

## **TOPIC 6: AUDIT PLANNING – ISA 300**

Audit planning involves establishing the overall audit strategy for the engagement and developing an audit plan. The audit strategy sets out the scope, direction, timing and conduct of the audit.

### **Importance/objectives of planning the audit**

1. To ensure that appropriate attention is devoted to the most important areas of the audit.
2. To ensure that potential problems are identified and resolved on a timely basis.
3. To ensure that all areas are covered and the audit is completed expeditiously.
4. To facilitate co-ordination of work done by other auditors and experts.
5. To facilitate allocation of audit duties to audit staff based on competence and experience.
6. It facilitates direction and supervision of audit work.
7. It facilitates optimal timing of audit procedures.
8. It ensures that the auditor adopts a systematic approach to the audit.
9. It facilitates control i.e. the plans and programmes act as a checklist against which the actual work done can be assessed.
10. It ensures that there is timely communication between the auditors and the client relating to aspects such as use of experts, use of other auditors work, use of internal auditors etc.
11. It ensures that the audit is carried out in an economics, efficient and effective manner.

### **Limitations of audit planning**

- 1) High audit staff turnover late.
- 2) Lack of co-operation from the client staff causing delays. 3) Several audit clients having similar year ends.
- 4) Changes in the clients business and situations which may disrupt the audit plan.
- 5) Abrupt assignments such as receivership.

- 6) Audit plans may be rigid such that if a situation that had not been planned for the audit staff may not be able to address it.

### **Causes of failure in the audit planning process**

- 1) The auditor beginning detailed testing before the planning work is completed. This may result into commissions and unnecessary work.
- 2) Lack of proper understanding of the client and its environment.
- 3) In-adequate documentation.
- 4) In-adequate information.
- 5) Abrupt changes in the clients systems and business.
- 6) Incompetence of the staff.
- 7) Abrupt assignments etc.

### **Minimizing problems associated with audit planning**

- 1) Adopt continuous audit approach or ask the client to prepare interim financial statement so that a lot of audit effort can be put in the interim audit and in the continuous field visits so as to minimize the pressure at the end of the year.
- 2) The auditor should work in close liaison with the client on a continuous basis to reduce delay in providing information.
- 3) The audit firm should have standby audit staff to replace those who may leave.
- 4) The audit firm should establish a special department for dealing with abrupt assignment e.g. part time staff can be hired for this purpose.
- 5) The audit firm should have long-term strategic plans regarding staff requirements.

### **Audit planning process**

- 1) Gathering and confirming background knowledge about the client.
- 2) Performing preliminary risk assessment.
- 3) Setting materiality levels. 4) Performing ARP's.
- 5) Determining the accounting systems and the related controls and recording the systems. 6) Performing compliance testing (test of controls) 7) Developing the overall audit plan and strategy.
- 8) Developing the audit programmes.

- 9) Budgeting and staffing considerations. 10) Preparing job timetables.

## 2) Preliminary Risk Assessment

This enables the auditor to identify the areas of the financial statements where the risk of mis-statement is high.

The auditor will then plan to devote more audit attention to the areas where the risk is highest.

## 3) Setting materiality levels

Materiality relates to the significance of an item.

An item is considered to be material if its omission or mis-statement can influence the decision of the users.

At the planning stage, the auditor considers materiality to determine:

- a) The nature, extent, and timing of audit procedures.
- b) To identify and assess risk of material mis-statements.
- c) To determine the nature, timing, and extent of risk assessment procedures.

In laying out the audit plan, the auditor should establish an acceptable level of significance in order to detect erroneous presentations.

Qualitative materiality should also be considered.

Consideration of materiality at the planning stage will also enable the auditor to plan for staffing requirements. During the audit, the materiality levels should be adjusted as new information becomes available. During the audit, the auditor should use performance materiality.

Performance materiality is an amount(s) that is less than the materiality for the financial statement as a whole. At the audit conclusion, the auditor also considers materiality.

### Criteria for determining materiality

#### 1. Value criteria

This involves judging materiality on the basis of the amount or quantity of an item. In this case, materiality is expressed as a percentage of the major elements of an item. In this case, materiality is expressed as a percentage of the major elements of the financial statements and materiality cut-off points established.

