

STANDARD AUDIT PROCEDURES AND STRUCTURE OF 1st LEVEL OF IFRS STATEMENTS FOR SME.

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Introduction

In theories of audit, audit procedures are directly related to management assertions on the financial statements. Audit procedures are operational basis to ensure that the financial statements in general are made in accordance with general accepted accounting. For the development of a process of transition from local GAAP to IFRS may be used relationship between audit procedures and claims management. IAS statements themselves can be seen as audit objectives which represent the starting point of the whole process. Apply audit procedures relating to detailed rules contained in IAS statements. Under this concept, each mirror IAS will be seen as a decision tree and each branch refers to the detailed audit procedures. A systematic decision-making process will automatically lead to detailed procedures and application of these procedures; will provide financial statements in accordance with IFRS.

1. Objectives, audit procedures and claims management

The financial statements can be viewed as a summary of the allegations under management. For group financial statements, SAS No. 80 (Section 326) of fully determined following categories:

- 1) The existence and events (occurrences / developments)
- 2) Complementarities
- 3) The rights and obligations
- 4) Valuation or allocation (allocation / data / distribution)
- 5) Presentation and disclosure (presentation / highlight)

SAS no. 31 includes two other statements which are of general interest:

- 1) Accuracy
- 2) Termination (cut-off)

These seven broad categories of management assertions can be used to formulate the development objectives of the audit and audit procedures useful for a transition process. The main difference between the way the audit and the manner of transition, that transition is not an audit of financial statements, but is increasing the level of self-statements to IFRS. This would undermine the principle of independence for a commitment to audit and generally is not legal under the EU 8th Directive in relation to the audit of financial statements. Because independence is not required by a commitment of transition, which is not an audit engagement claims management while not replaced, but the shifts represent the end of the transition process instead of starting it.

In table no. 1 below give an example of this process using the 1st level of IFRS statements:

| Management statement | Examples of Audit Objectives | Examples of Audit Procedures |
|------------------------------|--|---|
| The existence and events | The existence of construction contracts recorded in the inventory physically in accordance with IAS 11 | Review of client records confirming the work in progress |
| Complementarities | All leases are classified under IAS 17 | Review of all leases |
| Accuracy | Provisions are calculated according to IAS 37 | Review of calculation method |
| Termination (cut-off) | 'Evaluation of Revenue' to be followed under IAS 18 | Review all income resulting from the revaluation of assets or liabilities |
| The rights and obligations | All intangible assets controlled by an entity registered under IAS 38 | Review all contracts |
| Valuation or allocation | Deferred taxes assessed in accordance with IAS 12 | Review of tax assets and estimates of tax rates applied |
| Presentation and disclosures | Property specifically classified under IAS 40 | Review all the characteristics of Records lists qualifying |

Table 1

1.2. Records and audit tests

Audit tests in terms of audit procedures should be designed in such a way as to be able to verify whether the management assertions are correct or not. They are a means to obtain evidence about the quality of information contained in financial statements and form the basis for an audit opinion¹. Auditors use various methods or procedures to arrive at a conclusion such as investigation, monitoring, inspection and counting of assets, confirmation, examination of documents and analytical procedures.

In any case, competent and sufficient evidence of accounting are required to be available to them in order to obtain a decision. The procedures selected shall be in accordance with applicable international standards, and this provides an opportunity to be integrated in the transition process and operating procedures within the company's accounting department, and service procedures of companies' audit.

The main problems arise in situations where self IFRS does not contain enough rules. In this situation, a decision must be made in connection with accounting principles and methods applied. Procedures are not able to fill the gaps of regulations, and neither can make decisions, but it is possible that through the list to find a variety of solutions and different ways. Procedures are useful for auditors to give an idea on the fact that where can be found on the unaudited accounts of potential material misstatement. Preliminary analytical work performed in the planning phase of an audit is called the specific risk analysis, which means that accounts have been identified with the opportunity to cause trouble in order to be achieved at attention during the audit.

According to the audit standard procedures should be implemented in the early planning stages of each audit. The aim of this work is the "direction of attention" to signal the group's audit on the problems (errors, fraud) in excess of accounts and reports.

Procedures can take many forms, starting from the simplest to most complex.

