

Audit Planning, Strategy and Execution

3.1 - Audit Planning

Introductory Topics

Meaning

Establishing Overall Audit Strategy & developing an Audit Plan.

Importance of planning

1. To devote attention to important areas
2. Identify & resolve potential problems.
3. Organized and managed audit.
4. Selection of suitable ET.
5. Coordination of work done
6. Direction & supervision of ET.

Factors affecting Nature & Extent of Planning

1. Size and Complexity of Auditee (Client).
2. Past Experience
3. Changes in Circumstances

Contents of an Audit Plan

Audit plan shall include a description of:

- NTE of planned RAP, as determined under SA 315.
- NTE of planned FAP at assertion level, as determined under SA 330.
- Other planned audit procedures required to be carried out.

Factors to be considered in development of Overall Plan

1. Terms of engagement
2. Nature & timing of reports
3. Legal or statutory requirements.
4. Accounting policies & changes therein.
5. Effects of new accounting/auditing pronouncements.
6. Identification of significant audit areas.
7. Setting of materiality levels.
8. Degree of reliance on internal control.
9. Nature & Extent of Audit Evidence to be obtained.
10. Establishing & Coordinating Staffing Requirements.

Planning – a continuous process

Planning is not a discrete phase of an audit but a continuous process. It often begins shortly after completion of previous audit and continues until completion of current audit engagement.

Planning, includes consideration of timing of certain activities & audit procedures that need to be completed prior to performance of FAP. For example, planning includes need to consider, prior to auditor's identification & assessment of RoMM, such matters as:

- Analytical procedures to be applied as RAP.
- Obtaining a general understanding of legal & regulatory framework applicable to entity and how entity is complying with that framework.
- Determination of materiality.
- Involvement of experts.
- Performance of other RAP.



Preliminary Engagement Activities

Auditor shall undertake following activities at beginning of current audit engagement:

- Performing procedures required by SA 220 regarding continuance of client relationship & specific audit engagement;
- Evaluating compliance with ethical requirements, including independence, as required by SA 220; and
- Establishing understanding of terms of engagement, as required by SA 210.

Changes to Planning decisions

- Auditor shall update & change overall audit strategy and audit plan as necessary during course of audit.
- Auditor may need to modify overall audit strategy and audit plan as a result of:
 - ⇒ unexpected events,
 - ⇒ changes in conditions, or
 - ⇒ audit evidence obtained from results of audit procedures.
- Based on revised consideration of assessed risks, auditor need to modify the NTE of further audit procedures.

3.2 – Audit Strategy



Auditor shall establish an overall audit strategy that sets scope, timing & direction of audit, and guides development of audit plan. In establishing overall audit strategy, auditor shall:

- Identify characteristics of engagement that define its scope;
- Ascertain reporting objectives of engagement to plan timing of audit & nature of communications required;
- Consider factors that are significant in directing ET efforts;
- Consider results of preliminary engagement activities; and
- Ascertain NTE of resources necessary to perform.

Benefits of Audit Strategy

1. Employment of Qualitative Resources.
2. Allocation of appropriate quantity of resources.
3. Determining timing of deployment of resources.
4. Better Mngt. of resources in terms of direction, supervision, timing of team meetings etc.

Relationship - Audit Strategy & Audit Planning

- Audit strategy and audit plan are inter-related to each other because change in one would result into change in other.
- Audit strategy is prepared before audit plan. Audit plan contains more details than overall audit strategy.
- Audit strategy provides guidelines developing audit plan.

3.3 – Audit Programming and Stages of Audit Execution



Audit Programme

Detailed plan of work, comprises of techniques and procedures, may also contain objectives for each audit step.

Matters to be considered

- Nature of business.
- Overall Plan
- System of IC & accounting procedures.
- Size & structure of organization.
- Info. regarding organization.
- Accounting policies followed.

Circumstances requiring Changes

1. Substantial increase in Volume of turnover.
2. Significant changes in accounting procedures.
3. Observation w.r.t. ineffective internal control.
4. Substantial increase in book debts or inventory.
5. Suspicion as to misappropriation of assets.

