JMC vLearning
"your virtual learning partner"

Audit Planning

Chartered Accountancy
Corporate Level
Advanced Audit & Assurance (AAA)

Nilantha Weerasinghe
ACA, B.Sc. (Accounting and Finance)

JMC ජයසේකර කළමනාකරණ මධ්‍යස්ථානය JAYASEKERA MANAGEMENT CENTRE (PVT) LTD Estd. 1972

JMC Jayasekera Management Centre (Pvt) Ltd
Pioneers in Professional Education
65/2A, Chittampalam Gardiner Mawatha, Colombo 02 | T: +94 112 430451 | E: info@jmc.lk | F: +94 115 377917

AAA/Pack 02
June 2022

Advance Audit & Assurance (AAA)
CORPORATE LEVEL
June 2022

Audit Planning – SLAuS 300

NILANTHA WEERASINGHE

Audit Planning – SLAuS 300

1 The importance of planning

As with any other process, the better an audit is planned, the more efficient and effective it will be. The planning process is covered in general terms by SLAuS 300 *Planning an audit of financial statements,* 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 organise 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.

2.1 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.

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

2.2 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 shall include 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
- The planning for these procedures occurs over the course of the audit as the audit plan develops.

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 etc)
- Materiality for the financial statements as a whole and performance materiality

Any changes made during the audit engagement to the overall audit strategy or audit plan, and the reasons for such changes, shall be included in the audit documentation.

3 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**.

It can be beneficial for auditors to perform their audit work in two stages. 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.
We look at the different types of procedures later in this text, but because we refer to **substantive procedures** and **tests of control** during our explanation of the interim and final audit, we will define those terms here.
Tests of controls are performed to obtain audit evidence about the operating effectiveness of controls preventing, or detecting and correcting, material misstatements at the assertion level.

Substantive procedures are audit procedures performed to detect material misstatements at the assertion level. They are generally of two types:

- Substantive analytical procedures
- Tests of detail of classes of transactions, account balances and disclosures

Table 8.2: Typical procedures in interim and final audits

Interim audit procedures may include:	Final audit procedures include:
• 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.	• 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.

3.2 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.

3.3 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 While at the final audit, the amount of work needed to gain additional audit evidence about controls that were operating during the period between the interim audit and the yearend will depend on:
- The significance of the assessed risks of material misstatement at the assertion level.
- The specific controls that were tested during the interim period, and significant changes to them since they were tested, including changes in the information system, processes and personnel.
- The degree to which audit evidence about the operating effectiveness of those controls was obtained.
- The length of the remaining period.
- The extent to which the auditor intends to reduce further substantive procedures based on the reliance of controls.
- The control environment.

3.4 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. Conclusions will have been reached on the testing carried out at the interim audit; 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.

One approach an auditor that has carried out an interim audit can take is to compare and reconcile information concerning the balance at the period end with the comparable information at the interim date. Essentially, because the interim balance has been audited, the auditor can focus on auditing the movements in the balance between the interim date and the year end.
A point to note is that when misstatements that the auditor did not expect when assessing the risks of material misstatement are detected at an interim date, the auditor many need to modify the planned nature, timing or extent of substantive procedures covering the remaining period. This may result in repeating the procedures in full that were performed at the interim date. Therefore part of the expected benefit of carrying out the interim audit will have been lost.

QUESTION

As audit senior, you have recently attended a meeting with the managing director of BigMall Ltd (audit client) and the new audit partner assigned to the audit, Nipun Rajapakse, who has recently joined your firm. The audit partner is familiarising himself with the client.

BigMall Ltd is a large limited liability building company set up by Kasun Corea, who has been managing director since incorporation. It purchases land in and around major towns and builds retail parks and shopping malls, which the company then manages. You are familiar with the client, as you have taken part in the audit for the last three years. The other key member of the board is Clarice Singhe, who set up the business with Kasun Corea and is finance director. Clarice is a qualified accountant, and the accounting systems and procedures at BigMall Ltd have always appeared sound.

You took minutes of the meeting, which are given below.

