Chapter 2 - Audit Strategy, Audit Planning and Audit Programme

SA 300 - Planning an Audit of Financial Statements

Objective of Auditor

- Audit is performed in ***efficient*** and ***effective*** manner

Involvement of Key Engagement Team Members

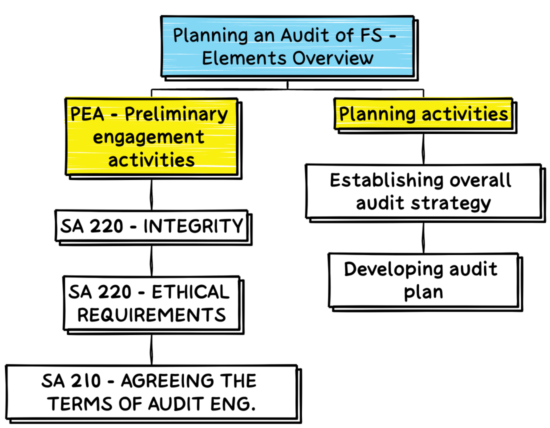
- EP and other key members of ET shall be ***involved*** in planning
- Advantage -
  - Draws on their ***experience*** & ***insight***
  - Enhances the ***effectiveness*** and ***efficiency*** of audit

Discussion of elements of planning with management

- May be done to ***facilitate*** the ***conduct*** and ***management*** of audit
- Overall audit strategy and audit plan remains auditor's ***responsibility***
- Care is required in order ***not*** to ***compromise*** the ***effectiveness*** of audit

Benefits of Planning in the Audit of FS🔥

- Appropriate ***attention*** to important areas
- Identify and resolve ***potential*** problems
- Properly ***organize*** and ***manage*** the audit
- ***Selection*** of ET members
- ***Direction***, supervision and review of ET and their work
- ***Coordination*** of work done by auditors of components and experts.



Preliminary Activities (PA)

SA 220 - INTEGRITY

- Performing ***procedures*** regarding the ***continuance*** of client relationship
- Will help auditor in ***ensuring*** - ***no issues*** with management ***integrity*** that may affect the auditor's willingness to continue the engagement

SA 220 - ETHICAL REQUIREMENTS

- Evaluating ***compliance*** with ***ethical requirements*** including independence.
- Will help the auditor in ***maintaining*** the ***necessary independence*** and ability to perform the engagement.

SA 210 - AGREEING THE TERMS OF AUDIT ENG.

- Establishing an ***understanding*** of ***terms*** of engagement with the client
- to ensure there are ***no misunderstandings*** with the client as to the terms of the engagement.

Planning activities

Discuss the factors that are going to impact the nature and extent of planning activities

The ***nature*** and ***extent*** of planning activities will vary according to the

- ***Size*** and ***complexity*** of the entity,
- key ***ET members' previous experience*** with the entity, and
- changes in ***circumstances*** that occur during the audit engagement.

Audit Strategy

Meaning

- Sets ***scope***, ***timing*** and ***direction*** of the audit, & guides the ***development*** of ***audit*** plan
- OAS is the ***basis*** of an ***audit plan***.

How would the audit strategy be helpful to the auditor?🔥

The process of establishing OAS assists the auditor to determine, subject to the completion of the auditor's RAP, such matters as: -

- ***Nature*** of Resources - Resources to deploy for specific audit areas (Experienced team members for high risk areas, involvement of experts)
- ***Extent*** of Resources - Amount of resources to allocate to specific audit areas
  - Inventory count at key location - More resources.
  - High risk areas - More resources.
  - Extent of review required in case of group audit.
- ***Time*** of Resources - When these resources are to be deployed (interim audit stage or at key cut-off dates)
- ***Management*** of Resources - How such resources are managed, directed and supervised
  - Timing of team briefing and debriefing meetings
  - Engagement partner and manager reviews (on-site or off-site)
  - Decision on conducting engagement quality control reviews

Factors to be considered for establishing overall audit strategy🔥

Characteristics and Scope

Identify characteristics of engagement that define its scope

- ***AFRF*** applicable to entity
- Nature of ***Business segment***
- ***Industry specific*** reporting requirement
- ***Expected use*** of audit evidence obtained in previous audit (issues within previous year's inventory management)

RO - Reporting Objectives

Ascertain reporting objectives to plan timing and nature of communication. Examples -

- Entity's ***timetable*** for reporting
- Organising ***meetings*** with MGMT to discuss scope and timing
- ***Discussion*** with MGMT regarding type and timing of reports
- ***Communication*** regarding audit status (update on progress)
- ***Internal team*** communication
  - ***How*** the audit team will communicate internally.
  - ***Timings*** of meetings and review

ETE

- The auditor directs the team to significant matters using professional judgment. Identifying material transactions, balances, disclosures sets an audit strategy
- The auditor need to consider where efforts should be directed, this will help in developing overall audit strategy

Factors that an auditor should consider in directing the engagement team's efforts

- Volume of transactions
  - Reliance on IC to be placed or not
- Significant industry developments
  - as changes in industry regulations and new reporting requirements.
- Changes in the financial reporting framework
  - such as change in AS
- Other significant relevant developments,
  - changes in the legal environment affecting the entity

Preliminary engagement activities other engagements (PEA/OE)

Results of preliminary engagement activities and knowledge gained on other engagements

- Results of previous audits
- Previous evaluation of IC
- Communication of Deficiencies in IC and action on those.

