

STATEMENT 3.220
AUDITING GUIDELINE
ACCOUNTING SYSTEMS

Introduction

1. Paragraph 5 of the Statement of Auditing Standard No. 3.101 "Audit Approach" states that:

"The auditor should ascertain the entity's system of recording and processing transactions and assess its adequacy as a basis for the preparation of financial statements."

This Auditing Guideline, which gives guidance on how that paragraph may be applied, should be read in conjunction with the Explanatory Foreword to Auditing Standards and Guidelines including the Glossary of Terms.

Background

2. As part of his audit planning, in particular in determining the nature of his audit tests, the auditor will need to consider the overall design of the accounting system and the adequacy of the books of account from which the financial statements are prepared.
3. The auditor will often have a separate and distinct responsibility to form an opinion as to the adequacy of the books of account for the purpose of complying with the legislation or regulations to which the entity may be subject. The Companies Ordinance sets out the requirements concerning books of account for companies incorporated under that Ordinance in Hong Kong.
4. The management of an entity requires complete and accurate accounting and other records to assist it in:
 - a. controlling the business;
 - b. safeguarding the assets;
 - c. preparing financial statements;
 - d. complying with legislation.

5. An accounting system should provide for the orderly assembly of accounting information and appropriate analyses to enable financial statements to be prepared. What constitutes an adequate accounting system will depend on the size, nature and complexity of the entity. In its simplest form for a small business dealing primarily with cash sales and with only a few suppliers the accounting system may only need to consist of an analysed cash-book and a list of unpaid invoices. In contrast, a company manufacturing several different products and operating through a number of dispersed locations may need a complex accounting system to enable information required for financial statements to be assembled.
6. Depending upon the size and nature of the business concerned an accounting system will frequently need to incorporate internal controls to provide assurance that:
 - a. all the transactions and other accounting information which should be recorded have in fact been recorded;
 - b. errors or irregularities in processing accounting information will become apparent;
 - c. assets and liabilities recorded in the accounting system exist and are recorded at the correct amounts.
7. The evaluation of the internal controls referred to in paragraph 6 is dealt with in a separate auditing guideline but in practice the auditor will probably carry out the work concurrently with his assessment of the accounting system.

Procedures

8. The auditor will need to obtain an understanding of the entity as a whole and how the accounting system reflects assets and liabilities and transactions.
9. The auditor will need to ascertain and record the accounting system in order to assess its adequacy as a basis for the preparation of financial statements. The extent to which the auditor should record the entity's accounting system and the method used will depend on the complexity and nature of the system and on the degree of reliance he plans to place on internal controls. Where the auditor plans to rely on internal controls, the accounting system needs to be recorded in considerable detail so as to facilitate the evaluation of the controls and preparation of a programme of compliance and substantive tests. The record may take the form of narrative notes, flowcharts or checklists or a combination of them.

10. As an aid to recording the accounting system, the auditor should consider tracing a small number of transactions (possibly one or two of each type) through the system. This procedure (often known as 'walk-through checks') will confirm that there is no reason to suppose that the accounting system does not operate in the manner recorded. The procedure is particularly appropriate where the entity has itself prepared the record of the system which the auditor is to use.
11. In addition to making an assessment of the adequacy of the accounting system the auditor needs to confirm that the system has operated as laid down throughout the period. Evidence of this may be obtained by means of the compliance tests that the auditor carries out when he chooses to rely on internal controls. Alternatively the evidence may be obtained indirectly from his substantive testing.