Sample Audit Programme - Movie Theatre Complex

- (1) Peruse MOA & AOA.
- (2) Ensure object clause permits entity to engage in this business.
- (3) **Income from sale of tickets:**
 - Ensure collections are properly accounted.
 - Verify system of online booking of various shows.
 - Check that there is overall system of reconciliation of collections with number of seats available.
- (4) Verify IC system & its effectiveness relating to income from café, shops, pubs, game zone etc.
- (5) Verify system of control relating to income from advertisements.
- (6) Verify system of collection from the parking areas.
- (7) Verify payments to distributors.
- (8) Verify system of payment of salaries and other benefits to the employees.

Stages of Audit Execution

Stage I - Execution Planning

Consider manpower requirement, qualification of members of ET, time factor etc.

Stage II - Risk & Control Evaluation

Conduct a detailed assessment of risk & control as per requirements of SA 315.

Stage III - Testing

- Test operating effectiveness of IC to determine whether controls are operating as designed.
- Perform appropriate substantive procedures (ToD and SAP) so as to collect SAAE w.r.t. completeness, accuracy and validity of accounting data.

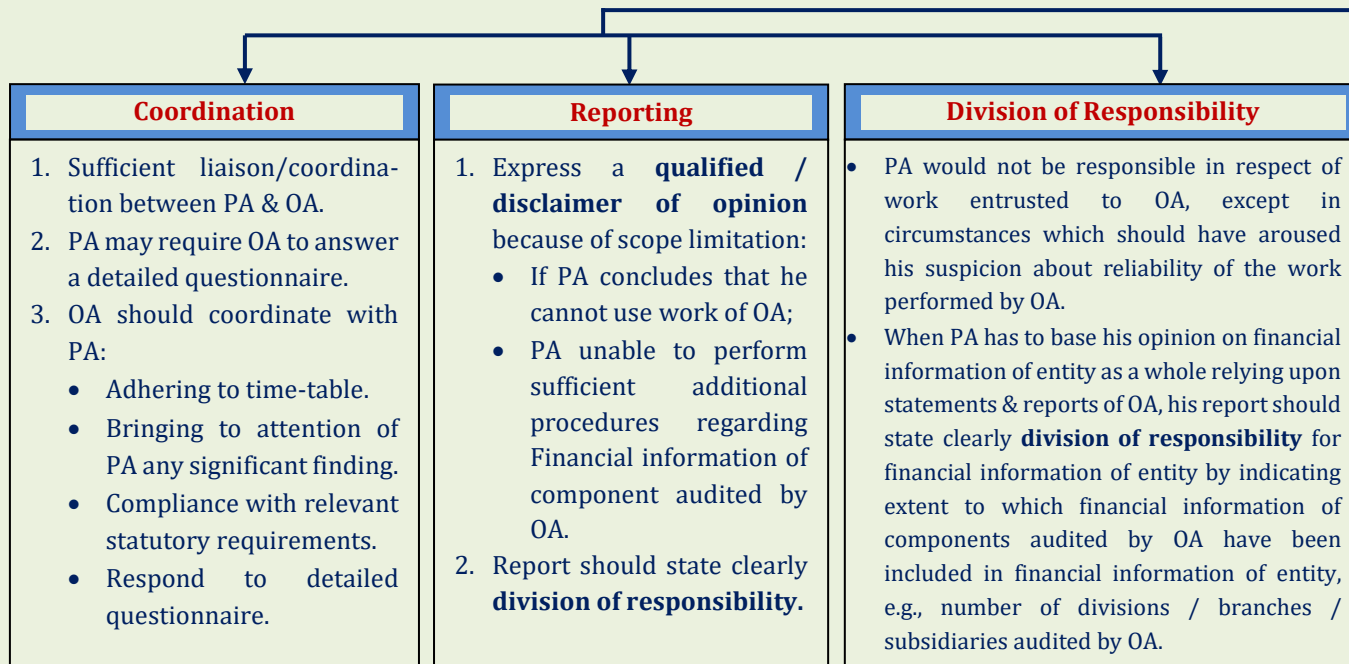
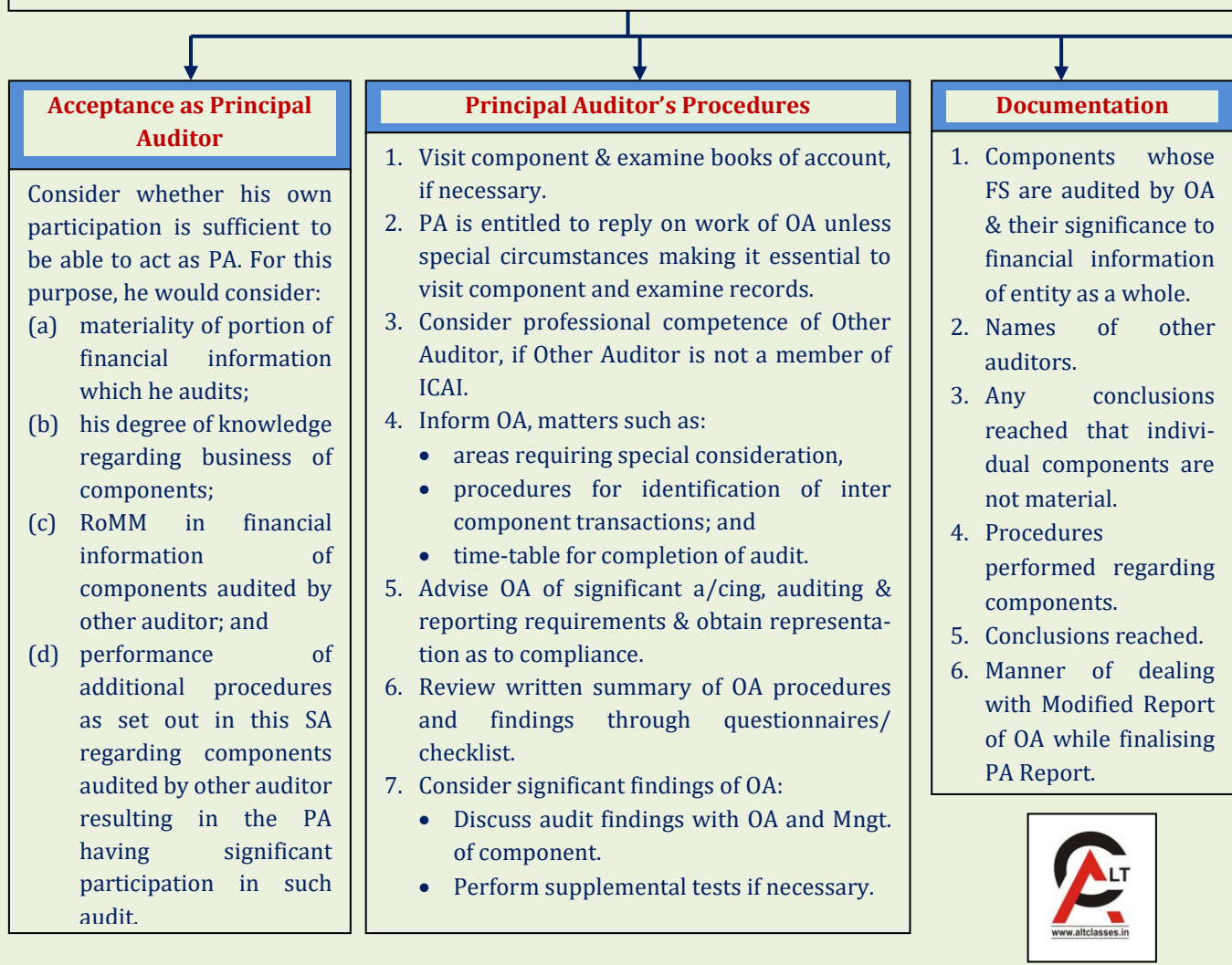
Stage IV - Reporting

- Review & assess conclusions drawn from audit evidence obtained as basis for expression of an opinion on F.S.
- Opinion so formed should be expressed in form of audit report as required by SA 700.