Minutes of a meeting between Nipun Rajapakse and Kasun Corea, 30 March 20X2

NR introduced himself to KC and asked for a brief history of the business, which was given. Currently, the majority of income is from the property management side, as the building market is becoming saturated. With interest rates set to rise, KC is less keen to borrow and build in the current climate.

NR asked KC whether a recent spate of terrorist bomb attacks in malls in tourist areas had had any effect on business. KC commented that he had been given the impression that retail was down and that customers were staying away from the retail centres – but he felt that some of that could be attributed to a rise in interest rates and was likely to be temporary. First months of the year are always poor for retail ...

NR asked whether there had been a rise in empty units in the retail centres and malls. KC said there had been a small rise.

NR asked KC about his views in relation to the current proposed legislation before the government concerning quality standards in the building trade. KC commented that it seemed like a 'load of nonsense' to him, and expressed some dissatisfaction with the current political situation... NR pressed the matter, enquiring as to KC's opinion on the likely effects on his business if more stringent standards were to be required in the future. KC is of the firm belief that it would not be passed. NR expressed his fear that the legislation was more than likely to be passed, and would have far-reaching and expensive effects on most builders in the country. KC repeated some of his previous comments about politicians.

Nipun is keen to reappraise the audit strategy taken towards the audit of BigMall, as he feels the audit could be conducted more efficiently than it has in the past. It has largely focused on substantive procedures up to now.

Required

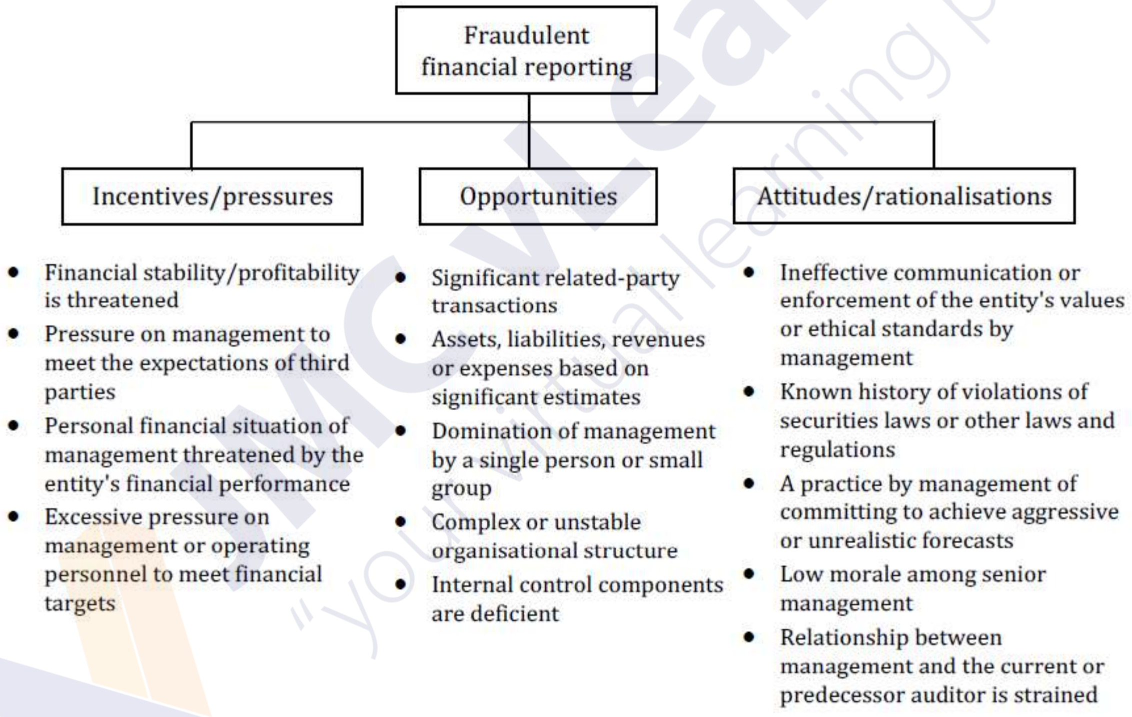
Nipun asks you to plan this year's audit as if BigMall was a new client:

(a) **Outline** the steps when approaching the audit plan of BigMall.

