2.1 Commencing an Audit

SA 200 “Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing” states that to achieve the overall objectives of the auditor, the auditor shall use the objectives stated in relevant SAs in planning and performing the audit. Without a careful plan, the overall objective of an audit may not be achieved. The audit planning is necessary to conduct an effective audit in an efficient and timely manner.

2.1.1 Benefits/Advantages of Planning in an Audit of Financial Statements

Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways described hereunder-

(i) Attention to Important Areas - Planning would help the auditor to devote appropriate attention to important areas of the audit.

(ii) Timely resolution of Potential Problems - It would also help the auditor identify and resolve potential problems on a timely basis.

(iii) Proper Organisation and Management of Audit Engagement - Adequate planning would help the auditor in properly organizing and managing the audit engagement so that it is performed in an effective and efficient manner.

(iv) Proper Selection of Engagement Team - Planning would assist the auditor in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.

(v) Direction and Supervision of Engagement Team - It would further facilitate the direction and supervision of engagement team members and the review of their work.

(vi) Easy Coordination - Also, planning would be helpful to the auditor in coordination of work done by auditors of components and experts.

2.1.2 Nature and Extent of Planning

So far as the nature of planning is concerned, it would vary according to-

(i) Size and Complexity of the Auditee - If the size and complexity of organization of which audit is to be conducted is large, then much more planning activities would be required as compared to an entity whose size and complexity is small.
(ii) Past Experience - The key engagement team members' previous experience also contributes towards variation in planning activities.

(iii) Change in Circumstances - Another factor contributing towards variation in planning activities is change in circumstances.

### 2.1.3 Planning - A Continuous Process

Planning is not a discrete phase of an audit but rather a continual and iterative process. It often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning includes consideration of the timing of certain activities and audit procedures.

For example, planning includes the need to consider such matters as:

- The analytical procedures to be applied as risk assessment procedures.
- Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
- The determination of materiality.
- The involvement of experts.
- The performance of other risk assessment procedures.

### 2.1.4 Overall Audit Strategy and Audit Plan - Responsibility of the Auditor

The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement. For example - to coordinate some of the planned audit procedures with the work of the entity's personnel.

Although these discussions often occur but the overall audit strategy and the audit plan remain the auditor's responsibility. When discussing matters about the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit. For example - discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

The engagement partner and other key members of the engagement team shall be involved in planning the audit. The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience thereby enhancing the effectiveness and efficiency of the planning process.

### 2.1.5 Preliminary Engagement Activities

The auditor shall undertake the following activities at the beginning of the current audit engagement-

(i) Performing procedures required by SA 220, “Quality Control for an Audit of Financial Statements” regarding the continuance of the client relationship and the specific audit engagement.

As per the combined reading of SA 220 and SQC 1, information and procedures such as the following assists the auditor in determining whether the conclusions reached regarding
the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity of the principal owners, key management and those charged with governance of the entity;
- Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
- Whether the firm and the engagement team can comply with relevant ethical requirements; and
- Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

In case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), auditors may be appointed in accordance with statutory procedures.

(ii) Evaluating compliance with ethical requirements, including independence, as required by SA 220; and

(iii) Establishing an understanding of the terms of the engagement, as required by SA 210.

2.1.6 Contents of an Audit Plan

The auditor shall develop an audit plan that shall include a description of:

(i) The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment”.

(ii) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 “The Auditor’s Responses to Assessed Risks”.

(iii) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

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.

2.1.7 Changes to Planning Decisions

The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit.
2.4 Advanced Auditing and Professional Ethics

The auditor may need to modify the overall audit strategy and audit plan due to below mentioned factors-

(i) result of unexpected events,
(ii) changes in conditions, or
(iii) the audit evidence obtained from the results of audit procedures.

Further, the auditor would also modify the nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks.

This may be the case when information coming to the auditor differs significantly from the information when he planned the audit procedures. For example, audit evidence obtained through the performance of substantive procedures may contradict the audit evidence obtained through tests of controls.

2.2 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.

2.2.1 Factors while establishing Overall Audit Strategy

Overall audit strategy would involve-

(i) Determination of Characteristics of Audit: Identify the characteristics of the engagement that define its scope.

(ii) Reporting Objectives: Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required.