3.4 - SA 600 "Using the Work of Another Auditor"

Applicability: In situation where an auditor (principal auditor - PA), reporting on the financial information of an entity, uses the work of another auditor (other auditor - OA) w.r.t. to the financial information of one/more components (Division, Branch subsidiary, J. V. etc.), included in the financial information of the entity.

Non-applicability: (a) Joint auditors (b) Auditor's relationship with a predecessor auditor.



3.5 - SA 610 "Using the Work of Internal Auditors (IA)"

Meaning & scope of Internal Audit Function

Function of an entity that performs assurance & consulting activities designed to evaluate & improve effectiveness of entity's governance, risk management & IC processes.

Scope of Internal Audit

1	Activities relating to governance.
2	Activities relating to Risk Management
3	Activities relating to IC: <ul style="list-style-type: none"> • Evaluation of IC • Examination of Financial & operating information • Review of Operating Activities • Review of Compliance with L & R.



External Auditor's Procedures w.r.t. Evaluation of Internal Audit Function

Determine Adequacy of Internal Audit Work for External Auditor's Purpose

by evaluating the following

- Objectivity of the internal auditors;
- Level of competency;
- Application of Systematic & disciplined approach

If Not Satisfactory

Do not use work of internal Audit function.

If Satisfactory

Determine Nature & extent of work of internal audit function that can be used.

Using the work of internal Audit Function

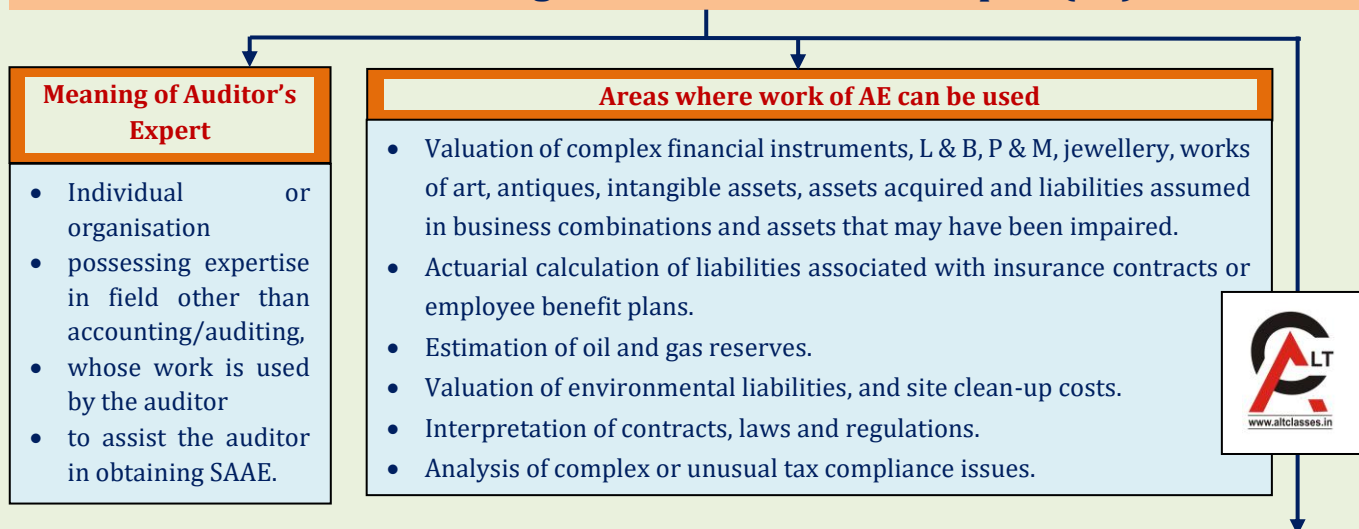
1. Discuss planned use of work of internal Auditor.
2. Read reports of internal audit function relating to work of function that external auditor plans to use to obtain an understanding of nature and extent of audit procedures it performed and the related findings.
3. Perform sufficient audit procedures on work of internal audit function as a whole that external auditor plans to use to determine its adequacy for purposes of the audit.
4. Evaluate whether external auditor's conclusions regarding internal audit function and determination of the nature and extent