(b) You need to **advise** Nipun whether to carry out the audit work in two stages – an interim audit and a final audit. **Explain** the procedure of the interim audit and how it operates in conjunction with the final audit. **Conclude** whether an interim audit is required in the case of BigMall.

Auditor's responsibilities in relation to fraud, laws & regulations – SLAuS 240

Figure 9.2: Risk factors for fraudulent financial reporting



- **Misappropriation of assets**
  - **Incentives/pressures**
    - Personal financial obligations
    - Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft
  - **Opportunities**
    - Large amounts of cash on hand or processed
    - Inventory items that are small in size, of high value, or in high demand
    - Easily convertible assets, such as bearer bonds, diamonds, or computer chips
    - Inadequate internal control over assets
  - **Attitudes/rationalisations**
    - Overriding existing controls
    - Failing to correct known internal control deficiencies
    - Behaviour indicating displeasure or dissatisfaction with the entity
    - Changes in behaviour or lifestyle

1.2.4 Responding to assessed risks

Generally, the auditor:

- Identifies fraud risks
- Relates this to what could go wrong at a financial statement level
- Considers the likely magnitude of potential misstatement

The auditor must then come up with responses to the assessed risks.

> **SLAuS 240.28**
>
> In accordance with SLAuS 330 the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.

In determining overall responses to address the risks of material misstatement due to fraud at the financial statement level, the auditor should:

(a) Consider the assignment and supervision of personnel

(b) Consider the accounting policies used by the entity, and

(c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures

SLAuS 240.30

In accordance with SLAuS 330, the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level.

The auditor may have to **amend** the **nature, timing or extent** of planned audit procedures to address assessed risks. The auditor should also consider the following:

- Audit procedures responsive to management override of controls
- Journal entries and other adjustments
- Accounting estimates
- Business rationale for significant transactions

1.2.5 Examples: specific audit procedures

The auditor might choose to attend previously unvisited branches to carry out inventory or cash checks.

The auditor might perform detailed analytical procedures using disaggregated data, for example, comparing sales and costs of sales by location.

The auditor might use an expert to assess management estimates in a subjective area.

1.3 Evaluation of audit evidence

The auditor evaluates the audit evidence obtained to ensure it is consistent and that it achieves its aim of answering the risks of fraud. This will include a consideration of results of analytical procedures and any misstatements found. The auditor must also consider the reliability of written representations.

The auditor must obtain written representation that management accepts its responsibility for the prevention and detection of fraud and has made all relevant disclosures to the auditors.

1.4 Documentation

The auditor must document:

- The significant decisions reached as a result of the team's discussion of fraud
- The identified and assessed risks of material misstatement due to fraud
- The overall responses to assessed risks

- Results of specific audit tests
- Any communications with management
- Reasons for concluding that the presumption that there is a risk of fraud related to revenue recognition is not applicable.

1.5 Reporting

There are various reporting requirements in SLAuS 240.

SLAuS 240.40

If the auditor has identified a fraud or has obtained information that indicates a fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.

SLAuS 240.41

Unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects fraud involving:

(a) Management

(b) Employees who have significant roles in internal control, or

(c) Others, where the fraud results in a material misstatement in the financial statements

the auditor shall communicate these matters to **those charged with governance** on a timely basis. If the auditor suspects fraud involving management, the auditor shall communicate these suspicions to those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit.

