

Audit, Business Processes and Digitalization [BL 5]

Business Level II | CA Sri Lanka

Study Text

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E.2: Audit Planning and Documentations

In the chapter we look at the contents of the overall audit strategy and the detailed audit plan. We also look at how auditors document their work in general. Audit documentation is important because it provides the evidence of the work performed by the auditors in carrying out the audit

Notes:



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E.2.1. Audit Planning

E.2.2. Audit Documentations

E.2.1. Audit Planning

The auditor formulates an overall audit strategy which is translated into a detailed audit plan for audit staff to follow

The importance of planning

An effective and efficient audit relies on proper planning procedures. The planning process is covered in general terms by SLAuS 300 Planning an Audit of Financial Statements (para. 4), which states that the auditor shall plan the audit so that the engagement is performed in an effective manner

Audits are planned to:

- Help the auditor devote appropriate attention to important areas of the audit
- Help the auditor identify and resolve potential problems on a timely basis
- Help the auditor properly organize and manage the audit so it is performed in an effective manner
- Assist in the selection of appropriate team members and assignment of work to them
- Facilitate the direction, supervision and review of work
- Assist in co-ordination of work done by auditors of components and experts

Audit procedures should be discussed with the client's management, staff and/or audit committee in order to co-ordinate audit work, including that of internal audit. However, all audit procedures remain the responsibility of the external auditors

A structured approach to planning will include:

Step 1 Ensuring that ethical requirements are met, including independence

Step 2 Ensuring the terms of the engagement are understood

Step 3 Establishing the overall audit strategy that sets the scope, timing and direction of the audit and guides the development of the audit plan

- ✓ Identify the characteristics of the engagement that define its scope
- ✓ Ascertain the reporting objectives to plan the timing of the audit and nature of communications required
- ✓ Consider significant factors in directing the team's efforts
- ✓ Consider results of preliminary engagement activities
- ✓ Ascertain nature, timing and extent of resources necessary to perform the engagement

Step 4 Developing an audit plan that includes the nature, timing and extent of planned risk assessment procedures and further audit procedures

The overall audit strategy and the audit plan

The overall audit strategy and audit plan shall be updated and changed as necessary during the course of the audit

The audit strategy

The overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan

The matters the auditor may consider in establishing an overall audit strategy are set out in the table below

The overall audit strategy: Matters to consider (SLAuS 300: Appendix)

Characteristics of the engagement (SLAuS 300: para. 8(a))

- Financial reporting framework
- Industry-specific reporting requirements
- Expected audit coverage
- Nature of business segments
- Availability of internal audit work
- Use of service organisations
- Effect of information technology on audit procedures
- Availability of client personnel and data

The overall audit strategy: Matters to consider (SLAuS 300: Appendix)

Reporting objectives, timing of the audit and nature of communications (SLAuS 300: para. 8(b))

- Entity's timetable for reporting
- Organisation of meetings with management and those charged with governance
- Discussions with management and those charged with governance
- Expected communications with third parties

<p>Significant factors, preliminary engagement activities, and knowledge gained on other engagements (SLAuS 300: para. 8(c)-(d))</p>	<ul style="list-style-type: none"> • Determination of materiality • Areas identified with higher risk of material misstatement • Results of previous audits • Need to maintain professional scepticism • Evidence of management's commitment to design, implementation and maintenance of sound internal control • Changes within the applicable reporting framework which may involve significant new or revised disclosures • Volume of transactions • Process used by management to identify and prepare disclosures • Significant business developments • Significant industry developments • Significant changes in financial reporting framework • Other significant recent developments
<p>Nature, timing and extent of resources (SLAuS 300: para. 8e)</p>	<ul style="list-style-type: none"> • Selection of engagement team • Assignment of work to team members • Engagement budgeting

Examples of items to include in the overall audit strategy could be:

- Industry-specific financial reporting requirements
- Number of locations to be visited
- Audit client's timetable for reporting to its members
- Communication between the audit team and the client

The audit plan

The audit plan converts the audit strategy into a more detailed plan and includes the nature, timing and extent of audit procedures to be performed by engagement team members in order to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level