In the planning stage procedures used to identify areas with potential problems so as to reduce the risk to overlook anything important the work is built following the audit. This application can be described as the "direction of attention" referring to accounts that may contain errors and fraud. Details revealed during preliminary analytical procedures do not provide direct evidence on the numbers of financial statements. They only help the group's audit schedule of audit program. With an organized approach, which serves as a starting point standard preliminary procedure can provide considerable familiarity with the client's business?

A good part of auditors begin with comparative financial statements and statements estimate the structure (vertical analysis) and changes in different account statements (horizontal analysis). This is the beginning of the description of activities for the year being audited. In this way data obtained analytical baseline.

A detailed analysis of the IFRS financial statements must be made within the framework of the sections of the audit standards to verify the audit standard operating procedures that meet the accounting requirements and regulations of a transitional process. In this sense, statements of IFRS will be presented as a model structured in the format of audit work and as a result of this would be possible appointment procedures for all important steps of a process of audit work.

2. Appropriate detail of 1st level of IAS statements. Decision-making structures.

Guarantees are based on management to develop audit objectives and audit methods. In order to become an operational control, a fulfillment of the general objectives of the audit, accounts and specific work procedures typically are classified in different sections of the audit, audit objectives, accounts for tests and procedures are also defined. Audit Sections sort out and regroup balance sheet accounts and securities gains and losses economic ties within the sections of the audit.

Over time, the theory and practice of auditing has developed standards section of standardized audit objectives and audit procedures.

To classify 1st level of IFRS statements by sections of auditing standards, will be used to classify Miller Audit Procedures. They include the recent pronouncements by SAS-101 audit (audit of fair value measurements and highlight extraction) (Auditing Fair Value Measurements and Disclosures). According to this classification the main parts of the audit are as follows:

- Cash and cash equivalents
- Investment in securities, derivative instruments and hedging activities
- Accounts Receivable and Sales
- Inventories and cost of sales
- Property, plant and equipment
- Prepaid expenses, deferred debts, intangible assets and other
- Accounts payable and purchases
- Payroll and other obligations
- Income Taxes
- Debt Obligations
- Capital
- The income and expenses

¹ "Responsibility to Detect and Report Errors and Irregularities" The Expectation Gap Standards: Progress, Implementation Issues, Research Opportunities, New York: AICPA

The following Table no. 2 shows the preliminary tasks of 1st level of IFRS statements in different sections of the audit:

| Audit Sections | IFRS statements |
|--|--|
| Inventory and Cost of Sales | IAS 2 Inventories, IAS 11 Construction Contracts |
| Property, plant and equipment | IAS 16 Property, plant and equipment; Leases IAS 17, IAS 40 Investment Property; Impairment of Assets IAS 36 (IFRS 5: discontinued operations, non-current assets held for sale) |
| Prepaid expenses, late payment, intangible assets and other assets | IAS 38 Intangible Assets |
| Payroll and other liabilities | Provisions, Contingent Liabilities and Contingent Assets IAS 37 |
| Income Taxes | Income Taxes IAS 12 |
| Income and expenditure | IAS 18 Income |

Table 2

As can be seen from the table above sections of the audit and IFRS financial statements do not conform in all respects, but they may overlap in some detail, noted that while the main content of IFRS financial statements comply with the sections of the audit.

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In this sense, statements of IFRS will be presented as a model structured in the format of audit work and as a result of this would be possible appointment procedures for all important steps of a process of audit work.

For practical reasons and due to cost effectiveness, it is useful to be processed similarities of the two processes. Although the IASB has developed a process of international projects, which includes a number of steps and addresses of different users (legal and regulatory authorities, professional organizations) to establish a new standard IFRS or discussion of changes in existing standards, there isn't a general scheme which to describe the structure of a statement of IFRS.

Typical elements of a standard to IFRS are as follows:

- Objective: Brief Description of the subject.
- Goal: distinguishing details of transactions that are covered or not by the standard.
- Definitions: Explanation of all key accounting terms used in statements.
- Recognition and making measurements for the first time: Description of the recognition criteria and methods for initial registration.
- Measurement after recognition: Description of evaluation methods for subsequent periods.
- Notes: List of additional disclosures.
- Transitional: Procedures for implementation.
- Effective Date: The first year of application.

