional or business judgements.
- **Professional behavior**: Members should comply with relevant laws and regulations and should avoid any action that discredits the profession.
- **Professional competence and due care**: Members should maintain professional knowledge and skill at a level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques. Members should act diligently and in accordance with applicable technical and professional standards.
- **Integrity**: Members should be straightforward and honest in all professional and business relationships.
- **Confidentiality**: Members should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority or unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of members or third parties.

3.8 Audit Process by ICAB

ICAB is the body in Bangladesh, which is responsible for regulating the activities of professional accountants and for matters connected therewith. Audit Practice Manual is the bible of the auditors and anything and everything written in it has to be followed by the auditor. A summarized version of the audit procedure can be found in four steps.



3.9 Guidelines for Materiality

It is clear from the points made about materiality criteria that materiality is judgmental, and an issue that auditors must be aware of when approaching all their audit work.

While materiality **must always be a matter of judgment** for the auditor, it is **helpful to have some guidelines** to bear in mind. Reasons for this are:

- The guidelines give the auditor a **framework** within which to base their thoughts on materiality.
- The guidelines provide a benchmark against which to assess the quality of auditing, for example, in the event of litigation or disciplinary action.

The following figures are appropriate starting points for the consideration of materiality.

	%
Profit before tax Value	5–10
Gross profit	½–1
Revenue	½–1
Total assets	1–2
Net assets	2–5
Profit after tax	5–10

3.10 Analytical Procedures

Analytical procedures are one of many financial audit processes which help an Auditor understand the client's business and changes in the business, and to identify potential risk areas to plan other audit procedures.

Analytical procedures are performed at three stages of audit: at the planning, in the execution and at the conclusion of the audit. These three stages are risk assessment procedures, substantive analytical procedures and final/overall analytical procedures.

Analytical procedures are required by ISA 315 to be completed as part of the risk assessment process.

Analytical procedures performed at the risk assessment stage assist the Auditor to better understand the business and to plan the nature, timing and extent of audit procedures.

3.11 Audit risk

Audit risk is the risk that the auditor gives an inappropriate opinion on the financial statements (ie the audit opinion is that the financial statements present fairly, in all material respects, when, in fact, they contain a material misstatement).

Audit risk is a function of two risks:

- The risk that the draft financial statements actually contain a material misstatement. This is the risk of material misstatement ('ROMM').
- The risk that audit procedures fail to detect it, so that the financial statements are published with the misstatement still present. This is detection risk.

ROMM has two components

- The risk that the error occurs in the first place. This is inherent risk.
- The risk that the client’s own procedures don’t pick up and correct that error. This is control risk.

3.12 Financial Statement Assertions

Essentially a financial statement assertion means whenever a figure appears in the financial statements it is making certain claims, proclamations or assertions.

- Occurrence—transactions and events that have been recorded or disclosed, have occurred, and such transactions and events pertain to the entity.
- Completeness—all transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
- Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.

- Cutoff—transactions and events have been recorded in the correct accounting period.
- Classification—transactions and events have been recorded in the proper accounts.
- Presentation—transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.
- Existence—assets, liabilities, and equity interests exist.
- Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
- Valuation and allocation—assets, liabilities, and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.

3.13 Audit sampling

The process involves:
- Sample design – includes specify the population (is it complete?)
- Sample size – must be sufficient to reduce sampling risk
- Sample selection – choose a selection method
- Performing audit procedures – test the selected items. This will be either a test of controls or a test of details (a substantive procedure).
- Evaluate sample results – investigate all 'errors' (see later) and conclude on the population.

In statistical sampling:
- Sample selection must be regarded as random, and
- Probability theory must be used to evaluate sample results including measurement of sampling risk (which will determine the sample size).

If either of these conditions is not met, sampling is non-statistical.

3.14 Tests of Details

Depending on the circumstances, the auditor may determine that performing only test of details are appropriate. Tests of details are substantive audit procedures designed to identify the correctness of the related account balances. (Ref ISA 330: Para 18, A46).

3.15 Audit File

A permanent audit file and a current audit file are the two categories in which working papers of an audit are segregated.

Auditors maintain a variety of working papers for each audit engagement every year. The audit working papers that are maintained for the current year and are relevant to the current year's audit engagement are referred to as "current working papers". On the other hand, sometimes working papers that are relevant to more than one audit engagement are often retained separately in a file known as "permanent working papers".