The audit plan includes the following:

- A description of the nature, timing and extent of planned risk assessment procedures
- A description of the nature, timing and extent of planned further audit procedures at the assertion level
- Other planned audit procedures required to be carried out for the engagement to comply with SLAuSs

Examples of items included in the audit plan could be:

- ✓ Timetable of planned audit work
- ✓ Allocation of work to audit team members
- ✓ Audit procedures for each major account area (eg inventory, receivables, cash)
- ✓ Materiality for the financial statements as a whole and performance materiality

Further application guidance was added to SLAuS 300 in 2015, to highlight the need for auditors to consider financial statement disclosures at the planning stage. Considering disclosures early in the audit helps auditors to identify:

- ✓ Changes in the entity's environment, financial condition or activities
- ✓ Changes in the applicable financial reporting framework
- ✓ The need to involve an auditor's expert (eg for disclosures related to pension)
- ✓ The need to discuss matters with those charged with governance



1.2.3 Example: Audit strategy and audit plan

B Co sells baked goods in ten shops across the country. Fifty per cent of the company's revenue comes from two of these shops.

The audit strategy will set out the location of the shops and their relative contribution to B Co's revenue, highlighting the fact that the majority of the revenue is linked to two of these shops.

The audit strategy will then identify what this would mean for the conduct of the audit, for example:

- The focus of audit procedures will be on the two major shops and appropriate audit resources will be allocated to this purpose.
- Internal controls will be tested at the two shops, followed by substantive procedures.
- The level of audit testing at the other locations will be representative of the level of activity at each shop. Audit team members will visit shops which have not been visited over the past three years and carry out limited audit procedures, to ensure that each location has been appropriately tested on a rotational basis over a period of three years.

The audit plan will expand on the approach set out in the audit strategy and identify:

- The audit team members who will carry out the audit procedures at each of the shops
- The dates at which each of the shops within this year's scope will be visited
- The specific tests of controls and substantive procedures to be carried out at each of the shops
- If sampling techniques are to be used, how samples are to be selected for each audit procedure

Interim and final audits

Auditors usually carry out their audit work for a financial year in one or more sittings. These are referred to as the interim audit(s) and the final audit. The interim audit visit is carried out during the period of review and the final audit visit will take place after the year end

The purpose of the interim audit and procedures likely to be adopted

The purpose of the interim audit is to carry out procedures that would be difficult to perform at the year end because of time constraints. Work at this visit tends to focus on risk assessment and on documenting and testing internal controls. Some substantive procedures can also be carried out but these are limited because statement of financial position figures will not be the ones to be reported on. The final audit will focus on the audit of the financial statements. It concludes with the auditor issuing a report which contains the opinion expressed on the financial statements covering the entire year being audited. The final audit opinion will take account of conclusions reached at both (or all) audit visits

Some audit procedures can only be performed at the final audit visit, such as agreeing the financial statements to the accounting records and examining adjustments made during the process of preparing the financial statements.

The following table summarizes some of the typical procedures carried out during the interim and final audits:

Interim audit procedures may include:	Final audit procedures include:
<ul style="list-style-type: none"> • Inherent risk assessment and gaining an understanding of the entity • Recording the entity's system of internal control • Evaluating the design of internal controls • Carrying out tests of control on the company's internal controls to ensure they are operating as expected • Performing substantive testing of transactions/balances to gain evidence that the books and records are a reliable basis for the preparation of financial statements • Identification of issues that may have an impact on work to take place at the final audit 	<ul style="list-style-type: none"> • Substantive procedures involving verification of statement of financial position balances and amounts in the statement of profit or loss • Obtaining third-party confirmations • Analytical procedures relating to figures in the financial statements • Subsequent events review • Agreeing the financial statements to the accounting records • Examining adjustments made during the process of preparing the financial statements • Consideration of the going concern status of the entity • Performing tests to ensure that the conclusions formed at the interim audit are still valid • Obtaining written representations

Impact of interim audit work on the final audit in general

The benefit of spreading audit procedures over an interim and final audit is that it is possible to provide shareholders and other users of the financial statements with the audited accounts sooner than if all audit procedures were carried out at a final audit taking place after the year end.