Sometimes elements are distributed on self statements, including attachments or on the basis of conclusions, and this makes it difficult finding accounting treatment for a particular transaction. Taking IFRS as a whole, the detailed structure leads to a confusing picture in total. From the perspective of an operational process, it is not quite clear how such a process should begin and what are the procedures.

The ability to compare the requirements of IFRS accounting content of the audit section is intended to reveal a structure that allows the implementation of standardized procedures and considerations of materiality, in connection with the audit methods and to determine the detailed steps of work. Below is analyzed one of the elements relating to the evaluation of inventory, such as construction contracts.

3. Construction Contracts

The key issue in accounting for a construction contract is the definition of income and expenditure for the relevant accounting period in which work is performed. Accounting rules have a major impact on the financial statements of construction companies that need to show construction contracts in their balance¹. Construction contracts are part of the evaluation of inventory. Accounting and reporting are subject to a single mirror of IAS. Due to the nature of activity undertaken in construction contracts in the period between the start of a process of building up to final handover to the client affects more than one accounting period. IAS 11 can be seen as a special insight to the recognition of revenue for construction companies and construction contracts. The structure of the decision to IAS 11 is as follows in Table 3². This standard should apply for financial statements covering periods from 1 January 1995 and after.

¹ International Accounting Standard 11: Construction Contracts.

² IAS 11: Construction Contracts

Construction contracts are formulated in numerous ways and diverse which for the purposes of this Standard, are classified as fixed price contracts and variable price contracts. Some construction contracts may contain characteristics of both fixed-price contract and what the price variable, for example a variable price contract but with a maximum price to accept.

A fixed price contract is a construction contract in which the contractor agrees to a fixed price contract or a fixed price per unit of output, which in some cases is subject to escalation in cost increases.

A variable price contract is a contract where the developer reimbursed for allowable costs or specifically defined, plus a percentage of these costs or a fixed fee. A construction contract can be negotiated for the construction of a single asset such as a bridge, road, building, perimeter wall, ship or tunnel. A construction contract may also object and building a number of assets that are closely related or interdependent on each other in terms of the project, technology and function or their ultimate use.

For the purposes of this standard, construction contracts include:

(a) Contract services which are directly related to the construction of an asset, for example, service contracts of the project managers and architects.

(b) The contract for demolition and restoration of the asset, and environmental restoration after the destruction of the asset.

Structure of IAS 11 reveals different phases, which should be implemented in a logical manner. Concerns of the first phase of the separation of individual balance issues, which would then be subject to assessment procedures. A construction contract can be a single contract or a combination of different contracts or a single contract can be divided into different items of the balance.

In both cases, contract revenue and contract costs are calculated for each contract and at each balance sheet date. Revenues and costs are calculated according to the degree of completion. In any post balance sheet date, all amounts should be recalculated. Changes in estimates or amendments of contracts may also vary greatly balanced.

3.1. Application of standard audit procedures

For construction contracts, procedures and test results of cost accounting systems already described in the inventory procedures for testing under IAS 11 and should be implemented. In addition to the accounting of revenue for construction contracts in the financial statements of the contracting parties recognize and directs SKK 8 which is based on IAS 11.

Application Procedures Auditing Standards relating to quality and cost accounting system is needed to verify the calculation of construction contracts. Application of Standards on Auditing Procedures passes are in five phases:

- 1) Defining the subject
- 2) Classification of contract
- 3) Revenue and cost calculation
- 4) Recognition according to completion

5) Follow-up procedures and disclosures

If we analyze the first phase of the contract "Determination of the Subject" will have:

a) The contract covers a number of assets if all of the following conditions are met:

- separate proposals have been submitted for each asset;
- each asset has been subjected to separate negotiations;
- customer and contractor have been able to reject or accept each asset;
- costs and revenues of each asset can be identified.

b) A group of contracts shall be treated as a single construction if:

- the group of contracts is negotiated as a single package;
- the contracts are so closely interrelated that they are part of a single contract with an overall profit margin;
- the contracts are performed concurrently or in a continuous sequence.