2 Law and regulations

The auditor must consider the risk of non-compliance with law and regulations causing a misstatement in the financial statements.
The auditor is also required to consider the issue of law and regulations in the audit. Auditors are given guidance in SLAuS 250 *Consideration of laws and regulations in an audit of financial statements*. The objectives of the auditor are:

- To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations that have a **direct effect** on the determination of material amounts and disclosures in the financial statements
- To perform specified audit procedures to help identify non-compliance with other laws and regulations that may have a **material effect** on the financial statements
- To respond appropriately to **non-compliance/suspected non-compliance** identified during the audit

2.1 Responsibilities of management compared with auditors

It is management's responsibility to ensure that the entity complies with the relevant laws and regulations. It is not the auditor's responsibility to prevent or detect non-compliance with laws and regulations.
The auditor's responsibility is to obtain reasonable assurance that the financial statements are free from material misstatement and, in this respect, the auditor must take into account the legal and regulatory framework within which the entity operates.
SLAuS 250 distinguishes the auditor's responsibilities in relation to compliance with two different categories of laws and regulations:

• Those that have a **direct effect** on the determination of **material amounts** and disclosures in the financial statements
• Those that **do not have a direct effect** on the determination of material amounts and disclosures in the financial statements but where compliance may be fundamental to the **operating aspects**, ability to **continue in business**, or to avoid **material penalties** For the first category, the auditor's responsibility is to obtain sufficient appropriate audit evidence about **compliance** with those laws and regulations.

For the second category, the auditor's responsibility is to undertake specified audit procedures to help **identify non-compliance** with laws and regulations that may have a **material effect** on the financial statements. These include enquiries of management and inspecting correspondence with the relevant licensing or regulatory authorities.

2.2 Audit procedures

In accordance with SLAuS 315, the auditor shall obtain a general understanding of:
• The applicable legal and regulatory framework
• How the entity complies with that framework
The auditor can achieve this understanding by using his/her **existing understanding** and updating it, and making **enquiries of management** about other laws and regulations that may affect the entity, about its policies and procedures for ensuring compliance, and about its policies and procedures for identifying, evaluating and accounting for litigation claims.

The auditor shall remain alert throughout the audit to the possibility that **other audit procedures** may bring instances of non-compliance or suspected noncompliance to the auditor's attention. These audit procedures could include:
• Reading minutes
• Making enquiries of management and in-house/external legal advisors regarding litigation, claims and assessments
• Performing substantive tests of details of classes of transactions, account balances or disclosures
The auditor shall request **written representations** from management that all known instances of non-compliance or suspected non-compliance with laws and regulations, whose effects should be considered when preparing the financial statements, have been disclosed to the auditor.

2.3 Audit procedures when non-compliance is identified or suspected

The following factors may indicate non-compliance with laws and regulations:

- Investigations by regulatory authorities and government departments
- Payment of fines or penalties
- Payments for unspecified services or loans to consultants, related parties, employees or government employees
- Sales commissions or agents' fees that appear excessive
- Purchasing at prices significantly above/below market price
- Unusual payments in cash
- Unusual transactions with companies registered in tax havens
- Payment for goods and services made to a country different to the one in
- which the goods and services originated
- Payments without proper exchange control documentation
- Existence of an information system that fails to provide an adequate audit trail or sufficient evidence
- Unauthorized transactions or improperly recorded transactions
- Adverse media comment

The following table summarises audit procedures to be performed when non-compliance is identified or suspected.

Table 9.1: Non-compliance audit procedures

Non-compliance: audit procedures
Obtain understanding of nature of act and circumstances.
Obtain further information to evaluate possible effect on financial statements.
Discuss with management and those charged with governance.
Consider need to obtain legal advice if sufficient information not provided and matter is material.
Evaluate effect on auditor's opinion if sufficient information not obtained.
Evaluate implications on risk assessment and reliability of written representations.

2.4 Reporting identified or suspected non-compliance

The auditor shall communicate with **those charged with governance**, but if the auditor suspects that those charged with governance are involved, the auditor shall communicate with the next higher level of authority such as the **audit committee or supervisory board**. If this does not exist, the auditor shall consider the need to obtain **legal advice.**

The auditor shall consider the impact on the **auditor's report** if he/she concludes that the non-compliance has a material effect on the financial statements and has not been adequately reflected, or is prevented by management and those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance is material to the financial statements.

The auditor shall determine whether identified or suspected non-compliance has to be reported to the **regulatory and enforcement authorities**. Although the auditor must maintain the fundamental principle of **confidentiality**, in some jurisdictions the duty of confidentiality may be **overridden** by law or statute.