

Chapter 2: AUDIT STRATEGY, AUDIT PLANNING AND AUDIT PROGRAMME

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1. Auditor's responsibility to plan an audit of financial statements

As per SA 300- Planning an audit of financial statements deals with the Auditors

Responsibility	to plan an audit	of financial statements
Objective		so that it will be performed in an effective manner.

I. Why Planning an audit is necessary? – Its Benefit

- Devote appropriate attention to important areas of the audit.
- Identify and resolve potential problems on a timely basis.
- Properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
- Assisting in the selection of engagement team members.
- Facilitating the direction and supervision of engagement team members and the review of their work.
- Assisting, where applicable, in coordination of work done by others such as experts.

Quick Revision		
Devote attention	Organize and manage Audit	D&S of ET and R of Work (DSR)
I&R Potential Problems	Assisting in Selection of ET	Coordination with Experts

II. Nature of Audit Planning- A Continuous and iterative process

- Planning is not a discrete phase of an audit, but rather a continual and iterative process.
- Begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement.

c) Planning includes consideration of the timing of certain activities and audit procedures that need to be completed **prior** to the performance of **further audit procedures** such as:

- ❖ The **analytical procedures** to be applied as **risk assessment procedures**.
- ❖ General understanding of the **legal and regulatory** framework applicable to the entity and how the entity is complying with that framework.
- ❖ The determination of **materiality**.
- ❖ The involvement of **experts**.
- ❖ The performance of **other risk assessment procedures**.

Quick Revision

AnPr - RAP	L&R framework and Entity's compliance	Materiality	Experts	O-RAP
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III. Involvement of key engagement team members in planning audit

- **Engagement partner** and other **Key members** shall be **involved** in planning,
- It **assists** in getting their experience and insights thereby enhancing the **effectiveness** and **efficiency** of planning process.

IV. Discussion of elements of planning with entity's management

- Auditor **may discuss** elements of planning with entity's management to **facilitate conduct of audit**.
- But such discussion shall **not compromise the effectiveness** of audit.

2. Planning Process- Elements of Planning

The elements of planning can be categorized as under

I. Preliminary engagement activities	II. Planning activities
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V. Preliminary engagement activities

The auditor considers whether relationship with client should be continued and whether ethical requirements including independence continue to be complied with. It includes: -

- a) Performing procedures regarding the continuance of the client relationship,
- b) Evaluating compliance with ethical requirements, including independence,
- c) Establishing an understanding of terms of engagement.

a) Performing procedures regarding the continuance of the client relationship:

- ❖ It should be ensured that appropriate procedures regarding acceptance and continuance of the client relationship that conclusions reached in this regard are appropriate.
- ❖ The firm should obtain necessary information before accepting an engagement and when considering acceptance of a new engagement with an existing client.
- ❖ Matters such as:

Integrity of principal owners and key management	Competence of ET to perform the audit engagement	Implications of matters that have arisen during current and previous audit
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- ❖ In case of initial engagements, communication with predecessor auditor should be made, where there has been a change of auditors.

b) Evaluating compliance with ethical requirements, including independence:

- ❖ Auditor shall continuously evaluate compliance with ethical requirements including independence.
- ❖ Engagement partner shall remain alert throughout the audit, by observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements.
- ❖ If matters have arisen regarding non-compliance with ethical requirements, Engagement partner in consultation with others in the firm shall take appropriate action.

The Engagement Partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall:

Obtain relevant information from the firm to identify and evaluate circumstances and relationships that create threats to independence

Evaluate information on identified breaches, if any, determine whether they create a threat to independence for the audit engagement and

Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered as appropriate, to withdraw from the audit engagement if permitted by law or regulation

c) Establishing an understanding of terms of engagement

- Auditor shall send Engagement letter before the commencement of engagement to avoid misunderstanding.