3.16 Audit Evidence

Audit evidence is the information auditors obtain in performing their audit work in order to form the basis of their opinion on financial statements. In this case, auditors have responsibilities to gather sufficient appropriate evidence on which to base their audit opinion.

Types of audit evidence include:

- **Auditors** generated evidence such as observing the client's performing the control procedures.
- **External** evidence such as bank statement issued by the client's bank
- **Internal** evidence such as client's receiving report
- **Written** evidence such as client's depreciation schedule
- **Original** form of evidence such as original supplier's invoice
- **Photocopied** form of evidence such as photocopy of client's purchase order
- **Oral** form of evidence such as client's explanation on a certain control procedure

Chapter 04: Audit Procedure for SME

4. Audit Procedure for SME

4.1 Introduction

All audits start by:

- Planning
- Understanding.

After these stages, the auditor can assess the risk of material misstatement and respond to that risk. Audit work must then be planned to reduce the risk of material misstatement finding its way into the financial statements.

4.2 Audit planning

The audit plan includes a description of the nature, timing and extent of planned risk assessment procedures (see s.3.2) and further audit procedures (i.e. the auditor's responses to assessed risks).

The overall audit strategy and the audit plan must be documented and should be updated as necessary during the course of the audit.

4.3 Understanding the entity

In order to identify and assess the risks of material misstatement, the auditor must obtain an understanding of:

- the entity;
- its environment;
- the applicable financial reporting framework; and
- system of internal control.

4.4 Risk assessment procedures

Risk assessment procedures (i.e. audit procedures designed and performed to identify and assess risks of material misstatement – 'RoMM') must include:

- Enquiries of management and others (e.g. internal audit) who may have information that is likely to assist in identifying RoMM.
- Analytical procedures which may help identify unusual transactions/events and ratios or trends that have audit implications. (SMEs may not have interim / monthly information)
- Observation (e.g. of processes) and inspection (e.g. of assets and documents) to support the enquiries and provide information.
- SME: Formal process unlikely. Risk identified through management's involvement.

4.5 Performing Audit Procedures

- The auditor shall perform audit procedures, appropriate to the purpose, on each item selected.
- If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item. (Ref: Para. A14)
- If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor shall treat that item as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details. (Ref: Para. A15-A16)

4.6 Financial Statement Assertions Test

The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

Assertions used by the auditor in considering the different types of potential misstatements that may occur may fall into the following categories:

4.7 Design and Perform Tests of Controls

The auditor designs tests of controls to obtain sufficient, relevant and reliable audit evidence that they operated effectively throughout the period of reliance. The more they relies on the operating effectiveness of controls in the risk assessment, the greater the extent of tests of controls.

The techniques that are generally used to test key controls are observation and enquiry, inspection and computation, or a combination thereof. The following overview gives an indication of how to test the operating effectiveness of key controls.

- Testing application controls
- Testing the assertions addressed
- Walkthrough testing of controls
- Testing individual items
- Reviewing evidence of controls
- Testing management and monitoring controls

4.8 Tests of Details

To identify the related account balances of a SME organization the auditor may perform details testing of documents, calculation and accounting process. The decision whether to use tests of details and which tests to apply during the audit of SME may include considerations such as:

- the risk of material misstatements
- whether the tests would likely provide the needed evidence for the pertinent risks

- the costs and benefits of using tests of details versus applying other procedures, such as analytical procedures
- the costs and benefits of performing tests of controls to achieve the intended control reliance

4.9 Methods of Testing Details

For SME entities the guideline of ISA is applicable and methods may use to test details as noted by ISA 500 para 10A52:

- audit sampling
- selecting all items (100% examination)
- selecting specific items based on risk or value (target testing).

4.10 Sample Design, Size, and Selection of Items for Testing

To perform the testing of supporting evidence and document checking and verification whether the amount is true or fair the auditor sampling the data with intention to cover the majority (aprox. 70-80% of value) of value of the financial statements. The following guideline should be considered when sampling of SMEs documents, data and information:

- When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. (Ref: Para. A4-A9)
- The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level. (Ref: Para. A10-A11)
- The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection. (Ref: Para. A12-A13)

These audit sampling methods may include:

- random selection
- systematic selection
- monetary unit sampling
- haphazard sampling
- block selection

4.11 Evaluating Results of Audit Sampling

The auditor shall evaluate:

- The results of the sample; and (Ref: Para. A21-A22)
- Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. (Ref: Para. A23)

4.12 Collection of Audit Evidence

In performing the audit, auditors may obtain evidence of different types from different sources of information.