Performing audit procedures before the period end can assist in identifying significant matters at an early stage of the audit and help resolve them with management's assistance or develop an effective audit approach to address them. This reduces the time taken at the final audit to gain the remaining sufficient appropriate audit evidence needed

Impact of interim audit work relating to internal controls on the final audit

If the auditors are to place reliance on internal controls they must obtain evidence that controls have operated effectively throughout the period. If the auditor obtains audit evidence about the operating effectiveness of controls at the interim audit, when it comes to the final audit, instead of having to gain evidence over controls covering the whole year the auditor can focus on:

- ✓ Obtaining audit evidence about significant changes to those controls subsequent to the interim period
- ✓ Determining the additional audit evidence to be obtained for the remaining period

Impact of substantive procedures performed during the interim audit on the final audit

If substantive procedures are performed at an interim date, the auditor must cover the remaining period by performing substantive procedures, or substantive procedures combined with tests of controls for the intervening period (SLAuS 330: para. 22).

Conclusions will have been reached on the testing carried out at the interim audit and the auditor essentially has to carry out any procedures necessary to provide a reasonable basis for extending the audit conclusions from the interim date to the period end

E.2.2. Audit Documentations

It is important to document audit work performed in working papers to:

- Enable the reporting partner to ensure that all of the planned work has been completed adequately
- Provide details of the work done for future reference
- Assist in the planning and control of future audits
- Encourage a methodical approach

Audit documentation is the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached

All audit work must be documented: the working papers are the tangible evidence of the work done in support of the audit opinion. SLAuS 230 Audit Documentation (para. 7), states that 'the auditor shall prepare audit documentation on a timely basis'.

Audit documentation is necessary for the following reasons:

- (a) It provides evidence of the auditor's basis for a conclusion about the achievement of the overall objective.
- (b) It provides evidence that the audit was planned and performed in accordance with SLAuSs and other legal and regulatory requirements.
- (c) It assists the engagement team to plan and perform the audit
- (d) It assists team members responsible for supervision to direct, supervise and review audit work.
- (e) It enables the team to be accountable for its work.
- (f) It allows a record of matters of continuing significance to be retained.
- (g) It enables the conduct of quality control reviews and inspections (both internal and external)

Form and content of working papers

The SLAuS requires working papers to be sufficiently complete and detailed to provide an overall understanding of the audit. Auditors cannot record everything they consider. Therefore judgement must be used as to the extent of working papers, based on the following general rule:

What would be necessary to provide an experienced auditor, with no previous connection to the audit, with an understanding of the work performed, the results of audit procedures, audit evidence obtained, significant matters arising during the audit and conclusions reached

The form and content of working papers are affected by matters such as:

- ✓ The size and complexity of the entity
- ✓ The nature of the audit procedures to be performed
- ✓ The identified risks of material misstatement
- ✓ The significance of the audit evidence obtained
- ✓ The nature and extent of exceptions identified