(iii) Team’s Efforts: Consider the factors that, in the auditor’s professional judgment, are significant in directing the engagement team’s efforts.

(iv) Preliminary Work: Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant.

(v) Nature, timing and Resources: Ascertain the nature, timing and extent of resources necessary to perform the engagement.

2.2.2 Benefits of Overall Audit Strategy

The process of establishing the overall audit strategy assists the auditor to determine such matters as-

(i) Employment of Qualitative Resources: 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) Allocation of Quantity of Resources: 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) Timing of Deployment of Resources: When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates.

(iv) Management of Resources: 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.

2.2.3 Considerations in Establishing the Overall Audit Strategy

Some of the examples of matters that the auditor may consider in establishing the overall audit strategy are given hereunder. Many of these matters will also influence the auditor’s detailed audit plan. All matters are not relevant to every audit engagement and the list is not necessarily complete.

Characteristics of the Engagement

(i) The financial reporting framework.

(ii) Industry-specific reporting requirements such as reports mandated by industry regulators.

(iii) The expected audit coverage, including the number and locations of components to be included.

(iv) The nature of the control relationships between a parent and its components that determine how the group is to be consolidated.

(v) The extent to which components are audited by other auditors.

(vi) The entity’s use of service organizations and how the auditor may obtain evidence concerning the design or operation of controls performed by them.

(vii) The expected use of audit evidence obtained in previous audits, for example, audit evidence related to risk assessment procedures and tests of controls.

(viii) The effect of information technology on the audit procedures.

(ix) The availability of client personnel and data.

Reporting Objectives, Timing of the Audit, and Nature of Communications

(i) The entity’s timetable for reporting.

(ii) The organization of meetings with management regarding audit work (Nature, timing and extent).

(iii) The discussion with management regarding type and timing of reports to be issued.

(iv) The discussion with management regarding communications on the status of audit work.

(v) Communication with auditors of components regarding types and timing of reports to be issued.
2.6 Advanced Auditing and Professional Ethics

(vi) The nature and timing of communications among engagement team members.

(vii) Whether there are any other expected communications with third parties, including any statutory or contractual reporting responsibilities arising from the audit.

Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements

(i) The determination of materiality in accordance with SA 320.

(ii) Preliminary identification of areas where there may be a higher risk of material misstatement.

(iii) The impact of the assessed risk of material misstatement at the overall financial statement level on direction, supervision and review.

(iv) The manner in which engagement team members need to maintain a questioning mind and to exercise professional skepticism.

(v) Results of previous audits including the identified deficiencies and action taken to address them.

(vi) The discussion of matters that may affect the audit with firm personnel responsible for performing other services to the entity.

(vii) Evidence of management's commitment to the design, implementation and maintenance of sound internal control.

(viii) Volume of transactions which may determine reliance on internal control.

(ix) Importance attached to internal control.

(x) Significant business developments affecting the entity.

(xi) Significant industry developments.

(xii) Significant changes in the financial reporting framework, such as changes in accounting standards.

(xiii) Other significant relevant developments, such as changes in the legal environment affecting the entity.

Nature, Timing and Extent of Resources

(i) The selection of the engagement team and the assignment of audit work to the team members.

(ii) Engagement budgeting.

2.2.4 Documenting the Audit Plan

The auditor shall document-

(i) The overall audit strategy;

(ii) The audit plan; and

(iii) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes as under-
(a) Record of Key Decisions: 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. For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit.

(b) Record of Nature, Timing and Extent of Risk Assessment Procedures: 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) Record of reasons for Change in Audit Plans: A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, 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.

2.2.5 Relationship between the Overall Audit Strategy and the Audit Plan

![Image](https://msp-c.com)

Fig 1: Audit Strategy and the Audit Plan are interrelated.*

The audit strategy is prepared before the audit plan. The audit plan contains more details than the overall audit strategy. Audit strategy and audit plan are inter-related because change in one would result into change in the other. The audit strategy provides the guidelines for developing the audit plan. It establishes the scope and conduct of the audit procedures and thereby works as basis for developing a detailed audit plan. Detailed audit plan would include the nature, timing and extent of the audit procedures so as to obtain sufficient appropriate audit evidence.