Quick revision				
Elements of Planning- Preliminary Engagement activities				
procedures regarding the continuance of the client relationship	Procedures Performed and conclusion is appropriate	Obtain necessary information for old and new audit	Integrity of owners, Competence of ET & Implications of matters	(New audit) Communicate with predecessor auditor
compliance with ethical requirements, including independence	Evaluate compliance with ethical requirement continuously	Remain alert to situations by inquiry and observation	Non-compliance, consult others and take actions	Conclusion On Independence shall: ↓
Establishing an understanding of terms of engagement	Send engagement letter to avoid misunderstanding	Identify and evaluate that create treat. Evaluate & determine whether they create threat. Take appropriate actions		

Student notes

VI. Planning activities

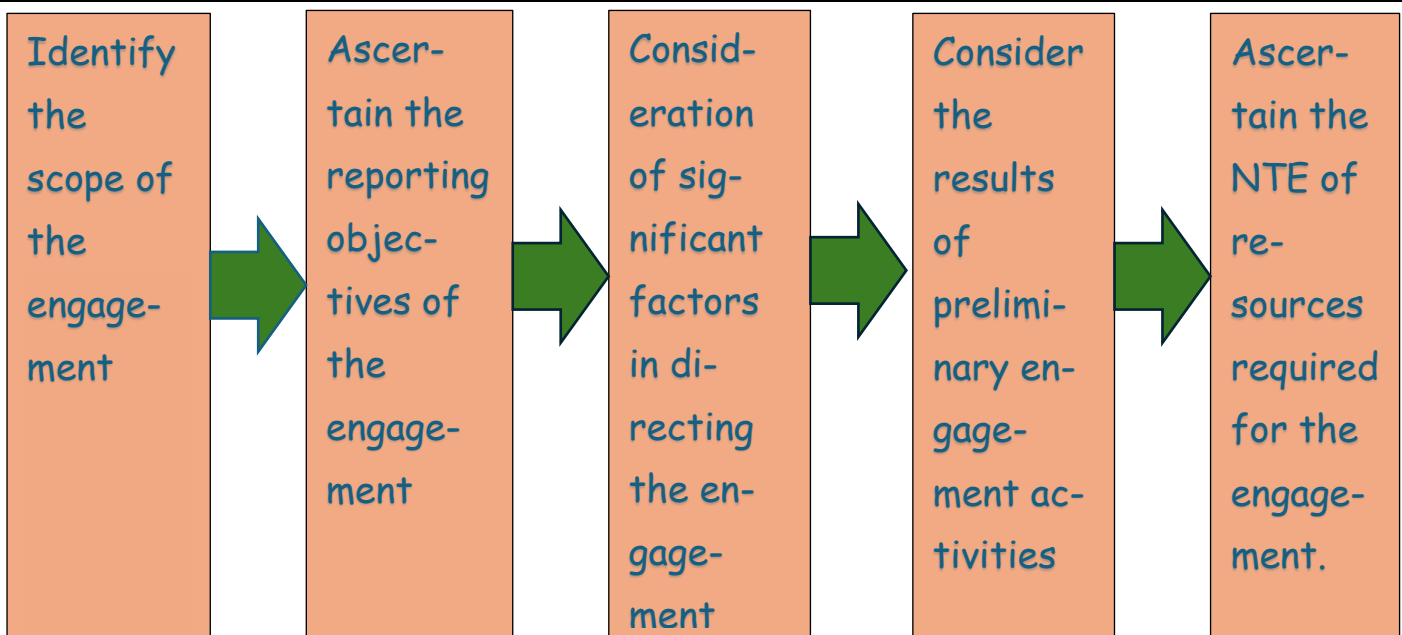
- A. Establishing the overall audit strategy (OAS).
- B. Developing an audit plan

A. Establishing the overall audit strategy (OAS)

Overall audit strategy:

- set scope, timing and direction (STD) to audit and
- guides development of audit plan.