If a contract provides an option for the construction of an additional asset the construction of the additional asset shall be treated as a separate construction if:

- the asset differs significantly in design, technology or function from the asset covered by the original contract;
- the price of the asset is negotiated without regard to the original contract price.

If we analyze the second phase of the contract "Classification of contract", in their diversity we can have these types of contracts:

a) A fixed type contract contains the following characteristics:

- a fixed contract price;
- a fixed rate per unit of output;
- possible cost escalation clauses

b) A cost plus contract contains the following characteristics:

- reimbursement clause for allowable or defined costs;
- additional percentage of these costs or
- additional fixed fee

Analyze the third phase of the contract "income and calculating the cost" and will have:

a) Contract³ revenue comprise:

- initial amount agreed in the contract plus variations, claims and incentives to the extent that they will result in revenue and can be measured reliably.
- uncertainties should be included in the estimation of variations which depend on the outcome of future events

Contract revenue is measured at fair value of payments received or to be taken. Fair value is the amount by which an asset could be exchanged or a liability settled, between knowledgeable parties, voluntary and unrelated to each other⁴. The measurement of contract revenue is affected by a series of questions that depend on the outcome of subsequent events. Predictions can be revised as new events occur and uncertainties have a solution. Thus, the amount of contract revenue may increase or decrease from one period to another.

³ IAS 11: Construction Contracts

⁴ MRS 8: Income.

b) Contract costs include:

- costs associated directly with the contract in question;
- costs which are the result of contract activity and can be distributed in the contract, and
- other costs which are specifically charged to the customer under the terms of the contract

Costs directly related to a contract include⁵:

- 1) Wages of construction workers;
- 2) The costs of building materials;
- 3) Depreciation of property used in construction;
- 4) Transportation costs of equipment and materials;
- 5) Costs of equipment rented for construction;
- 6) Costs of design and technical assistance;
- 7) Projected costs of warranty;
- 8) Costs of design and technical assistance that directly relates to the construction contract;
- 9) Claims by third parties.

These costs can be reduced by any accident that income is not included in contract revenue, for example income from the sale of surplus materials and the sale of machinery and equipment at the end of the contract.

Analyze the fourth phase of the contract "Recognition of revenue and expenditure". To evaluate the results of a reliable construction contract should know:

1. If it is a fixed-price contract
 - a. Recognition criteria set by the IASB's Framework; that is:
 - (1) Total contract revenue can be measured reliably.
 - (2) It is probable that economic benefits flow to the entity.
 - b. Both the cost to complete the contract and the stage of completion can be measured reliably.
 - c. Contract costs attributable to the contract can be identified properly and measured reliably so that comparison of actual contract costs with estimates can be performed.
2. If it is a cost-plus contract
 - a. It is probable that the economic benefits will flow to the entity.
 - b. The contract costs attributable to the contract, whether or not reimbursable, can be identified and measured reliably.

Analyze the fifth stage of the contract "the continuation of disclosure procedure". During this phase can be resolved one of the following methods:

1. Part of the established contract costs be calculated on the total cost of contract
2. Review of method of work done
3. Completion of a physical part of the method of employment contract

When the stage of completion is determined by reference to contract costs incurred to date, certain costs are to be excluded from contract costs.

1. Contract costs that relate to future activity
2. Payments made to subcontractors in advance before performing work by the subcontractor

When the total contract costs will exceed the total contract revenue, then the expected loss should be recorded as an

expense immediately. This loss should be calculated on the basis of the total cost for the full contract, which must include the contract costs incurred to date plus estimated costs.

4. Determination of fair value

In IAS 36, impairment is defined as value addition performed on the recoverable amount and the recoverable amount is defined as the larger of the two alternative measures: the fair value at low cost to sell and value in use. If one of the two alternative measures is higher than the carrying amount, the asset or asset group is not damaged. Fair value is based on market prices. An asset is impaired when its carrying amount is greater than its recoverable amount. Determining whether a revalued asset may be impaired or not depends on the basis used to find fair value⁶:

- a) If the fair value of the asset is worth having in the marketplace, the only differences between the fair value of the asset and fair value less costs to dealers are additional direct costs for the removal of the asset.
- b) If the fair value of the asset determined on a basis that is not its market value, then the revalued amount (so fair value) may be larger or smaller than its recoverable amount.