* Source : msp-c.com
2.8 Advanced Auditing and Professional Ethics

Example
CA. Sapna has already developed an audit strategy for Hitesh Ltd. While a detailed audit plan is being developed, she decided that materiality levels set earlier need to be increased as weaknesses in the internal controls were highlighted in the internal audit report. Subsequently, a deviation from the audit strategy is felt necessary. Therefore, Sapna would firstly modify the overall strategy and thereafter prepare the audit plan according to the strategy. This shows that the audit strategy and audit plan are closely inter-related as change in one is resulting into change in the other.

2.3 Audit Programme
In I(IPC) study material, we have discussed audit programme generally so as to enable the students to know the utility and nature of audit programmes. An audit programme is commonly prepared to allocate work to team members which may include the list of audit procedures and instructions to be followed by the member. It also estimates the duration for completing an audit task.

2.3.1 Formulating an Audit Programme

- Generally ascertaining whether the assets are in good working order;
- Ascertaining their existence on the balance sheet date;
- Finding out encumbrances attaching the assets, if any;
- Confirming ownership;
- Proper categorisation of assets;
- Determining the valuations;
- Presentation of relevant information for a proper understanding of their nature value and usefulness;
It is very useful for students to know how to plan an audit programme. The programme may contain audit objectives for each area and should have sufficient detail to serve as a set of instructions to the assistants involved in the audit and as a means to control the proper execution of work. It may be emphasised that a clear spelling out of audit objectives for each area is important to link up the procedures with audit objectives and to ensure a purposeful audit. For example, in the area of fixed assets, audit objectives can be the following:

Procedures of verification for this purpose may include physical verification, review of working papers, document verification including verification of loan documents, checking of provisions for depreciation, review of accounting policy on fixed assets, verification of compliance with legal requirements about disclosure and verification of jobs work performed by the assets. This linkage in the mind of the assistants on job is imperative and without this the audit would be just a mechanical performance. They should be able to identify the assertions made in the Balance Sheet and Profit and Loss Account because that provides key to the auditor’s selection of the procedures. The important matters which need to be considered in this regard are:

(a) **Nature of business in which the organisation is engaged:** On his first appointment, the auditor should examine in detail the financial and accounting organisation of the business by visiting the client’s office; by observing different stages through which papers pass before each transaction is authorised and recorded; the record that is kept and the titles of books in which it is kept. In the case of an industrial concern, he must also visit the factory to acquaint himself with the different processes of manufacture, the quantitative records maintained and the manner in which statistics are compiled in respect of losses in process.

The nature of business carried on by the concern has a great relevance to different audit procedures. The auditor, therefore, should draw up the programme of audit on a consideration of the technical, financial and accounting set-up of the company.

(b) **Overall plan:** Overall plan for the audit programme should be drawn up to ensure a systematic approach to the work. If in drawing the audit programme, any divergence from the overall plan becomes necessary, first the overall plan should be modified after due consideration and thereafter only the matter may be taken in the audit programme. The frame provided by the overall plan should be strictly adhered to.

(c) **System of internal control and accounting procedures:** The existence of a system of internal control is essential for every business organisation. It ensures that both financial and statistical records are checked continuously; it also unearth errors, both of omission and of commission. The auditor, in framing his opinion on financial statements needs reasonable assurance that transactions are properly authorised and recorded in the accounting records and that transactions have not been omitted. Internal control may contribute to the reasonable assurance the auditor seeks. Therefore, it has become an accepted audit practice to study and evaluate internal control. The study and evaluation of internal control helps the auditor to establish the reliance he can place on the internal control in determining the nature, timing and extent of his substantive auditing procedures. The auditor also obtains an understanding of the accounting system to identify points in processing of transaction and handling of assets where errors or fraud may occur. When the auditor relies on internal control, it is at these points that he must be satisfied that internal control procedures applied by the entity are effective for his
The auditor’s examination of the system of internal control should have three features - review and preliminary evaluation, testing of compliance and evaluation.

(i) **Review and preliminary evaluation** - The auditor should review the accounting system and related internal control to gain an understanding of the flow of transactions and the specific control procedures to be able to make a preliminary evaluation and identification of these aspects of internal control on which it might be efficient and effective to rely in conducting his audit.

(ii) **Test of compliance** - Compliance tests should be conducted by the auditor to gain evidence that those internal controls on which he intends to rely operate generally as identified by him and that they function effectively throughout the period of intended reliance. Based on the results of his compliance procedure including observed deviations, the auditor should evaluate whether the internal controls are adequate for his purposes.