Factors to be taken into consideration to establish overall audit strategy:



a) Identify the characteristics of the engagement that define its scope:

Applicable financial reporting Framework (AFRF)	Nature of business segments to be audited	Industry specific reporting requirements	Expected use of audit evidence obtained in previous audits
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b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required:

The entity's timetable for reporting	Meetings to discuss of nature, timing & extent (NTE) of audit work with management	Discussion with management regarding the expected type and timing of reports	Discussion with management regarding the expected communications on the status of audit work
Expected nature & timing of communications among engagement team members including nature and timing of team meetings and timing of the review of work performed.			

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

Volume of transactions	Significant industry developments	Significant changes in the financial reporting framework	Other significant relevant developments
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d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement

e) partner for the entity is relevant:

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.	The way the auditor emphasizes to engagement team members the need to maintain professional skepticism in gathering and evaluating audit evidence.
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f) Ascertain the nature, timing and extent of resources necessary to perform the engagement:

- ❖ Selection of engagement team and assignment of audit work to team members is a significant factor in establishing overall audit strategy.

Benefits of overall audit strategy:

- ✓ The resources to deploy for specific audit areas. (Quality)
- ✓ The amount of resources to allocate to specific audit areas. (Quantity)
- ✓ When these resources are to be deployed. (Timing)
- ✓ How such resources are managed, directed and supervised. (DSR)

B. Development of Audit plan

- ❖ 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.
- ❖ Understanding client's business is one of the important principles in developing an audit plan.
- ❖ SA-300 states that auditor shall develop an audit plan that shall include description of:
 - The nature, timing and extent of planned risk assessment procedures.
 - The nature, timing and extent of planned further audit procedures at assertion level.
 - Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

Student notes

Elements of Planning- Planning activities

Establishing Overall audit strategy (OAS)

Development of Audit plan

Benefits of OAS= Quality, Quantity, Timing & DSR of Resources

NTE of RAP, FAP, & other Audit procedures

Factors to be taken into consideration for establishing OAS

a. Scope of Engagement	b. Reporting Objective	c. Efforts of Engagement team	d. Results of Pre. Engagement activity
AFRF	TT of reporting	Volume of Tran.	
Nature of business	NTE of audit to Mgt	Δ in AFRF, Regulatory & other	Results of P/Y audit
Industry Specific reporting	Type & timing of report		Professional skepticism
P/Y AE Use	Status of audit		
	Expected NT among ET	e. NTE of resources necessary	

3. Relationship between audit strategy and audit plan

Overall audit strategy	Audit plan
Sets broad overall approach	Address matters identified in OAS
Determine STD of audit	Determine how OAS is implemented
Less detailed than audit plan	More detailed
Establishing OAS and 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.	

Student notes

4. Changes to planning decision during the course of audit

The auditor shall update and **change the overall audit strategy and the audit plan** as necessary during the audit. As a result of

Unexpected events	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,
Changes in conditions	

5. Planning Supervision and Review of work of engagement team

The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work depending on many factors, including:

The size and complexity of the entity	The area of the audit.	Assessed Risk of material mis-statement (AROMM)	Capabilities and Competence of ET members
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6. Documentation

The auditor shall document

The overall audit strategy	The audit plan	Changes and Reasons for change in OAS and audit plan
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- ✓ 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.
- ✓ Documentation of the **audit plan** is a record of the planned **nature, timing and extent** of **risk assessment procedures** and **further audit procedures** at the assertion level.
- ✓ A record of the **significant changes** to the overall audit strategy and the audit plan, and **resulting changes** to the planned nature, timing and extent of audit procedures, **explains why the significant changes were made**, and finally **adopted for the audit**

7. Audit Programme

Audit programme is a **list of examination and verification steps** to be applied and set out in such a way that the **interrelationship** of one step to another is clearly shown and designed, **keeping in view the assertions** at financial statement level or accounting records of client.

VII. Evolving one audit programme- Not Practicable for All businesses

- ✓ Businesses **vary in nature, size and composition**.
- ✓ **Work** which is **suitable** to one business may **not be suitable** to others.
- ✓ **Efficiency** and operation of **internal controls** and
- ✓ **Nature of the service** to be rendered by the auditor are the other factors that **vary** from assignment to assignment.

On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable.