4.12.1 Procedures for Obtaining Evidence

Auditors can obtain audit evidence by performing the following audit procedures:

Procedures for Obtaining Audit Evidence	
Inspection of documents or records	This is the process of examination of documents or records. It can be used to test the existence or occurrence assertion of transactions or balances.
Inspection of tangible assets	This is the process of physical examination of tangible assets. Inspection of tangible assets needs to include their condition too. For example, for an item such as machinery, auditors may need to verify if it's still working or not.
Observation	This is the process of watching the client's staff performing a particular control procedure.
Inquiry	This is the process of asking information from a relevant party, internal or external, in written form or oral form. This process is usually performed with other procedures such as inspection of documents.
Confirmation	This is the process of obtaining a representation of information or of an existing condition directly from a third party.
Recalculation	This is the process of checking the mathematical accuracy of documents or records.
Reperformance	This is the process of auditor's independent execution of procedures that were originally performed by the client's staff as part of the internal control.
Analytical procedures	This is the process of evaluation of trends, ratios, and relationships of data, both financial and non-financial data.

4.13 External Confirmations

The objective of the Auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence. For SMEs receivable, payable, bank balance, advance, deposit and prepayment should be verified through circularization to related parties.

4.14 Financial Statements Related Procedures

4.14.1 Financial statements tie-out

- Agree amounts from the financial statements with the underlying accounting records (e.g., trial balance), including agreeing or reconciling information in disclosure, whether such information is obtained from within or outside of the general and subsidiary ledgers,
- Agree that the grouping of general ledger accounts into the reported FSs is appropriate, consistent and complete.
- Verify the mathematical accuracy if the general ledger
- Perform consistency and quality review procedures on financial statements

4.14.2 Comparative information

- Determine whether the accounting policies reflected in the comparative information are consistent with those applied in the current period.
- Consider if a material misstatement in the comparative information has been identified while performing the current period audit. (Perform appropriate audit procedures to address any identified material misstatement)
- Determine if the financial statements include the comparative information required by the applicable framework, by performing each of the following:
    - Agree comparative financial information with the amounts and other disclosures presented in the prior period
    - Agree that financial information is appropriately classified
    - Where appropriate, agree that prior period information

4.14.3 Documentation

- The auditor shall document:
  (a) The overall responses to address the assessed risks of material misstatement at the financial statement level, and the nature, timing and extent of the further audit procedures performed;
  (b) The linkage of those procedures with the assessed risks at the assertion level; and
  (c) The results of the audit procedures, including the conclusions where these are not otherwise clear.
- Documentation shall demonstrate that the financial statements agree or reconcile with the underlying accounting records.

4.14.4 Considerations specific to SMEs:

- Not be many control activities that could be identified by the auditor.
- Extent to which their existence or operation have been documented may be limited.
- It may be more efficient for the auditor to perform further Substantive audit procedures.

4.15 Conclusion and Reporting

This stage of the audit involves the audit team making sense of the evidence they have obtained from the client and seeing whether they have enough competent evidence to support management assertions. This step of the audit involves using professional judgment to make sure the evidence gathered is appropriate (relevant and reliable) and sufficient.

Having thoroughly evaluated the audit evidence, an appropriate audit report is issued.

4.16 Assembly of the final audit file

The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. It is very important that an auditor should maintain proper working papers to demonstrate the audit work.

