

## Chapter 2 Audit Planning Audit Strategy and Audit Programme

### SA 300 Planning an audit of financial statements

#### Topic-1 Benefits of Planning

- Appropriate attention to important areas.
- Identify and Resolve Potential Problems
- Efficient and Effective Audit
- Selection of Team Members
- Direction and Supervision of Team & Review of work
- Coordination with other Auditors and Experts

#### Topic-2 Nature of Planning

- *Planning is not a separate or distinct phase of an audit. It is to be viewed as a continual and repetitive process.*
- *It is a continuous process that begins with completion of previous audit and continues till the completion of 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: -
  1. The *analytical procedures* to be applied as risk assessment procedures.
  2. Obtaining a *general understanding of the legal and regulatory framework* applicable to the entity and how the entity is complying with that framework.
  3. The determination of *materiality*.
  4. The involvement of *experts*.
  5. The performance of *other RAP*.

#### Involvement of Key Engagement Team Members in Audit Planning

The engagement partner and other key members of the audit team shall actively participate in the planning process, including discussions among team members. Their involvement leverages their experience and insights, enhancing both the effectiveness and efficiency of audit planning.

#### Discussion of Planning Elements with Management

The auditor may choose to discuss certain aspects of the audit plan with the entity's management to streamline the audit process. *However, while sharing details related to the overall audit strategy or plan, caution must be exercised to ensure that the effectiveness of the audit remains uncompromised.*

#### Topic-3 Elements of Planning

##### a. Preliminary Engagement Activities

- ❖ Performing procedures regarding the continuance of the client relationship
- It should be ensured that appropriate procedures regarding the *acceptance and continuance of client relationships and audit engagements* have been followed and that conclusions reached in this regard are appropriate.
- The firm should *obtain information considered necessary* in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing 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 engagement team to perform the audit engagement and implications of matters that have arisen during current and previous audit engagement may need to be considered.
- **Besides, in case of initial engagements, communication with predecessor auditor should be made, where there has been a change of auditors.**

❖ Evaluating compliance with ethical requirements, including independence

- **"Independence"** means that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.
- Throughout the audit engagement, the engagement **partner shall remain alert**, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team.
- If matters come to the engagement partner's attention that indicate that members of the engagement team have not **complied with relevant ethical requirements**, the engagement partner, in consultation with others in the firm, shall determine the 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, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement
  - ✓ **Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation.** The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

❖ Establishing an understanding of terms of engagement

- It is in the interests of both the entity and the auditor that the **auditor sends an audit engagement letter before the commencement of the audit** to help avoid misunderstandings with respect to the audit.
- **It ensures that there is no confusion** with the client regarding terms of the engagement.

**b. Planning Activities**

❖ Establishing the overall audit strategy

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: -

- (i) **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
- (ii) **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.

- (iii) *When these resources are to be deployed*, such as whether at an interim audit stage or at key cut-off dates.
- (iv) *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.

**Factors to be taken into consideration by auditor for establishing audit strategy (v.imp)**

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

It is important for auditor to identify scope of the engagement. There are many characteristics of engagement defining its scope. Some of characteristics are as under:

- *Applicable financial reporting framework* applicable to the entity
- *Nature of business segments to be audited* including the need for specialized knowledge
- *Industry specific reporting requirements* required by industry regulators
- *Expected use of audit evidence obtained in previous audits*

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

Some of the instances are given under

- *The entity's timetable for reporting*
- *Organization of meetings* to discuss of nature, timing and extent of audit work with management
- *Discussion with management* regarding the expected type and timing of reports to be issued including the auditor's report
- *Discussion with management* regarding the expected communications on the status of audit work throughout the engagement.
- *Expected nature and timing of communications among engagement team members*, including the 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**

Few examples are listed as under:

- *Volume of transactions* which may determine whether it is more efficient for the auditor to rely on internal control
- *Significant industry developments* such as changes in industry regulations and new reporting requirements
- *Significant changes in the financial reporting framework*, such as changes in accounting standards.
- *Other significant relevant developments*, such as changes in the legal environment affecting the entity.