VIII. The Assistant to keep an open mind.

- ✓ Auditor having **regard to nature, size and composition** of the business & **dependability** of the **internal control** also the given **scope of work** should frame programme aim at **providing for minimum essential work** i.e. standard audit programme.
- ✓ As experience is gained programme may be altered and **assistant** should be **encouraged to keep an open mind**.
- ✓ **Assistant** should be **instructed to note and report** significant matters coming to his notice to his seniors.

Student notes

IX. Periodic review of the audit programme

- ✓ 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, based on 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**.
- ✓ 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.
- ✓ So long as the **programme is not officially changed** by the principal, every **assistant should unfailingly carry out** the detailed work according to the instructions governing the work.

X. Audit Programme- Designed to provide audit evidence.

- ✓ **Audit evidence** may be defined as the **information used** by the auditor in **arriving at the conclusions** on which the auditor's opinion is based. Audit evidence includes:
 - Information contained in the accounting records underlying the financial statements and
 - other information.
- ✓ What is **best evidence** for testing the **accuracy of any assertion** is a **matter of expert knowledge and experience**.
- ✓ This is the **primary task before** the auditor when he draws up the **audit programme**.
- ✓ Transactions are varied in nature and impact; procedures to be prescribed depend on prior knowledge of what evidence is reasonably available in respect of each transaction.
- ✓ An auditor picks up evidence from a variety of fields and it is generally of the following broad types:

Documentary examination	Arithmetical calculations by the auditor	Subsequent action by the client and by others.
Physical examination	State of internal controls and internal checks	Statements and explanation of management, officials and employees & third parties
Subsidiary and memorandum records	Inter-relationship of the various accounting data	Minutes

XI. Constructing an audit programme

- ✓ Audit planning and related programmes commences at the conclusion of previous audit and should be reconsidered for modification.
- ✓ Such consideration is based on.
 - Auditors review of Internal control.
 - Preliminary evaluation.
 - Results of compliance procedures (TOC) & substantive procedures.
- ✓ While developing an audit programme auditor may conclude that relying on certain internal controls are an effective and efficient way to conduct his audit.
- ✓ Auditor may also decide not to rely on internal controls when there are other efficient ways of obtaining sufficient appropriate audit evidence.
- ✓ 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 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 describing 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 useful steps and procedures in accomplishing the verification purpose.
- Include the audit objectives for each area.
- Consider all possibilities of error.
- Co-ordinate the procedures to be applied to related items.

Quick revision		
Stay within scope	Co-ordination of work	Possibility of Errors
Written audit programme	Audit Objective of each area	Reasonable and Best AE
Apply useful steps	Memory technique: " SPACE ² -O "	

XII. Advantages of audit programme.

- Provides total and clear set of instructions to the assistants.
- Provide a total perspective of the work to be performed for major audits.
- Helps Selection of assistants.
- Without a written audit programme there is a danger of ignoring or overlooking things
- Work can be track back to assistants by signing on the programme.
- Principle can track progress of different assignments.
- Serves as guide for future audits.
- Serves as evidence in event of charge of negligence.

Quick revision			
Clear instructions	Selection of ETM	Track back To Members	Guide for future
Total perspective	Ignoring & overlooking	Principal can Track progress	Evidence for Charges

XIII. Disadvantages of audit programme

- The work may become mechanical if performed without any understanding of the object
- The programme often tends to become rigid and inflexible.
- Inefficient assistants may take shelter behind the programme.
- A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.

All these disadvantages may be eliminated by:

- ✓ Imaginative supervision.
- ✓ Receptive attitude as regards the assistants.
- ✓ Assistants should be encouraged to observe matters objectively.
- ✓ bring significant matters to the notice of supervisor/principal.

Quick revision

Disadvantages	Elimination of disadvantages
work may become mechanical	Imaginative supervision
Programme may become rigid and inflexible	Receptive attitude
Inefficient assistants take shelter	Observe matters objectively
Kill the initiative of entrepreneurs	Notice significant matters to seniors