Then, after the revaluation requirements have been implemented, an entity applies this Standard to determine whether the asset may be impaired or not. Table no. 3 illustrates the process of calculating fair value.

⁵ MRS 8: Income.

⁶ International Accounting Standard 36, Impairment of Assets.

IAS 36 – Fair Value Determination

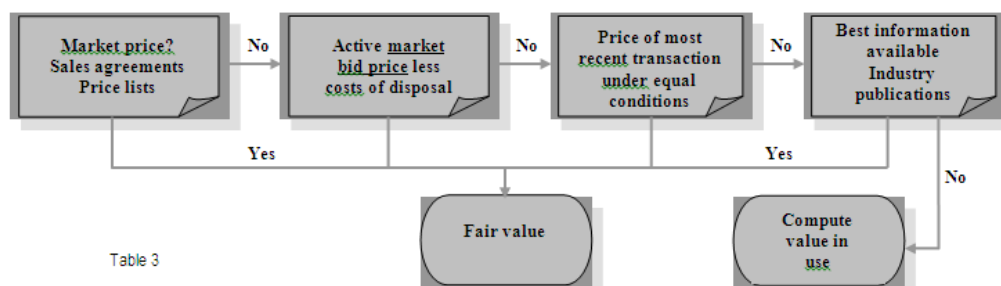


Table 3

The two alternatives to fair value and value in use are equal methods for measuring recoverable amount¹. In the case of market prices or other information available provided an estimate of fair value less costs to sell, but it is not necessary to calculate a value to use if the accounting value is lower than fair value. Better information fair value less costs to sell an asset is the price of a binding sales contract in a transaction carried out voluntarily between the parties unrelated to each other, regulated by additional costs which would charged directly to the disposal of that asset².

Calculating fair value³ seems to be easier due to market-oriented relationships right and usually an entity would be able start an impairment test using this option.

Value in use is a specific value of the entity and not based on market prices. Measuring value in use ensures the validity of the factors available only to individual business. In general, if the calculated value in use should be implemented, it is important to remember that any method or assumption should be applied consistently. Value method used, especially offers more opportunity to influence the outcome depending on how decisions reflected.

Assessment of value in use of an asset involves the following steps⁴:

- Valuation of future cash flows inflows and outflows arising from continued use of the asset and the issuance by the use of this asset at the end, and
- Implementation of appropriate discount rate on these future cash flows

Design of future cash flow should be based on reasonable assumptions, which means to market data and growth rates that are consistent with known developments and dealing with its budget-management and forecasts⁵.

Raising rates of income growth are only possible in exceptional circumstances and the assessment is based on the most recent years. Comparison between the growth rates in recent years and projected rates of growth related to development costs and other factors allow an estimate of future cash flows. IAS 36 describes a five-year projection of rates and stable or declining rates. If rates increase, the growth rate should not exceed the term rate of growth of industry in which the entity participates.

The discount rate used to measure value in use of an asset, should not reflect risks for which estimates are adjusted

future cash flows. Current market rate for transactions with free dole is the basis for impairment testing at any specific date and must be adjusted to spread risks across assets. IAS 36 provides another alternative to risk adjustment. Through probability can be designed various cash-flow and the weighted average is calculated afterwards. If cash-flow forecast for the uncertainties directly regulated, market rates are used for discounts. Actual values of the two alternatives will be different in most cases.

5. Standard audit procedures. Test methods of depreciation.

Audit steps in the assessment of impairment test methods focus on general assumptions basic to any computation and evaluation of cash flows. The first step in the process of determining a method is the most important. Any incorrect assumption will result in the emergence of difficulties, despite the alternatives used in computing and the actual value.

Standard audit procedures should be applied in the process of determining depreciation methods. The audit program includes the following key steps should be adjusted according to specific circumstances.

Test of impairment: Investigation of Key Assumptions: Based on circumstances and available information, tests of fair value measurements, used one or more of these ways:

Based on the circumstances and available information, test the fair value measurements by using one or more of the following approaches:

- Test management's significant assumptions, the valuation model and the underlying data. When using this approach, perform the following steps:
 - Evaluate the source and reliability of evidence supporting management's assumptions.
 - Consider the assumptions in light of historical and market information and whether they are consistent with the entity's plans and past experience.
 - Consider whether management has identified the significant assumptions (e.g. those that are sensitive to variation or bias) and factors influencing the measurement of fair value.
 - If management has not identified particularly sensitive assumptions, consider techniques to identify those assumptions.
 - Ensure that there is no contrary data indicating that marketplace participants would use different assumptions (e.g. discount rates that do not appear to reflect current market assumptions).