Using Direct Assistance (DA) of Internal Auditors (IA)

<p>1 Determining whether IA can be used to provide DA</p> <p>If not prohibited by law or regulation, external auditor may use an internal auditor to provide direct assistance if:</p> <p>(a) There are no significant threats to objectivity of internal auditor; &</p> <p>(b) Internal auditor is sufficiently competent to perform proposed work.</p> <p>2 Determining Nature & Extent of Work that can be assigned to IA</p> <p>IA shall not be used to provide DA to perform procedures that:</p> <p>(a) Involve making significant judgments in the audit; Significant judgments include the following:</p> <ul style="list-style-type: none"> • Assessing the risks of material misstatement; • Evaluating the sufficiency of tests performed; • Evaluating appropriateness of management's use of going concern assumption; • Evaluating significant accounting estimates; and • Evaluating the adequacy of disclosures in the F.S., and other matters affecting the auditor's report <p>(b) Relate to higher assessed risks of material misstatement;</p> <p>(c) Relate to work with which IA have been involved; or</p> <p>(d) Relate to decisions, external auditor makes in accordance with this SA w.r.t. IA function & use of its work or direct assistance.</p>	<p>3 Using Direct Assistance of Internal Auditor</p> <ol style="list-style-type: none"> 1. Prior to using internal auditors to provide direct assistance for purposes of audit, external auditor shall: <ol style="list-style-type: none"> (a) Obtain written agreement from entity that IA will be allowed to follow external auditor's instructions, & that entity will not intervene in work, IA performs; & (b) Obtain written agreement from IA that they will keep confidential specific matters as instructed by external auditor & inform external auditor of any threat to their objectivity. 2. External auditor shall direct, supervise & review work performed by IA on engagement in accordance with SA 220. 3. Direction, supervision & review by external auditor of work performed by IA shall be sufficient in order for external auditor to be satisfied that IA have obtained SAAE to support conclusions based on that work.
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3.6 - SA 620 "Using the Work of Auditor's Expert (AE)"



Procedures to be followed while using the work of auditor's expert

1	Determining need for an Auditor's Expert	
	<p>An auditor's expert may be needed to assist the auditor for the following:</p> <ul style="list-style-type: none"> Obtaining an understanding of entity & its environment, including IC. Identifying & assessing RoMM. Determining & implementing overall responses to assessed risks. Designing & performing FAPs to respond to assessed risks. Evaluating sufficiency and appropriateness of audit evidence obtained. 	
	Factors influencing auditor's decision w.r.t. use of AE when Mngt. had used a management expert:	
	<ol style="list-style-type: none"> 1. Nature, scope & objectives of management's expert's work. 2. Whether Mngt. expert is employed by entity, or is a party engaged by it to provide relevant services. 3. Extent to which mngt. can exercise control or influence over work of management's expert. 4. Management's expert's competence and capabilities. 5. Whether Mngt. expert is subject to technical performance standards or other professional or industry requirements. 6. Any controls within entity over the management's expert's work. 	
2	Evaluate Competence, Capability and Objectivity of the Expert	
	Matters that may be relevant for evaluation of Competency	Evaluating the objectivity of the expert
	<ul style="list-style-type: none"> Relevance of expert's competence to matter for which that expert's work will be used, including any areas of specialty within that expert's field. Auditor's expert's competence with respect to relevant accounting & auditing requirements. Whether unexpected events, changes in conditions, or audit evidence obtained from results of audit procedures indicate that it may be necessary to reconsider initial evaluation of competence, capabilities & objectivity of expert as audit progresses. 	<p>(a) Inquire of entity about any known interests or relationships the entity has with auditor's external expert that may affect that expert's objectivity.</p> <p>(b) Discuss with expert applicable safeguards; & evaluate whether safeguards are adequate to reduce threats to an acceptable level.</p> <p style="color: red;">Interests and relationships that may be relevant to discuss with the auditor's expert include:</p> <ul style="list-style-type: none"> Financial interests. Business and personal relationships. Provision of other services by expert. <p>Obtain WR from auditor's external expert about any interests or relationships with entity of which that expert is aware.</p>
3	Obtain an understating of expert work	
	<ul style="list-style-type: none"> To enable auditor to determine nature, scope & objectives of that expert's work for auditor's purposes. Evaluate adequacy of that work for the auditor's purposes. 	



