

**Chapter 2** AUDIT STRATEGY, AUDIT PLANNING AND AUDIT PROGRAMME  
(including SA 300 AND 320)

**Question :** M & Co. was appointed as auditor of IGI Ltd.. As an auditor what are the factors that would be considered in the development of overall audit plan? (5 Marks) (May 2018)

**Answer:** Development of an Overall Plan: **The auditor should consider the following matters in developing his overall plan** for the expected scope and conduct of the audit -

- The terms of his engagement and any statutory responsibilities.
- The nature and timing of reports or other communication.
- The applicable legal or statutory requirements.
- The accounting policies adopted by the client and changes in those policies.
- The effect of new accounting or auditing pronouncements on the audit.
- The identification of significant audit areas.
- The setting of materiality levels for audit purposes.
- Conditions requiring special attention, such as the possibility of material error or fraud or the involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
- The degree of reliance he expects to be able to place on accounting system and internal control.
- Possible rotation of emphasis on specific audit areas.
- The nature and extent of audit evidence to be obtained.
- The work of internal auditors and the extent of their involvement, if any, in the audit.
- The involvement of other auditors in the audit of subsidiaries or branches of the client.
- The involvement of experts.
- The allocation of work to be undertaken between joint auditors and the procedures for its control and review.
- Establishing and coordinating staffing requirements.

**Question :** "An adequate planning benefits the audit of financial statements." Discuss. (Nov. 2018) (5 Marks)

**Answer: Benefits of Planning** in the audit of financial statements: Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:

1. Helping the auditor to devote appropriate **attention to important areas** of the audit.
2. Helping the auditor identify and resolve **potential problems on a timely** basis.
3. Helping the auditor properly organize and manage the audit engagement so that it is performed in an **effective and efficient manner**.
4. Assisting in the **selection of engagement team** members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
5. Facilitating the **direction and supervision** of engagement team members and the review of their work.
6. Assisting, where applicable, in coordination of work done by **auditors of components and experts**.

**Question :** "Planning is not a discrete phase of an audit, but rather a continual and iterative process." Discuss. (Nov. 2018) (5 Marks)

**Answer:** Audit Planning- a Continuous Process

Planning is not a discrete phase of an audit, but rather a continual and iterative process *that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement*. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:

- (i) **The analytical procedures** to be applied as risk assessment procedures.

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- (ii) Obtaining a **general understanding** of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
- (iii) The determination of **materiality**.
- (iv) The involvement of **experts**.
- (v) The performance of other **risk assessment procedures**.

**Question :** Describe how the process of establishing the overall audit strategy assists the auditor in marshalling his human resources. **(May 2019) (4 Marks)**

**Answer:** The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. The process of establishing the **overall audit strategy assists the auditor** to determine, subject to the completion of the auditor's risk assessment procedures, such matters as:

- (1) The **resources to deploy** for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters.
- (2) The **amount of resources to allocate to specific audit areas**, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas;
- (3) **When** these resources are to be deployed, such as whether at an **interim audit stage or at key cut-off dates**; and
- (4) **How** such resources are **managed, directed and supervised**, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off -site), and whether to complete engagement quality control reviews.

**Question :** In establishing overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. Elucidate those cases by which auditor can ascertain the reporting objectives of the engagement. **(Nov., 2019) (4 Marks)**

**Answer:** In establishing the overall audit strategy, auditor shall ascertain the **reporting objectives of the engagement** to plan the timing of the audit and the nature of the communications required. The cases by which auditor can ascertain the reporting objectives of the engagement are:

- (i) The entity's **timetable for reporting**, such as at interim and final stages.
- (ii) The **organization of meetings** with management and those charged with governance to discuss the nature, timing and extent of the audit work.
- (iii) The **discussion** with management and those charged with governance regarding the **expected type and timing of reports** to be issued and other communications, both written and oral, including the auditor's report, management letters and communications to those charged with governance.
- (iv) The discussion with management regarding the expected communications on the **status of audit work throughout the engagement**.

**Question :** Discuss the points to be considered by auditor for the purpose of constructing an audit programme. **(Nov., 2019) (4 Marks) (May 19)**

**Answer:** While developing an audit programme, the auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit.

However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence.