Item expressed as a % of:	Materiality cut-off point
Net profit before tax	≥ 5%

Net profit after tax	0.5 – 1%
Turnover (sales)	0.5 – 1%
Total assets	2 – 5%
Net assets	1 – 2%

## 2. Nature criteria

There are some items that are considered to be material by virtue of their characteristics or nature regardless of the amount involved e.g. any dealings between the company and its directors is material regardless of the amount involved.

## 3. Impact criteria

An item is considered to be material if it has the potential of covering a profit into a loss or a loss into a profit.

## 4. Performing ARP's

ARP's include computation of significant accounting rates, trend analysis, cross-sectional analysis and reasonableness checks.

ARP's are done at the planning stage.

- i) To identify potentially problematic areas.
- ii) To assess risk.
- iii) To determine the amount of time that will be required in the audit.
- iv) To determine the staffing requirements in terms of numbers and the levels of skills.
- v) To determine the nature, extent and timing of further risk assessments procedures.
- vi) To determine the nature, extent and timing of audit procedures.

### **Limitations of ARP's at the planning stage of the audit**

1. The final accounts have not been finalized and hence the figures used in the ARP's are not the actual ones that will be appearing in the final accounts which the auditor will be auditing and expressing an opinion on.
2. The figures could be containing errors which are later corrected by the year end.
3. End of year adjustments have not yet been made.

4. Changes in accounting policy.
5. Some firms do not maintain complete records, they will wait until the end of the year where they extract the final accounts from the available information.

### **5. Determining the Accounting systems and the related controls Accounting system**

This refers to all the accounting procedures that identifies and process financial transactions that accounting records and the supporting documents and the financial reporting processes. The auditor needs to understand the clients accounting system at the planning stage to enable him:

- a) Identify the major classes of transactions.
- b) Understand how the transactions are identified and processed.
- c) Understand the format of the clients accounting records.
- d) Understand the client's financial reporting processes. **6.**

#### **Internal control system**

The ICS refers to the whole system of controls put in place by the management to ensure that:

- 1) Business is conducted in an orderly and efficient manner.
- 2) The assets of the organization are safeguarded.
- 3) There is adherence to the management policies.
- 4) To secure a far as possible completeness an accuracy and timely provision of financial information.

The auditor needs to determine the nature of the ICS in the client's business and how it operates. He should then evaluate the systems to determine the extent of reliance he can place on the systems. If the systems are strong, he will place reliance on the system and plan to do limited substantive testing. If on the other hand the systems are deficient, the auditor will not place reliance on the system and will therefore plan to carry out extensive substantive testing.

### **7. Preparing the overall audit plan and strategy**

The audit partner should develop the overall audit plan and audit strategy which will involve documentation of a description of:

- 1) The nature, timing and extent of planned risk assessment procedures.
- 2) The nature timing and extent of further audit procedures at the assertion level.

- 3) Other planned audit procedures that are required to be carried out so that the engagement complies with the ISA's.

Specifically the audit plan should provide for the following:

- 1) Planning for the audit of interim financial statement.
- 2) Planning for the field visits.
- 3) Planning for substantive tests on transactions and balances.
- 4) Planning for verification of assets and liabilities.
- 5) Planning for 3rd party confirmations.
- 6) Planning for attendance of the annual stock take.
- 7) Planning for comparison of audit work.
- 8) Planning for employment of experts.
- 9) Planning for time and cost budgets.

### **Planning memorandum**

This is a documentation or file containing all the planning details and all that will be relevant for the conduct of the audit. **Contents:**

- 1) A summary of the terms of engagement that sets out the nature and the scope of the audit work.
- 2) The job time-tables giving the dates and the timing of the audit work.
- 3) Background information about the client.
- 4) A record of any changes in the client since the last audit.
- 5) Details of planning decisions such as identified areas of weaknesses in the systems which will require more detailed work.
- 6) Entails of the key clients contracts such as the finance director, internal auditor, chief accountant etc.
- 7) Extent of reliance that will be placed on the internal auditors work.
- 8) The materiality levels set.
- 9) Staffing requirements
- 10) Risk assessment.

### **N/B**

The planning memorandum sets out the proposed strategy for the audit and it's based on cumulative audit knowledge and experience as well as important matters which have been brought to the attention of the auditor.