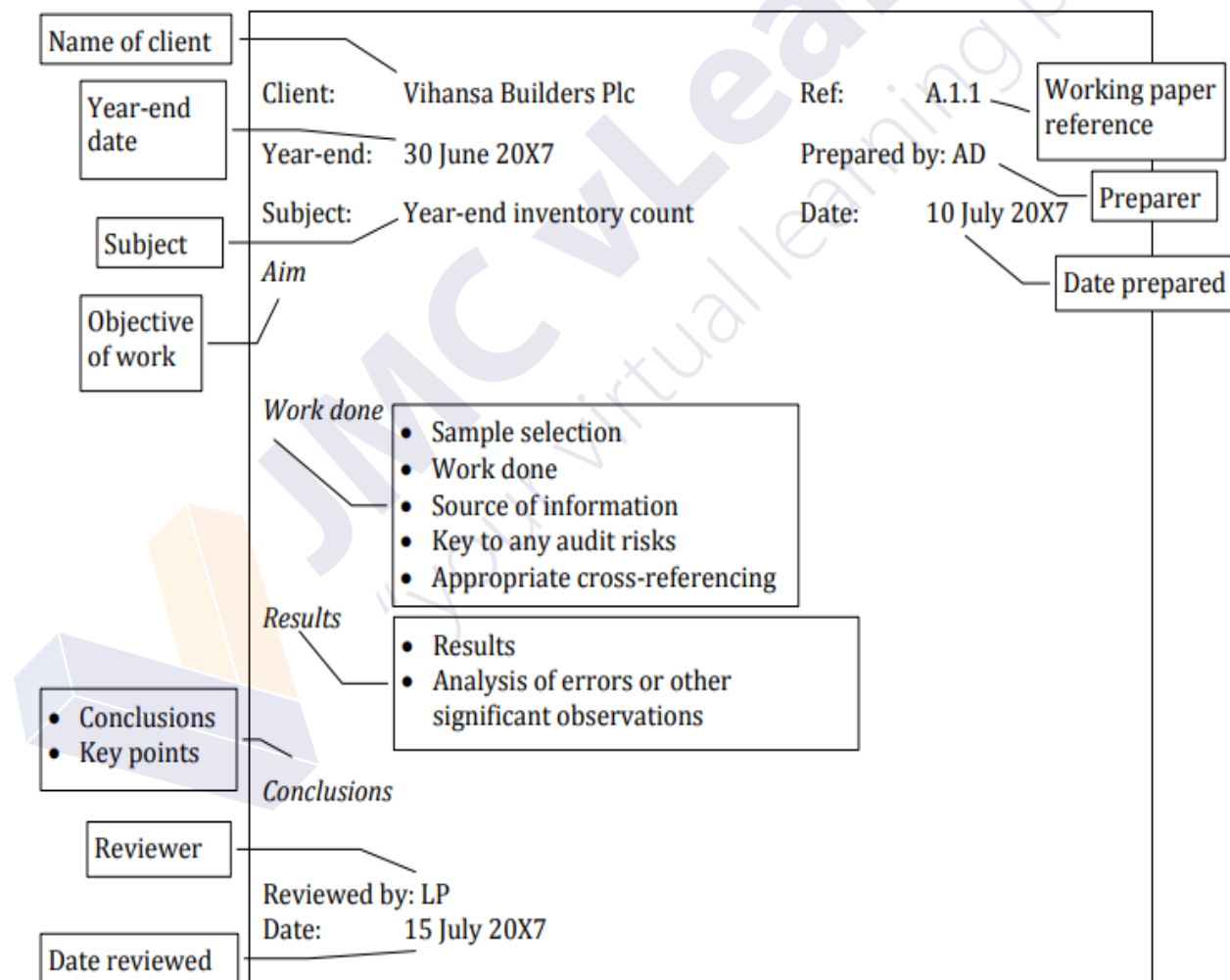
Examples of working papers

(a) Information obtained in understanding the entity and its environment, including its internal control, such as the following:

- (i) Information concerning the legal documents, agreements and minutes
 - (ii) Extracts or copies of important legal documents, agreements and minutes
 - (iii) Information concerning the industry, economic environment and legislative environment within which the entity operates
 - (iv) Extracts from the entity's internal control manual
- (b) Evidence of the planning process including audit programs and any changes thereto
- (c) Evidence of the auditor's consideration of the work of internal audit and conclusions reached
- (d) Analyses of transactions and balances
- (e) Analyses of significant ratios and trends
- (f) Identified and assessed risks of material misstatements
- (g) A record of the nature, timing, extent and results of audit procedures
- (h) Evidence that the work performed was supervised and reviewed
- (i) An indication as to who performed the audit procedures and when they were performed
- (j) Details of audit procedures applied regarding components whose financial statements are audited by another auditor
- (k) Copies of communications with other auditors, experts and other third parties

- (l) Copies of letters or notes concerning audit matters communicated to or discussed with management or those charged with governance, including the terms of the engagement and significant deficiencies in internal control
- (m) Written representations received from management of the entity
- (n) Conclusions reached by the auditor concerning significant aspects of the audit, including how exceptions and unusual matters, if any, disclosed by the auditor's procedures were resolved or treated
- (o) Copies of the financial statements and auditors' reports
- (p) Notes of discussions about significant matters with management and others
- (q) In exceptional circumstances, the reasons for departing from a basic principle or essential procedure of an SLAuS and how the alternative procedure performed achieved the audit objective

The following is an illustration of a typical audit working paper. This could be a paper workpaper or an electronic one.