The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts.

Further, the auditor normally has flexibility in deciding when to perform audit procedures.

However, in some cases, the auditor may have no discretion as to timing, for example, when observing the taking of inventories by client.

For the purpose of programme construction, the following points should be kept in mind:

- Stay within the **scope and limitation** of the assignment.

- Prepare a **written** audit programme setting forth the **procedures** that are needed to implement the audit plan.
- Determine the **evidence reasonably available** and identify the **best** evidence for deriving the necessary satisfaction.
- Apply **only those steps and procedures which are useful** in accomplishing the verification purpose in the specific situation.
- Include the **audit objectives** for each area and sufficient details which serve as a **set of instructions** for the assistants involved in audit and help in controlling the proper execution of the work.
- Consider **all possibilities of error**.
- **Co-ordinate** the procedures to be applied to related items.

**Question :** With Ref. to SA 320 "Materiality in planning and performing an audit" Indicate the factors which may effect the identification of an appropriate benchmark while determining materiality for the financial statements as a whole. (Nov. 2020) (4 Marks)

**Answer:** Determining materiality involves the exercise of professional judgment. *A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.* Factors that may affect the identification of an appropriate benchmark include the following:

1. **The elements of the financial statements** (Example - Assets, liabilities, equity, revenue, expenses);
2. Whether there are items on which the **attention of the users** of the particular entity's financial statements tends to be focused (Example - For the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets)
3. The **nature of the entity**, where the entity is at in its **life cycle**, and the industry and economic **environment** in which the entity operates;
4. The entity's **ownership** structure and the way it is **financed** (Example - If an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings;)
5. The relative **volatility** of the benchmark. (Example: When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenue)

**Question :** M/s TP & Co., a firm of Chartered Accountants, is auditor of KSR Ltd. for many years. KSR Ltd. has diversified their business into newer areas during the last year. The senior member of the audit team handed over the standard audit programme of earlier years to the audit assistants and instructed them to follow the same. The assistants are conducting the audit accordingly. Whether the **attitude of the audit assistants is justified or they are required to keep an open mind?** Guide them. (Dec.2021) (4 Marks)

**Answer:** The Assistant Engaged – Be Encouraged to Keep an Open Mind:

To start with, an auditor having regard to the nature, size and composition of the business and the dependability of the internal control and the given scope of work, should frame a **programme which should aim at providing for a minimum essential work** which may be termed as a **standard programme**.

As experience is gained by actually carrying out the work, the programme may be altered to take care of situations which were left out originally, but are **found relevant** for the particular concern.

Similarly, if any work originally provided for proves beyond doubt to be **unnecessary or irrelevant**, it may be dropped.

The assistant engaged in the job should be encouraged to keep an **open mind beyond the programme given to him**.

He should be instructed to **note and report significant matters coming to his notice, to his seniors** or to the partners or proprietor of the firm engaged for doing the audit.

In the given case, the attitude of assistants of TP & Co. is not justified. They should keep an open mind and go beyond the programme to take care of newer areas of the business of KSR Ltd. into which the Company has diversified.

**Question: Short note on: Establishment of overall Audit strategy.**

**Answer :** In establishing the overall audit strategy, the auditor shall

**(a) Identify the characteristics of the engagement that define its scope;**

Example • The expected audit coverage, including the number and locations of components to be included. • The nature of the business segments to be audited, including the need for specialized knowledge. • The expected use of audit evidence obtained in previous audits, for example, audit evidence related to risk assessment procedures and tests of controls.

**(b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;**

Example • The entity's timetable for reporting, such as at interim and final stages The organization of meetings with management and those charged with governance to discuss the nature, timing and extent of the audit work. • The discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, both written and oral, including the auditor's report, management letters and communications to those charged with governance. • The discussion with management regarding the expected communications on the status of audit work throughout the engagement.

**(c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;**

**(d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant;** and  
Example • Preliminary identification of areas where there may be a higher risk of material misstatement. • Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them. • Volume of transactions, which may determine whether it is more efficient for the auditor to rely on internal control.