Nature, timing and extent of resources

Ascertain the nature, timing and extent of resources necessary to perform the engagement.

- Selection of ET and assignment of audit work to team members is a significant factor in establishing overall audit strategy.
- Experienced team members and more time are allocated to areas where ROMM is high

Audit Plan

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 ET members.

- The ***NET*** of planned ***RAP*** - SA 315
  - Planning of the auditor's risk assessment procedures occurs early in the audit process.
- The ***NET*** of planned ***FAP*** at assertion level - SA 330
  - Planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures.
- Other planned audit procedures ***(O-AP)*** required to be carried out so that engagement complies with SAs

Change in OAS and AP

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
- Audit ***evidence obtained*** from results of audit procedures

Examples

- ***Revised*** consideration of assessed ***risks***.
- ***Information*** comes to the auditor's ***attention*** that ***differs significantly*** from the information ***available when*** the auditor ***planned*** the audit procedures.
- ***performance*** of ***substantive procedures*** may ***contradict*** the audit evidence obtained through tests of controls

Relationship between OAS and AP

- Overall audit strategy deals with ***scope***, ***timing***, and ***direction*** of Audit
- Audit ***plan*** includes ***nature***, ***extent*** and ***timing*** of ***RAP***, and ***further audit procedures*** and other ***audit procedures*** as required by SAs.
- Audit ***strategy*** is ***broad*** while audit ***plan*** is ***detailed***
- Audit ***strategy*** is the ***basis*** of ***audit*** plan or we can say that audit plan is made on the basis of audit strategy
- They are ***not sequential*** or discrete.
- They are ***closely interrelated*** to each other. Change in one will lead to change in another.

Direction, Supervision and Review

- The auditor shall plan the NET of direction and supervision of ET members and the review of their work.
- Factors
  - ***Area*** of the audit
  - Assessed risks of material misstatement ***(ROMM)***
  - ***Capabilities*** and competence of individual team members performing the audit work
  - ***Size*** and ***complexity*** of the entity.

Documentation🔥

- Overall audit strategy
  - record of the ***key decisions***
    - considered necessary ***to properly plan*** the audit and
    - **to communicate significant matters** (of audit strategy) to ET **(Hum OAS ki documentation mein key decision**

ko record karte hai taaki audit ache se plan ho paaye aur Significant matters ET ko communicate ho paaye)

- Audit Plan
  - record of the **proper planning** of the **audit procedures**
  - that can be **reviewed** and **approved** prior to their performance
- significant **changes** made during the audit engagement to the overall audit strategy or audit plan, and **reasons** for such changes.
  - **explains why** significant changes were made
  - and the overall strategy and audit plan **finally adopted** for the audit.
  - It also **reflects appropriate response** to significant changes occurring during the audit.

Planning is a Continuous Process 🔥

- Planning is **not a discrete** phase of an audit, but rather a **continual** and **iterative** process
  - **begins shortly after completion** of **previous audit** and
  - **continues** until **completion** of **current** audit engagement.
- However Planning includes **consideration** of **timing** of **certain activities** and **audit procedures**.
- Planning includes need to consider certain matters, prior to the identification and assessment of ROMM
  - Analytical procedures to be applied as RAP
  - Obtaining a general understanding of legal and regulatory framework applicable to entity and how the entity is complying with that framework
  - Determination of materiality
  - Involvement of experts
  - Performance of other RAP

Additional Consideration in Initial Audit Engagements

- **Purpose** and **Objective** Same
- Need to **expand** the planning activities Why? - **No** Previous **Experience**.
- Performing procedures required by SA **220** regarding the **acceptance**
- **Communicating** with the **predecessor auditor** - where there has been a **change** of **auditors**.
- **Other procedures** required by the firm's system of quality control for initial audit engagements
- For example, **review** of the overall **strategy** by senior **partner** before starting the audit

Audit Programme

Meaning

An audit programme consists of

- a series of verification procedures
- to be applied to FS and accounts of a given company
- for the purpose of obtaining SAAE
- to enable the auditor to express an informed opinion on FS

Evolving one audit programme- Not Practicable for All businesses 🔥

- All businesses are not same
- Vary in
  - **Nature**
  - **Size**
  - Capital Raised
  - **Internal Controls**
  - Applicability of Law and Regulations
- Because of above factors
  - Scope of Services Differ
  - not possible to develop one