Audit files

For recurring audits, working papers may be split between:

Permanent audit files (containing information of continuing importance to the audit). These contain:

- ✓ Engagement letters
- ✓ New client questionnaire
- ✓ The memorandum and articles
- ✓ Other legal documents such as prospectuses, leases, sales agreement
- ✓ Details of the history of the client's business
- ✓ Board minutes of continuing relevance
- ✓ Previous years' signed accounts, analytical review and reports to management
- ✓ Accounting systems notes, previous years' control questionnaires

Current audit files (containing information of relevance to the current year's audit). These should be compiled on a timely basis after the completion of the audit and should contain:

- ✓ Financial statements
- ✓ Accounts checklists
- ✓ Management accounts details
- ✓ Reconciliations of management and financial accounts
- ✓ A summary of unadjusted errors
- ✓ Report to partner including details of significant events and errors
- ✓ Review notes
- ✓ Audit planning memorandum
- ✓ Time budgets and summaries
- ✓ Written representations
- ✓ Report to management
- ✓ Notes of board minutes
- ✓ Communications with third parties such as experts or other auditors

They also contain working papers covering each audit area. These should include the following:

- ✓ A lead schedule including details of the figures to be included in the accounts
- ✓ Problems encountered and conclusions drawn
- ✓ Audit programs
- ✓ Risk assessments
- ✓ Sampling plans
- ✓ Analytical review
- ✓ Details of substantive tests and tests of control

Standardized and automated working papers

The use of standardized working papers, for example, checklists and specimen letters, may improve the efficiency of audit work but they can be dangerous because they may lead to auditors' mechanically following an approach without using audit judgement.

Automated working paper packages have been developed which can make the documentation of audit work much easier. Such programs aid preparation of working papers, lead schedules, the trial balance and the financial statements themselves. These are automatically cross-referenced, adjusted and balanced by the computer.

The advantages of automated working papers are as follows:

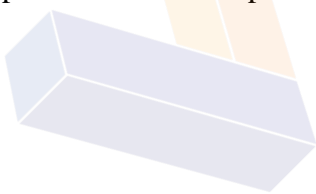
- (a) The risk of errors is reduced.
- (b) The working papers will be neater and easier to review.
- (c) The time saved will be substantial, as adjustments can easily be made to all working papers, including those summarizing the key analytical information.
- (d) Standard forms do not have to be carried to audit locations.
- (e) Audit working papers can be transmitted for review via a modem or fax facilities

Safe custody and retention of working papers

Judgement may have to be used in deciding the length of holding working papers, and further consideration should be given to the matter before their destruction. SLAuS 230 requires a period of no less than five years from the date of the auditor's report (SLAuS 230: para. A23).

Working papers are the property of the auditors. They are not a substitute for, nor part of, the entity's accounting records.

Auditors must follow ethical guidance on the confidentiality of audit working papers. They may, at their discretion, release parts of or whole working papers to the entity, as long as disclosure does not undermine the audit process. Information should generally not be made available to third parties without the permission of the entity



Chapter review questions

1. Complete the definitions.

An is the formulation of a general strategy for the audit

An is a set of instructions to the audit team that sets out the further audit procedures to be carried out

2. Changes to the overall audit strategy or audit plan do not need to be documented

True
False

3. What should audit documentation contain as a general rule

4. State two advantages of standardized working papers.

(1)

(2)

5. Complete the table, using the working papers given below

Current audit file	Permanent audit file
Engagement letters	New client questionnaire
Financial statements	Report to management
Accounts checklists	Audit planning memorandum
Board minutes of continuing relevance	Accounting systems notes