

Before Planning Audit Programme

1. Before embarking upon devising an audit programme in detail following important auditing pronouncement may be kept in mind which is obligatory for auditor in carrying out his duties.
 1. Objective and scope of Audit of Financial Statement (AAS 2)
 2. Terms of Audit Engagement (AAS 26)
 3. Audit Planning (AAS8)
 4. Audit Materiality (AAS 13)
 5. Audit Sampling (AAS 15)
 6. Analytical Procedure (AAS 14)
 7. Audit Evidence (AAS 5)
 8. Audit Practice Quality control for audit work (AAS 17)

Checklists on most of the above pronouncements have been given in chapter 8.

2. Terms of Audit Engagement (AAS 26)

It is necessary that terms of the Audit engagement is recorded either as a contract or as engagement letter. In case of company audits the objective and scope of audit is regulated by the Companies Act or the Pronouncements of ICAI. The engagement letter would be informative for clients. Such letter should be sent by the auditor before the commencement of the audit. The form and contents of audit engagement letter would generally include object of audit, Management's responsibility for things like consistent application of appropriate accounting policies and implementation of applicable accounting standards, fees, planning of audit, maintenance of adequate accounting records, going concern basis, etc. The letter should be sent on the first appointment and subsequently when there are any variations in the terms of appointment.

3. Extent of check

3.1 AAS 15 describes how to design and select audit sample and how to evaluate the sample results. Either method of sampling — statistical or non statistical can be applied. The auditor has to select sample so that it provides sufficient audit evidence. Sample and its size have to be designed based on the specific audit objectives and population. The population means entire set of data or all transactions or full lists from which auditor draws sample so as to reach the goal to have efficient and effective sample. Through the process of stratification, population is divided into sub-populations having similar characteristics such as larger value of items in account receivables, unpaid invoices, unmatched suppliers statements etc. By the process of stratification the auditor can direct his efforts to items having potential monetary error.

3.2 While determining the sample size auditor has to consider the risk in both — test of control and substantive procedures. He has also to consider tolerable error and expected error.

The sample's character has to be representative of the population so that all items in the population have an opportunity of being selected.

There are various methods of selection of the samples and auditor has to take care in selecting the sample either at random either systematically or otherwise.



- 3.3 An auditor is not supposed to check cent per cent transactions for the period covered under Audit. He has to determine the extent of checking of transactions keeping in mind various factors such as volume of transactions, internal control and internal check, extent of internal audit, value of transactions etc. He has to strike a balance keeping all these factors in mind. He can, for instance, check the transactions for a particular period in a month or for particular months in a year or one month in a quarter etc. He can also determine the value over which transactions should be checked. Clear instructions have to be given in regard to extent of check for each of the class of transactions e.g. purchases vouchers, payment vouchers, etc.

4. Materiality

- 4.1 AAS 13 deals with materiality and its relationship with audit risk.

During audit planning, the auditor should make preliminary judgments regarding overall materiality. He should also set materiality levels for account balances and class of transactions based on the audit objectives set by him. The overall materiality should be determined by reference to key components of the financial statements. The key components may include profit, net worth, share capital, total assets, total liabilities, total revenue and total expenses. The auditor should make a preliminary judgment about amounts with reference to each key component. When determining overall materiality, the auditor should normally use the lowest materiality which has been established in relation to the identified key components. The auditor should set the materiality level at an amount which is appropriate for all key components that would be affected by misstatement. An error of Rs.1 million in a turnover of over Rs. 1,000 million may not be material but for a profit level of Rs. 50 million, an error of one million may be material. The items which are insignificant or trivial may be dealt without devoting time of the auditor. This is done in case of non material individual items and not group of item. The determining materiality qualitative professional judgment is of prime importance. The Chartered Accountant in practice will be held guilty of professional misconduct if he fails to disclose material fact known to him which makes financial statement misleading or fails to report a material misstatement in a financial statement.

- 4.2 AAS 13 covers materiality in detail. Materiality depends on the size and nature of item, judged in the particular circumstances of its misstatement. Thus materiality provides threshold or a cut-off point rather than primary qualitative characteristic, which the information must have to be useful. If the Companies Act, 1956 or AS require an item to be accounted for or disclosed in a particular manner, any misstatement in that item is more likely to be regarded as material than a similar misstatement in an item for which there is no such requirement. A misstatement in a transaction affecting Balance Sheet classification is less likely to be material than misstatement that affects the determination of profit.

5. Work done by other Chartered Accountant

In course of audit function, the Auditor may have to delegate certain functions to another auditor or audit firm, for example branch audit or unit audit. While devising programme for audit, the Auditor will have to verify the audit programme, extent of check and depth of check exercised by the other auditor or Chartered Accountant and consider extent of test check to be applied by him in the areas covered by that auditor.

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