SA 620 “Using the Work of Auditor’s Expert (AE)”



Procedures to be followed while using the work of auditor’s expert

<p>4 Agreement with Auditor’s Expert</p> <p>Need to be in writing and cover following:</p> <ul style="list-style-type: none"> • Nature, scope & Objectives of AE work. • Respective Role & Responsibilities of Auditor and AE. • NTE of Communication including form of report. • Confidentiality requirements to be observed by AE. <p style="background-color: yellow;">Factors suggesting need for detailed & written agreement with AE</p> <ol style="list-style-type: none"> 1. AE will have access to sensitive or confidential entity information. 2. Respective roles or responsibilities of auditor and AE are different from those normally expected. 3. Multi-jurisdictional legal or regulatory requirements apply. 4. Matter to which AE work relates is highly complex. 5. Auditor has not previously used work performed by that expert. 6. Greater the extent of AE, and its significance in context of the audit. 	<p>5 Evaluate appropriateness of Expert work</p> <ul style="list-style-type: none"> • Finding & Conclusion – Relevance, Reasonableness & Consistency with other A.E. • Assumptions and Methods – Relevance and Reasonableness. • Source Data – Relevance, Completeness and accuracy. <p style="background-color: yellow;">Specific procedures to evaluate adequacy of AE work for auditor’s purposes</p> <ol style="list-style-type: none"> (a) Inquiries of the auditor’s expert. (b) Reviewing the auditor’s expert’s working papers and reports. (c) Corroborative procedures, such as: <ul style="list-style-type: none"> • Observing auditor’s expert’s work; • Examining published data, such as statistical reports from reputable, authoritative sources; • Confirming relevant matters with 3rd parties; • Performing detailed APs; and • Re-performing calculations. (d) Discussion with another expert with relevant expertise when, e.g., findings or conclusions of AE are not consistent with other audit evidence. (e) Discussing AE report with management. 	<p>6 Expert work not adequate for audit purposes</p> <p>If Auditor concludes that work of AE is not adequate for the auditor’s purposes & auditor cannot resolve matter through the additional audit procedures, it may be necessary to express a modified opinion.</p>
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Nature, Timing and Extent of Audit Procedures

While determining NTE of procedures to be performed w.r.t. the requirements SA 620, auditor shall consider matters including:

- (a) Nature of matter to which that expert’s work relates;
- (b) RoMM in the matter to which that expert’s work relates;
- (c) Significance of that expert’s work in the context of the audit;
- (d) Auditor’s knowledge of & experience with previous work performed by that expert.

Factors suggesting need for different or extensive procedures

1. Work of auditor’s expert relates to a significant matter that involves subjective and complex judgments.
2. Auditor has not previously used the work of AE, and has no prior knowledge of that expert’s competence, capabilities and objectivity.
3. AE is performing procedures that are integral to the audit, rather than being consulted to provide advice on an individual matter.
4. Expert is an auditor’s external expert and is not, therefore, subject to the firm’s quality control policies and procedures.

Reference to the Auditor’s Expert in the Auditor’s Report

- No reference required in case of unmodified Audit Report unless required by L & R.
- In case of modified reports, it may be appropriate to refer to auditor’s expert, to explain nature of modification. In such case, auditor may need permission of auditor’s expert before making such a reference.



3.7 - SA 540 "Auditing Accounting Estimates (AE), including Fair Value Accounting Estimates and Related Disclosures"

Objective of Auditor: To obtain SAAE whether (a) AE including Fair Value AE are reasonable; and (b) related disclosures in the F.S. are adequate.