**(e) Ascertain the nature, timing and extent of resources necessary to perform the engagement.**

Example • The selection of engagement team and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas where there may be higher risks of material misstatement. • Engagement budgeting, including considering the appropriate amount of time to set aside for areas where there may be higher risks of material misstatement.

**Question :** "Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy". Explain.

**Answer :**

- Once the overall audit strategy has been established, *an audit plan can be developed to address the various matters identified in the overall audit strategy*, taking into account the need to achieve the audit objectives through the *efficient use of the auditor's resources*.
- The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but *are closely inter-related* since changes in one may result in consequential changes to the other
- The auditor **shall develop an audit plan that shall include a description of**
  - (a) The *nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment"*.
  - (b) The *nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 "The Auditor's Responses to Assessed Risks"*.
  - (c) Other *planned audit procedures* that are required to be carried out so that the engagement complies with *SAs*.

- The **audit plan is more detailed** than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.

**Question :** “The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors.” Explain.

**Answer:** The **nature, timing and extent of the direction and supervision of engagement team** members and review of their work vary depending on many factors, including:

1. The **size and complexity** of the entity.
2. The **area** of the audit.
3. The assessed **risks of material misstatement** For Example, An increase in the assessed ROMM for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work.
4. The **capabilities and competence** of the individual team members performing the audit work.

**Question :** “The utility of the audit programme can be retained and enhanced only by keeping the programme and also the client’s operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed’. Discuss The advantages and disadvantages of an audit programme.

**Answer :**

The **advantages of an audit programme** are:

- (a) It provides the assistants total and clear set of instructions of the work generally to be done.
- (b) It is essential, particularly for major audits, to provide a total perspective of the work to be performed.
- (c) Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.
- (d) Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some ‘mental’ plan. In that case, there is always a danger of ignoring or overlooking certain books and records.
- (e) The assistants, by putting their signature on programme, accept the responsibility for the work carried out by them individually and, if necessary, the work done may be traced back to the assistant.
- (f) The principal can control the progress of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
- (g) It serves as a guide for audits to be carried out in the succeeding year.
- (h) A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of professional auditor.

The **disadvantages** of an audit programme are:

- (a) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit;
- (b) The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on.
- (c) Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.
- (d) A hard and fast audit programme may kill the initiative of efficient and enterprising assistants

**Question:** Is it necessary to document the audit plan? If so, what all activities in the planning phase needs to be documented? State with Examples.

**Answer: As per SA 300, The auditor shall document:**

- (a) the overall audit strategy;
- (b) the audit plan; and

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(c) any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

The documentation of the overall audit strategy is a **record of the key decisions** considered necessary to properly plan the audit and to communicate significant matters to the engagement team.

The following things should form part of auditor's documentation:

- ◆ A summary of discussions with the entity's key decision makers.
- ◆ Documentation of audit committee pre-approval of services, where required.
- ◆ Audit documentation access letters.
- ◆ Other communications or agreements with management or TCWG regarding the scope, or changes in scope, of our services.
- ◆ Auditor's report on the entity's financial statements.
- ◆ Other reports as specified in the engagement agreement.

Question: Evolving One Audit Programme is not Practicable For All Businesses. Comment.

Answer:

- Businesses vary in nature, size and composition.
- The work which is suitable to one business may not be suitable to others.
- The efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment.
- Because of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable.
- However, it becomes a necessity to specify in detail in the audit programme the nature of work to be done so that no time will be wasted on matters not pertinent to the engagement and any special matter or any specific situation can be taken care of.

Question: Periodic Review of The Audit Programme should be done. Explain.

Answer:

- There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions.
- Unless this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an obsolete programme . the whole audit may be held as negligently conducted and the auditor may have to face legal consequences.
- The utility of the audit programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed.
- However, as a basic feature, audit programme not only lists the tasks to be carried out but also contains a few relevant instructions, like the extent of checking, the sampling plan, etc.
- So long as the programme is not officially changed by the principal, every assistant should carry out the detailed work according to the instructions governing the work.
- Many persons believe that this brings an element of rigidity in the audit programme.
- This is not true provided the periodic review is undertaken to keep the programme as up-to-date as possible.

Question: Financial statements should disclose all 'material items, i.e. the items the knowledge of which might influence the decisions of the user of the financial statement. Materiality is not always a matter of relative size. Give two examples of Quantitative materiality.