Assistant to keep an open mind 🔥

- Consider
  - Nature
  - size
  - composition of business
  - internal control reliability, and
  - scope of work.
- A standard audit programme should cover the **minimum essential work** required.
- As the audit progresses, the programme may be altered to include situations which were left out originally, but are found relevant and drop unnecessary work.
- Assistants engaged in the job should be encouraged to keep an **open mind** beyond the programme given to him.
- Assistants should be instructed to note and **report significant matters** coming to his notice, to his seniors/partners/proprietor of the firm

Periodic review of Audit Programme 🔥

- Purpose
  - Ensures the programme remains adequate for obtaining necessary **knowledge** and evidence about transactions.
- Without periodic review
  - Changes in business policy may go unnoticed.
  - Audit work may be carried on an **obsolete** programme.
  - Audit may be considered **negligently** conducted, leading to legal consequences for the auditor.
- Retaining and enhancing utility
  - by keeping the programme as also client's operations and IC under periodic review so that inadequacies or redundancies of the programme may be removed
- Structure of the Audit Programme
  - Includes a task list and relevant instructions (e.g., extent of checking, sampling plan).
- Execution and **Flexibility**
  - Assistants must follow the programme unless officially modified by the principal.
  - Some perceive the programme as rigid, but periodic reviews ensure it stays up to date.

  - Assistants should be encouraged to observe key accounting functions of the client.

Constructing an Audit Programme

- The auditor may or may not rely on IC for conducting the audit.
- The auditor normally has flexibility w.r.t timing of Audit procedures except in a few cases -
  - observing the taking of inventories by client personnel or
  - verifying the securities and cash balances at the year-end

Points to be kept in mind by the auditor for the purpose of constructing an audit programme 🔥

- Stay within the ***scope*** and ***limitation*** of the assignment.
- Must be ***Written*** with procedures required to implement audit plan
- ***Evidence*** (Best for necessary satisfaction and Reasonably Available)
- ***Steps*** and ***Procedures*** (Use only relevant audit techniques)
- Include - ***Audit Objective*** Area-wise and sufficient details and clear instruction for assistants for proper execution
- Consider ***Possibilities*** of ***Error*** - Include looking for potential mistakes or misrepresentations in the data
- ***Coordinate*** procedures to be applied on ***related*** items

Audit Programme- Designed to provide Audit Evidence

- Audit Programme designed to provide evidence by describing procedures & techniques.
- In most of the assertions much of the evidence be drawn and each one should be considered and weighed to ascertain its weight to prove or disprove the assertion
- Best evidence for a given depends on Professional judgment
  - For cash in hand, the best evidence is 'count'.
  - For investment pledged with a bank, banker's certificate.

Variety of fields for Audit Evidence

- Documentary examination
- Physical examination
- Management Explanation
- Third Party Explanations
- Arithmetical Calculations
- State of IC
- Relationship among financial and non financial data
- Subsidiary and Memorandum records
- MoM
- Subsequent action by client

Advantages of Audit Programme

- ***Clear set*** of instructions
- Total ***perspective*** of work
- ***Selection*** of assistants
- Danger of overlooking reduced, which is high in "mental unwritten plan
- Acceptance of ***responsibility*** by assistants by putting their signature. Also, work done can be traced back to assistant
- ***Progress*** can be controlled by the Principal. Helpful in managing multiple audits at a time
- ***Guide*** for audits in succeeding year
- Serves as ***evidence*** in case of charge of negligence. Exercised reasonable skill and care.

Disadvantages of Audit Programme

- Mechanical work without understanding:
  - may become ***mechanical***
  - may be carried out without understanding objective
- ***Rigidity*** and Lack of Adaptability
  - may fail to adapt to changes in the business's operations or IC
- ***Shelter*** for ***inefficient*** Assistants
  - On the ground that no instruction in the matter is contained therein.
- May ***kill*** the ***initiative*** of enterprising assistants
  - A hard and fast audit programme can do this.

Extract of Sample audit programme pertaining to sales of an entity

Name of concern	XXX
Financial year	20XX-XX
Prepared by	Name of person with date
Reviewed by	Name of person with date
Approved by	Name of person with date

S.No	Nature of Procedure	Extent of Check	Basis of sample	Done by
(a)	Vouch few sales invoices from copies available in record of the concern			
(b)	Trace these invoices into the account books of the concern.			
(c)	Verify a few invoices with e-way bills generated on the e- way bill portal.			
(d)	Trace a few sales invoices into the stock records to ensure that sold quantities have been reduced from stocks.			
(e)	Trace also few sales invoices into accounts of buyers			

Short Forms

EP	Engagement Partner
ET	Engagement Team
OAS	Overall audit strategy
AP	Audit Plan
RAP	Risk assessment Procedures
SAAE	Sufficient Appropriate Audit Evidence