**(d) Consider the results of preliminary engagement activities and, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant**

Examples are listed as under: -

- *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 manner in which the auditor emphasizes to engagement team members the need to maintain a questioning mind and to exercise professional skepticism in gathering and evaluating audit evidence.*
- e. 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.  
*Experienced team members* may be assigned in areas where there is higher risk of material misstatement.  
 Similarly, *engagement budgeting and devotion of more time* to areas of higher risk of material misstatement are to be kept in mind.

❖ 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, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.
- Understanding client's business is one of the important principles in developing an audit plan. In fact, without adequate knowledge of client's business, a proper audit is not possible.
- *Gaining knowledge of client's business is, therefore, one of the foremost requirements to develop audit plan.*
- SA-300 states that auditor shall develop an audit plan that shall include description of-
  1. The nature, timing and extent of *planned risk assessment procedures*
  2. The nature, timing and extent of *planned further audit procedures at assertion level*
  3. *Other planned audit procedures* that are required to be carried out so that the engagement complies with SAs.
- The auditor plans what type of audit procedures are to be performed, their timing and how much work should be done taking into account sample size etc.
- 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.*  
 For example, *planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures.* In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

**Topic-4 Relationship b/w Audit Strategy & Audit Plan**

- *Audit strategy sets the broad overall approach to the audit whereas audit plan addresses the various matters identified in the overall audit strategy.*
- *Audit strategy determines scope, timing and direction of audit. Audit plan describes how strategy is going to be implemented.*
- *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.*

- 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.

#### **Topic-5 Changes to planning decisions during the course of audit**

- 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.
- This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures. For example, audit evidence obtained through on detailed checking may contradict the audit evidence obtained through testing internal controls.

#### **Topic-6 The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work.**

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: -

- The size and complexity of the entity.
- The area of the audit.
- The assessed risks of material misstatement
- 4.The capabilities and competence of the individual team members performing the audit work.

#### **Topic-7 Documentation**

##### **a. Overall Audit Strategy**

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.

##### **b. Audit Plan**

The 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 in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

##### **c. Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.**

Documentation explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit.

## **Audit Programme**

### Meaning

It is a **detailed plan of applying the audit procedures in the given circumstances** with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.

### Periodic Review of Audit Programme

- 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.**
- **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.

### Different AP for Different Entities

- **Businesses vary in nature, size and composition;**
- **work w+hich is suitable to one business may not be suitable to others;**
- **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.

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

### The Assistant to keep an open mind (READ)

- 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.

### Construction of Audit Programme

- 1) **Stay within the scope and limitation of the assignment.**
- 2) Prepare a **written audit programme setting forth the procedures that are needed to implement the audit plan.**
- 3) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.

- 4) *Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.*
- 5) *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.
- 6) *Consider all possibilities of error.*
- 7) *Co-ordinate the procedures to be applied to related items.*

#### Advantages

- *It provides the assistant carrying out the audit with total and clear set of instructions of the work generally to be done.*
- *It is essential, particularly for major audits, to provide a total perspective of the work to be performed.*
- *Selection of assistants for the jobs* on the basis of capability becomes easier when the work is rationally planned, defined and segregated.
- *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. Under a properly framed programme, such danger is significantly less and the audit can proceed systematically.
- *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.
- *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.
- *It serves as a guide for audits to be carried out in the succeeding year.*
- *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.*

#### Disadvantage

- *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 scheme.
- *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. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.
- *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.
- *A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.*

#### Note

*All these disadvantages may be eliminated by*

- *imaginative supervision of the work* carried on by the assistants;
- *the auditor must have a receptive attitude* as regards the assistants;
- *the assistants should be encouraged* to observe matters objectively and bring significant matters to the notice of supervisor/principal.