¹ International Accounting Standards Board.

² International Accounting Standards, IAS 36.

³ IFRS 2008 - Wiley Text (The official Approved by the EU Standards, 2008 edition).

⁴ International Accounting Standards, IAS 36.

⁵ National Accounting Standards, Albania.

- (6) Identify any sources of documented support for management's assumptions.
- (7) Determine whether management's reliance on historical financial information, if any, is justified in developing assumptions.
- (8) Review related written plans and other documentation such as budgets and minutes.
- (9) If the entity used a valuation model, review the model and evaluate whether the assumptions used are reasonable and the model is appropriate.
- (10) Test the data used to develop the fair value measurements and disclosures (e.g. by verifying the source of the data, mathematical recompilation and reviewing information for internal consistency).
- (11) Evaluate whether the fair value measurements have been properly determined from such data and management's assumptions.

Develop independent fair value estimates to corroborate management's measurement. Under this approach, the auditor can use his or her own developed model, or develop an independent estimate to corroborate management's measurement. In such circumstances, the auditor nevertheless should understand management's assumptions and use that understanding to:

- (1) Determine the appropriateness of the assumptions that he or she developed.
 - (2) Ascertain that his or her independent estimates take into account all significant variables.
 - (3) Evaluate any significant differences from management's estimates.
- b. Review subsequent events and transactions. Under this approach, consider those subsequent events or transactions that reflect circumstances existing at the balance-sheet date and their effect on the entity's fair value measurements and disclosures.

Conclusions

I. Application Procedures Auditing Standards relating to quality and cost accounting system is needed to verify the calculation of construction contracts. Application of Standards on Auditing Procedures must pass in five stages, where the quality of their proceedings will also provide a quality audit work.

Reference:

- Bank of Albania (www.bankofalbania.org)
- Tools and techniques for determining the value of any asset see: Damodaran, A., "Investment Valuation", 2nd Ed. New York 2002.
- International Accounting Standards, IAS 11.
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- Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-To-Market Accounting (published by the SEC).
- National Accounting Standards, n.8, Albania.
- National Accounting Council (www.kkk.gov.al)
- National Accounting Standards (www.minfin.gov.al)

II. Impairment testing in accordance with IAS 36, regarding the transition process for SMEs, will be a new method for most companies. Usually, the SME business is more transparent than the major international companies operating in the scholarships listed because they operate in segments of the industry or are just in a particular region. In addition, SMEs operating in large markets with competitive structures. In the case of impairment testing, market data under the "fair value less costs to sell" should be available. IASB draft of IAS for SMEs suggests that "value in use" is not necessary for SMEs. This means that if it is not possible to calculate "fair value less costs to sell, no further investigation is not necessary with the result that a potential injury will not be registered. This kind is not healthy because of impairment testing is required only if there is a clear indication of the cause or event which suggest that long-term depreciation of fixed assets and only exists in this case additional testing is needed.

III. Development of damage test methods in accordance with IAS 36 is one of the requirements of accounting, because the direction of IAS is limited to the extent general methods are described, although in Appendix IAS 36 contained some illustrative examples. Testing IAS of damage is a general method of measurement and affects all voices and long-term off-balance and requires general decisions about the grouping of assets, possible market information and mathematical methods. One advantage can be seen in the fact that, due to systematic depreciation of fixed assets, the probability of appreciation will automatically be reduced by increased depreciation, and over time will reduce the carrying amount. If a company applies the method of revaluation of fixed assets for which parts of the market price information is available, will be limited to the practical problems of assessing the damage. Therefore, the decision reassessment method for selecting and testing related injury as a method of accounting is a matter of professional discretion at the time of adoption of IAS, market information available and possible methods of calculation. If the same thing can be say for the application of MRS in Albania, particularly MRS 5, 6, 9, related to these issues and their harmonization with IAS.