(iii) **Evaluation** - It is essentially an objective process of application of auditor’s judgement to determine whether all or any of the internal controls in the client’s organisation can be relied upon in carrying out the audit. Based on the degree of reliance which may be full, partial or none, the auditor will programme for the substantive verification of transactions for expression of audit opinion. The results of compliance procedure directly provide the basis for this evaluation and, in turn, basis to determine the nature, timing and extent of the substantive audit procedure. In evaluating the auditor recognises that some deviations from compliance may have occurred.

(d) **Size of the organisation and structure of its management** - An increase in the size of the organisation enhances the complexity of the examination of its accounting records specially when it has a number of branches, deals in several products or has a very large turnover. With the increase in the size ordinarily the scope and extent of the system of internal control also should increase but it may not be so in every case. It has been the experience that while many small businesses have excellent controls, some of the large enterprises are deficient in their operational controls. For example, the reports of the Comptroller and Auditor General on audit of accounts of Public Enterprises show that some of them have a very poor system of internal control. In such cases, the magnitude of the tasks of the auditor increases considerably.

(e) **Information as regards organisation of the business** - To plan audit programme, it is necessary that the auditor should obtain from his client information as regards the under mentioned matters:

- Client’s history and business.
- Purpose and nature of engagement.
- Time schedule for the completion of audit.

Before accepting a new audit, the auditor should satisfy himself as to the desirability of being associated with the job. If the concern is not known to him, he should enquire into its standing, financial background, nature of business and other similar matters. As far as practicable, he
should also try to ascertain the reputation of the concern as also the honesty and integrity of principal executive.

(f) Accounting and management policies: On the first appointment it is necessary that the auditor should review the financial statements of the past several years, audited by his predecessors specially those of the immediately preceding previous year. This would reveal to him a great deal of information regarding accounting and management policies which have been followed in the past and whether these have been employed consistently.

2.3.2 Drawing up the audit programme

After the auditor has collected the aforementioned information, he will be in a position to draw up the programme of audit. He can now decide the areas to be covered by audit, also those to be covered in detail and those which should be covered by the applications of the test checks. He will also be able to decide the specific audit procedures which should be applied in each case. These procedures vary widely because of the conditions under which each concern operates, its form of organisation, its nature of business and the condition of its accounts. On this account, it is not practicable to draw up a typical audit programme. When an auditor is appointed to audit the accounts of an entity for the first time, the audit programme should be developed in three stages stated below:

(i) To begin with, a broad outline of the audit programme should be drawn up.

(ii) After the internal and accounting procedures have been reviewed, the details should be filled up on a consideration of the deficiencies in the system of internal control.

(iii) After the detailed checking formality is over, the extent to which the special procedures need to be applied should be determined, e.g., independent verification of balances of
debtor and creditors, physical inspection of fixed assets, personal inspection of various items of stock included in closing inventories and testing their values. At times, special procedures may have to be applied on a consideration of the nature of business e.g. verification of provision for tax liability in case of a shipping company regarding freight booked in different countries or for making a provision for unexpired liability in case of an insurance company, etc.

At each subsequent engagement the programme should be reviewed and, if necessary, modified on account of:

(i) experience gained during the previous audits;

(ii) important changes that have taken place in the business specially in the system of internal control, accounting procedures or in the structure of management or of the scope of business; and

(iii) evaluation of internal control made for the current year.

Given below are a few circumstances where in the audit programme would have to be suitably altered:

(1) If the audit procedures were designed for a certain volume of turnover and subsequently the volume have substantially increased. Also, when there have been significant changes in the accounting organisation, procedures and personnel subsequent to the audit procedures.

(2) Where during the course of an audit, it has been discovered that internal control procedures were not as effective as assumed at the time the audit programme was framed.

(3) Where there has been an extraordinary increase in the amount of book debts or that in the value of stocks as compared to that in the previous year.

(4) When a suspicion is aroused during the course of audit or information has been received that assets of the company have been misappropriated.

It may be noted that the audit plan and related programme should be reconsidered as the audit progresses. Such re-consideration is based on the auditor’s review of internal control, his preliminary evaluation thereof and the result of his compliance and substantive procedures.