**Matters to put into consideration in developing the overall Audit strategy** – the overall audit strategy describes in general terms how it will be carried out.

The audit plan on the other hand details the specific procedures to be carried out to implement the strategy and to complete the audit.

### **1. Characteristics of the engagement**

- 1) The financial reporting framework used by the client.
  - 2) Industry specific reporting requirements.
  - 3) Expected coverage including the no. of locations of components.
  - 4) Availability of the work of internal auditors and the extent of reliance on the work.
  - 5) Effect of IT on audit procedures. 6) Availability of personal data. 7) Coordination.
2. Significant factors such as preliminary engagement activities and knowledge gained on other engagements.
  3. The reporting objectives such as timing of the audit.

The nature of communications, entities timetable for reporting, meeting with the management and those charged with governance, communication with auditors' components. The nature, timing and extent of resources.

4. Materiality.
5. The ICS and the accounting system.
6. The volume of transactions.
7. Conditions that require special attention.
8. Possibility that the going concern assumption may be doubtful.
9. Co-ordination, direction, supervision and review.

### **8. Preparing the Audit programmes**

An audit program is a breakdown of all the audit work to be performed with respect to each item included in the financial statement.

It provides for the substantive procedures necessary in the audit of financial statement.

A separate audit program will be prepared for each item included in the financial statement.

### **Audit programme sample/Example**

Name of audit firm

Address

Name of  
client

Address of client

Financial period covered.....

### **Audit program for cash**

Specific audit procedures	Specific audit objective	Audit findings	Audit conclusions	Auditor's initials	Date
Test the control over cash payments	To verify that all cash payments are valid and authorized.				
Count cash	To verify existence and amount available in the company.				

### **CONTENTS**

- 1) Name and address of the audit firm.
- 2) Name and address of the client company.
- 3) The financial period covered by the financial statements being audited.
- 4) The specific audit procedures to be carried out.
- 5) The specific objectives to be achieved by each procedure.
- 6) The timing of each procedure.

- 7) The auditor's findings from the procedure.
- 8) The auditors conclusion based on the findings.
- 9) The initials of the auditor who carries out the audit procedure.

### **Types of Audit programs**

- 1) Standardized Audit programs
- 2) Progressive Audit programmes

### **Importance of Audit programmes**

- 1) They set out the procedures that are needed to implement the audit plan.
- 2) The programme serves as a set of instructions for the audit staff.
- 3) The programmes provide a means of control and record of work done.
- 4) They facilitate effective and efficient completion of the audit.
- 5) They force the auditor to adopt a systematic approach to the audit.
- 6) They facilitate review of the work done.
- 7) They facilitate timely completion of the audit work.

#### **a) Standardized Audit programs**

These are pre-prepared audit programmes developed by the audit firm to be used for all audits

#### **Advantages**

- 1) They save on time and cost.
- 2) They enhance uniformity of the audit work.
- 3) They provide for cross-referencing of the work done by the auditor.
- 4) They facilitate review of the audit work.
- 5) They serve as a set of staff instructions.
- 6) They facilitate planning of the subsequent year's audit.
- 7) They force the auditor to adopt a systematic approach to the audit which enhances the quality of the audit.
- 8) They facilitate delegation of audit duties.
- 9) They facilitate training of new recruits.

## Limitations

- 1) If followed mechanically they will make the audit to become mechanical and hence boring.
- 2) They discourage initiative and use of auditors' judgment.
- 3) The client staff may become familiar with the auditor's programs.
- 4) They lack flexibility to cope with changes.
- 5) They assume that all the audit clients are the same.
- 6) Inefficient staff may hide their inefficiency in the audit programs.

### **b) Progressive Audit programs**

These are audit programs that are allowed to develop as the audit progresses.

The auditor uses his professional skill and judgment to determine the proceeds to perform.

## **8. Budgeting and staffing**

### **considerations Importance of time budgets in the Audit**

- 1) It enables the auditor to meet the clients reporting deadlines.
- 2) It shows the time covered in each area of the audit. 3) It shows the level of staff who will do the work.
- 4) It ensures that all the audit matters are addressed within the required time.
- 5) The budgets shows the charges per hour and the total amount for each audit area i.e. it assists the auditor in costing the audit.
- 6) It facilitates faster completion of audit work.