Meaning & Nature of Accounting Estimates

Accounting estimate

"An approximation of a monetary amount in absence of a precise means of measurement". This term is used for an amount measured at fair value where there is estimation uncertainty.

Estimation Uncertainty

Susceptibility of an accounting estimate & related disclosures to an inherent risk of precision in its measurement.

Examples of Accounting Estimates

- ⇒ Provision for Bad Debt,
- ⇒ Inventory loss,
- ⇒ Warranty Obligations,
- ⇒ Depreciation,
- ⇒ Provision against carrying amount of investments, etc.

Examples of Fair Value A.E.

- ⇒ Share Based Payments,
- ⇒ Assets held for disposal,
- ⇒ Financial Instruments,
- ⇒ Assets acquired in business combinations.

Estimates with low estimation uncertainty

- ⇒ Accounting estimates arising in entities that engage in business activities that are not complex.
- ⇒ Accounting estimates that are frequently made and updated (routine transactions).
- ⇒ Accounting estimates derived from data that is readily available.
- ⇒ Fair value accounting estimates where method of measurement prescribed by applicable FRF is simple and applied easily to asset or liability requiring measurement at fair value.
- ⇒ Fair value accounting estimates where model used to measure accounting estimate is well-known or generally accepted.

Estimates with high estimation uncertainty

- ⇒ Accounting estimates relating to outcome of litigation.
- ⇒ Fair value accounting estimates for derivative financial instruments not publicly traded.
- ⇒ Fair value accounting estimates for which a highly specialised entity-developed model is used or for which there are assumptions or inputs that cannot be observed in the market place.



Risk Assessment Procedures & Related

1. Obtain an understating of:
 - Requirements of applicable FRF
 - How mngt identifies transactions, events and conditions that give rise to need for accounting estimates (**through inquiry from mngt.**)
 - Estimation making process adopted by mngt.

Estimation making process

- Methods/Model used in making accounting estimates.
- Relevant Controls
- Use of Management Expert.
- Changes in the methods from the prior period along with reasons.
- Assessment of effect of estimation uncertainties.

2. Review of outcome of accounting estimates of prior period.

Inquiries of management about changes in circumstances

- (i) Whether entity has engaged in new types of transactions that may give rise to accounting estimates.
- (ii) Whether terms of transactions that gave rise to accounting estimates have changed.
- (iii) Whether a/cing policies relating to accounting estimates have changed, as a result of changes to requirements of applicable FRF or otherwise.
- (iv) Whether regulatory or other changes outside control of mngt. have occurred that may require mngt. to revise, or make new, accounting estimates.
- (v) Whether new conditions or events have occurred that may give rise to need for new or revised accounting estimates.

Matters that auditor may consider in obtaining an understanding of assumptions

- (1) Nature of assumptions, including which of the assumptions are likely to be significant assumptions.
- (2) How management assesses whether assumptions are relevant & complete.
- (3) Where applicable, how mngt. determines that assumptions used are internally consistent.
- (4) Whether assumptions relate to matters within control of mngt., & how they conform to entity's business plans & external environment, or to matters that are outside its control.
- (5) Nature & extent of documentation, if any, supporting assumptions.

3.7 - SA 540 "Auditing Accounting Estimates (AE), including Fair Value Accounting Estimates and Related Disclosures"

Risk Assessment Procedures & Related

Review of outcome of accounting estimates

- Nature & extent of auditor's review takes whether information obtained from review would be relevant to identifying & assessing RoMM of accounting estimates made in current period F.S.
- Review is not intended to call into question judgments made in prior periods that were based on information available at that time.
- Outcome of an accounting estimate will often differ from accounting estimate recognised in prior period F.S. By performing RAP to identify & understand reasons for differences, auditor may obtain:
 - (a) Information regarding effectiveness of Mngt. prior period estimation process.
 - (b) Audit evidence that is pertinent to re-estimation, in current period, of prior period accounting estimates.
 - (c) Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in F.S.
- Review of prior period accounting estimates may also assist auditor, in current period, in identifying circumstances or conditions that increase susceptibility of accounting estimates to, or indicate presence of, possible management bias.