4.16.1 Contents of Permanent Audit File

For SMEs a permanent audit file contains information on the following:

- The legal and organizational framework of the client's entity, for example, the Memorandum of Association (MOA) and Articles of Association (AOA) in the case of a company
- Extracts or copies of essential legal papers, agreements (e.g., loan agreements), and minutes that may be important and relevant for the audit
- A record of the study and evaluation of the internal control system of the entity (This could take the form of narrative descriptions, questionnaires, flow charts, or a combination of the three.)
- The letter of engagement
- A list of client's investments
- An analysis of critical ratios concerning the performance of the business and their trends
- Copies of the audited financial statements of the previous year (or years)
- Notes regarding significant accounting policies being followed by the company
- Important audit observations made in the earlier financial years
- Details of leases, if any

4.16.2 Contents of Current Audit File

For SMEs a current audit file contains information on the following:

- Correspondence on the acceptance of the annual reappointment of the auditor
- Copies of management letters and representations
- Letters of attorneys
- Extracts of significant matters contained in the minutes of Board Meetings and General Meetings relevant to the audit

- An analysis of business transactions and ledger balances
- Copies of communication with other auditors, experts (e.g., valuers), and third parties
- Overall Audit plan, risk assessments, and Audit programme
- Conclusions obtained on important audit issues
- Copies of financial statements and the audit report
- Workings of the entity's trial balance and worksheets
- Details of adjusting journal entries and reclassification entries
- Documentation relating to the consideration of internal control and the consideration of fraud risk factors
- Record of test of controls carried out and substantive tests
- Record of audit exceptions (i.e., deviations from the anticipated results of testing of control activities) and their resolutions
- Confirmation responses
- A record of queries raised during the course of the audit and their clearance, with notes for future reference (if, any).
- A record of results of audit tests on transactions and ledger balances and conclusions reached

4.17 Management Representation Letter

All historical financial records and other internal records are, essentially, management representations. The general nature of the definition covers both oral and written representations made by management during an audit of financial statements. Application of ISA 580 "Management Representations" to small and medium-sized enterprises may become easier. Obtained management representation letter from management, including agreeing each of the following:

- That an appropriate template is used
- That the letter is dated as near as practicable, but not after, the date of our audit report
- That the representations cover all financial statements and period(s) referred to in our audit report
- That the need for an updated letter (e.g., a substantial delay in actually issuing the audit report) has been considered

However, if representations are not provided or doubts are identified as to the reliability of the representations received, discuss with management, reevaluate management integrity, consider any impact on reliability of audit evidence, and consider need for further actions and any impact on audit report.

4.18 Audit Report

The auditor prepare a report to the management which expresses an opinion as to whether the financial statements are prepared, in all material respects, in accordance with the financial reporting framework and applicable laws and regulations.

There are two sources of difficulty when forming an opinion on financial statements of SMEs:

- Material misstatements
- Lack of sufficient appropriate audit evidence

4.18.1 Unmodified audit opinion

Neither of these difficulties has arisen.

4.18.2 Qualified audit opinion (except for)

One or both has arisen. The problem is material but not pervasive, so the problem can be isolated. The financial statements present fairly, in all material respects, except for…

4.18.3 Adverse opinion

One or more material misstatements that is as serious as to be pervasive so that the financial statements, as a whole, do not present fairly.

4.18.4 Disclaimer of opinion

A lack of sufficient appropriate audit evidence that is as serious as to be pervasive so that the auditor cannot form an opinion on the financial statements as a whole.

Chapter 05: Analysis & Findings

5. Analysis & Findings

No system is perfect or without problems that prevent us from achieving our goals. I also saw a few general shortcomings in the audit procedures during my time at Mahfel Huq & Co. Chartered Accountants, as well as a few growing pains that auditors had when conducting audit engagements. As a member of the audit team, I directly experienced the following flaws and negligence:

5.1 Difficulties in learning of audit procedures

The common pupils find it difficult and rather hard to understand audit methods generally. Standards are hard to grasp since they utilize substantial language everywhere. Recalling and applying norms requires intensive practice.

5.2 Less Quality Audit Practices

The audit process is frequently hampered by a lack of employees and laborious evidence. Therefore, many companies are unable to carry out quality audit procedures as advised by standards.

5.3 Time Constraint

Clients have a tendency of contacting the firm at the latest possible moment, which creates a pressure in its own on the auditors to complete the audit process.

5.4 Unsystematic Rotation between Audit Engagements

Some cases were observed where the junior students, involved in one audit process, were called to attend and take care of another audit for some unforeseen reasons. This prevents the students from gaining a complete understanding of the entire audit process.

5.5 In-cooperation of Management

There are times when the employees of the client organization are reluctant to provide the documents needed to complete the audit in time or provide the documents in lackluster manner rather being organized. There were also moments when the employees of client were observed to be rude, unprofessional and not provide the necessary support to the auditors. This makes the collection of audit evidence challenging.