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Answer: In certain cases **quantitative limits of materiality is specified**. For example:

- (a) A company should disclose by way of notes additional information regarding any item of income or expenditure which exceeds 1% of the revenue from operations or `1,00,000 whichever is higher in accordance with general Instructions for preparation of Statement of Profit and Loss in Schedule III to the Companies Act, 2013.
- (b) A company should disclose in Notes to Accounts, shares in the company held by each shareholder holding more than 5 per cent shares specifying the number of shares held.

**Question:**

Whether misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements? State what is performance materiality.

**Answer :**

- When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole.
- If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.
- Performance Materiality : *Performance materiality means the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.*
- If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

Question: Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Explain,

Answer: As per SA 320, although financial reporting frameworks may discuss materiality in different terms, they generally explain that:

1. **Misstatements are material if expected to influence the economic decisions of users taken on the basis of the financial statements:** Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;
2. **Judgments about materiality are affected by the size or nature of a misstatement :** Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
3. **Judgments about matters that are material are based on a consideration of the common financial information needs of users** as a group : The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

Question: The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements. What can auditor assume in this respect.

Answer: SA 320 states that the auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial

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statements. In this context, it is reasonable for the auditor to assume that users:

- (a) Have a **reasonable knowledge** of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
- (b) **Understand** that financial statements are prepared, presented and audited to **levels of materiality**;
- (c) Recognize the **uncertainties inherent in the measurement** of amounts based on the use of estimates, judgment and the consideration of future events; and
- (d) Make **reasonable economic decisions** on the basis of the information in the financial statements. The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

Question: What is relevant financial data In relation to the chosen benchmark.

Answer: In relation to the chosen benchmark, relevant financial data ordinarily includes –

- ◆ prior periods' financial results and financial positions,
- ◆ the period to-date financial results and financial position, and
- ◆ budgets or forecasts for the current period,
- ◆ adjusted for significant changes in the circumstances of the entity (for example, a significant business acquisition) and relevant changes of conditions in the industry or economic environment in which the entity operates.

Question: Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised, comment.

Answer: As the Audit Progresses Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business), new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.

- Example If during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality.
- If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.

Question: short note on: Documenting the Materiality

Answer: The audit documentation shall include the following amounts and the factors considered in their determination:

- (a) Materiality for the financial statements as a whole;
- (b) If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures ;
- (c) Performance materiality ; and
- (d) Any revision of (a)-(c) as the audit progressed.



<p><b>Question :</b> A well designed and drafted audit plan and audit strategy which takes care of all the uncertainties and conditions, need not be changed during the course of audit. <b>(Nov. 2018) (2 Marks)</b></p> <p><b>Answer:</b> Incorrect: The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks.</p>
<p><b>Question :</b> Under a properly framed audit programme by the auditor, the danger is significantly less and audit can proceed systematically. <b>(Nov., 2019) (2 Marks)</b></p> <p><b>Answer:</b> Correct: Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records. Thus under a properly framed programme, the danger is significantly less and the audit can proceed systematically.</p>
<p><b>Question :</b> It is not necessary for the auditor to periodically review the audit programme. <b>(Nov. 2020) (2 Marks)</b></p> <p><b>Answer:</b> Incorrect: There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions. Unless this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an obsolete programme and for this negligence, the whole audit may be held as negligently conducted and the auditor may have to face legal consequences.</p>
<p><b>Question :</b> The audit plan is more detailed than the overall audit strategy. <b>(Nov. 2020) (2 Marks)</b></p> <p><b>Answer:</b> Correct: The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Once the overall audit strategy has been established, an audit plan can be developed to achieve the audit objectives through the efficient use of the auditor's resources.</p>
<p><b>Question :</b> Determining materiality involves the exercise of professional judgement. <b>(Jan. 2021) (2 Marks)</b></p> <p><b>Answer:</b> Correct: Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.</p>
<p><b>Question :</b> When Profit before tax from continuing operations is non-volatile, other benchmarks will be appropriate. <b>(Dec.2021) (2 Marks)</b></p> <p><b>Answer: Incorrect:</b> Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues.</p>