Estimation Uncertainty

For accounting estimates that give rise to significant risks, auditor shall evaluate:

- (a) How mngt. has considered alternative assumptions or outcomes, and why it has rejected them.
- (b) Whether significant assumptions used by mngt. are reasonable.
- (c) Where relevant to reasonableness of significant assumptions used by mngt. or appropriate application of applicable FRF, mngt. intent to carry out specific courses of action and its ability to do so.

Factors Influencing Degree of Estimation Uncertainty

- (i) Extent to which accounting estimate depends on judgment.
- (ii) Sensitivity of accounting estimate to changes in assumptions.
- (iii) Existence of recognised measurement techniques that may mitigate estimation uncertainty.
- (iv) Length of forecast period, & relevance of data drawn from past events to forecast future events.
- (v) Availability of reliable data from external sources.
- (vi) Extent to which accounting estimate is based on observable or unobservable inputs.

Management Bias

- Lack of neutrality by mngt. in preparation and presentation of information.
- Auditor shall review judgments & decisions made by mngt. in making of accounting estimates to identify whether there are indicators of possible mngt. bias.

Indicators of possible management bias

- Changes in accounting estimate or method for making it, where mngt. has made a subjective assessment that there has been a change in circumstances.
- Use of entity's own assumptions for FV accounting estimates when they are inconsistent with observable marketplace assumptions.
- Selection or construction of significant assumptions that yield a point estimate favourable for management objectives.
- Selection of a point estimate that may indicate a pattern of optimism or pessimism.

Written Representations

Obtain WRs as to whether mngt. believes significant assumptions used by it in making accounting estimates are reasonable.

WRs about accounting estimates may include representations:

- (a) About appropriateness of measurement processes, including related assumptions models, used by mngt. in determining accounting estimates in context of applicable FRF, and consistency in application of processes.
- (b) That assumptions appropriately reflect mngt. intent & ability to carry out specific courses of action on behalf of entity, where relevant to accounting estimates and disclosures.
- (c) That disclosure related to accounting estimates are complete and appropriate under the applicable FRF.
- (d) That no subsequent event requires adjustment to accounting estimates & disclosures included in the F.S.



3.8 - SA 520 "Analytical Procedures"

Meaning and Nature of Analytical Procedures

Evaluation of financial information
↓
through analysis of relationships
↓
among both financial & non-financial data.
AND
also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Analytical Procedures

Consideration of Comparisons of Financial Information	Consideration of relationships among
with comparable information for prior periods. or with anticipated results of the entity or Auditor's expectations or Similar industry information.	Elements of financial information or Financial information and relevant non-financial information.

Auditor's Procedures

- 1 Determine the suitability of particular substantive analytical procedures (SAPs)**
- Following factors requires consideration:
 1. SAPs more suitable to large volumes of transactions tending to be predictable over time.
 2. But suitability of AP influenced by:
 - Nature of assertion.
 - Auditor's assessment of APs effectiveness to identify material misstatement.
 3. In some cases, unsophisticated predictive models may be useful.
 4. Different types of APs provide different levels of assurance.
 5. Particular SAP may be considered suitable when Tests of Details are performed on same assertion.
- 2 Evaluate the reliability of data**
- Following factors affects the reliability:
 - Source of the information available.
 - Comparability of the information available.
 - Nature and relevance of the information available, and
 - Controls over the preparation of the information
- 3 Develop an expectation of recorded amounts or ratios** and evaluate whether the expectation is sufficiently precise to identify material misstatement.
- 4 Determine the amount of any difference of recorded amounts from expected values** that is acceptable without further investigation.
- 5 Investigating Results of Analytical Procedures**
- If auditor identified fluctuations or relationships that are inconsistent with other relevant information or differ from expected values by a significant amount, the auditor shall investigate such differences by:
 - (a) Inquiring of management; and
 - (b) Performing other audit procedures as necessary in the circumstances.
 Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.