5.6 Difficulty in Issuing an Unbiased Opinion:

According to the guideline of ethical principle requires the auditors to be independent from client and business. Due to the closeness of the auditors and the owner/manager, the management reports prepared after the audit exercise are usually an unqualified report, certifying that all is well with the company (even when it is not so)

5.7 Lack of Documentation

External Auditors in many instances have to prepare the accounts from scratch with inadequate information. Inadequacy of financial records significantly affects the statutory Auditing of Small and Medium Scale Enterprises in Bangladesh. It was observed that many SMEs are not able to keep extensive documentation requirements of auditory standards.

Hence, the application of auditing and accounting standard to the operation of SMEs raised an onerous obligation.

5.8 Endless Evidence Collection Tasks Can Slow the Process

One of the most widespread audit challenges according to our survey respondents is manual, repetitive tasks associated with evidence collection.

5.9 Auditability

It is sometimes suggested that the characteristics of small businesses present difficulties to auditors which render them “unauditable”. This is generally not the case. However, when, in extreme and exceptional circumstances, auditors encounter significant problems, they consider the impact on their report on the financial statements and whether they may need to disclaim an opinion. If such concerns are identified at an earlier stage, this may affect the auditors' decision whether to accept the engagement.

Chapter 06: Recommendations & Conclusion

6. Recommendations & Conclusion

6.1 Recommendations

Robert H. Shuller once said, *"Problems are not stop signs, they are guidelines"*. The solutions to a problem might not be immediate, but are eventual. Some recommendations have been listed below as to how the problems might be reduced:

- The firm can add a clause which mentions the stipulated time needed for them to complete the audit and when the client should contact them in order to avail their services.
- Considering the use of auditing software like AuditBoard, Netwrix Auditor etc. to reduce the load on auditors.
- Making the sampling process as detailed as possible to ensure the utmost audit quality by the firm.
- Reporting any noncooperation or attempts to influence to the auditors to the regulatory bodies and mentioning them in the audit reports.
- Having sufficient staffing to ensure that no junior student is called from one audit engagement and assigned to another until the ongoing audit, in which the student is involved, is completed in situations of unforeseen events.
- The profession should better promote users understanding of audit and other services that meet those needs, as well as to develop new offerings, or modify existing ones, as the demands arise. In the case of SMEs, the focus should not only be on delivering what is prescribed by the legislator, but also on understanding clients' needs, demonstrating how audit and other services meet these needs, and adapting services where necessary.
- Findings from the study also reveals that effective and proper accounting system has a profound impact in the successful auditing of Small and Medium Enterprises and by extension on the performances of the firms. In light of the above findings the following recommendations are made:

1) SMEs should be encouraged to adopt and embrace sound accounting system
2) The cost of installing and operating such systems should be minimized to encourage the SMEs to keep extensive documentation requirements of auditing standards.
3) Auditors in the audit of SMEs should adopt methodologies that will adequately capture the accounting and reporting needs of the enterprise.
4) Auditors involved in the audit of SMEs should be bold and courageous enough to comment properly on the peculiarities of the firm in the audit report, if necessary give a qualified report.
5) Professional Accountancy bodies and national standard setters should come up with practical auditing standards that will focus on risks associated with auditing of SMEs.

6.2 Conclusion

The internship program acts as a bridge between theoretical and practical knowledge, allowing the intern to gain a better understanding of the entire process as a whole. This enriches the intern with knowledge and allows him or her to explore a dimension of experience that he or she was unaware of before. The internship program has been a rewarding experience as it is a real eye-opener. It closes the distance between reality and fantasy, allowing us to break free of the illusion of a perfect job and the ease of getting it done that we harbor inside us. I have tried to cover the audit procedure for SMEs have to be followed in Bangladesh in this report. There are however some loopholes in the process. In this era of rapidly changing technology and economy, chartered accountants play a key role in success. The procedures should develop ways of providing more sophisticated tech-savvy process for audit SMEs and alleviating audit stress for firms and organizations. The procedures of audit of a SME entity are very cumbersome which increase the fee demand of the audit firm as well as the cost of SME organization. On the other hand, tons of paper work have to be done for audit documentation which is one kind of harassment for both of the parties involved.

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