

2. Audit Strategy, Planning and Programming

Important Point of this chapter

1. Audit Strategy
2. Analytical Procedure
3. Audit engagement Letter
4. Development of an overall Plan of audit

Audit Strategy

Audit strategy is concerned with designing optimized audit approaches that seeks to achieve the necessary audit assurance at the lowest cost within the constraints of the information available. Its involves following steps

1. Obtaining Knowledge of business
 - SA 315 and SA 330 ‘identifying and assessing the Risk of Material Misstatement through Understanding the Entity and its Environment’ and “the Auditor’s Responses to Assessed Risks” States that in performing an audit of financial statements, the auditor should have or obtain knowledge of the business sufficient to enable the auditor to identify and understand the events, transactions and practices that, in the auditor’s judgment, may have a significant effect on the financial statements or on the examination or audit report.
 - It is also ensures that audit staff assigned to an audit engagement obtains sufficient knowledge of business to enable them to carry out the audit work delegated to them.
2. Performing Analytical Procedures
 - The use of analytical procedures during the planning stage requires the extensive use of accounting ad business knowledge and experience to assess the potential for material misstatement in the financial statements as a whole, because the key aspect of the task is to identify the relevant risk indicators and to interpret them properly.
3. Evaluating inherent risk
 - To assess inherent risk, the auditor would use professional judgment to evaluate numerous factors such as quality of accounting system, unusual pressure on management etc. having regard to his experience of the entity form previous audit engagements of the entity, any controls established by management to compensate for a high level of inherent risk, and his knowledge of any significant changes which, might have taken place since last assessment.
4. Evaluating Internal control
 - For strategy purpose auditor should obtain a sufficient understanding of the control environment. The auditor needs an understanding of the accounting systems, regardless of whether the audit strategy will involve an extended assessment of internal accounting controls. This is done by
 - a. Considering the results of gathering or updating information about the client;
 - b. Making preliminary judgments about materiality, inherent risk and control effectiveness. These will include identification of the system; the auditor proposes to subject to an extended assessment of controls.

Analytical Procedures

As per SA 520 “analytical Procedures” when the auditor intends to perform analytical procedures on data prepared by the client, he should consider the following:

1. Suitable Analytical Procedures: determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
2. Source of data: evaluate the reliability of data from which the auditor’s expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparations.
3. Development of Data: develop an recorded amounts or ratios and evaluate whether the expectations is sufficiency precise to identify a misstatement that, individually or when aggregated with other misstatement, may cause the financial statements to be materially misstated; and
4. Reason for difference in ratio: determine the amount of any difference of recorded amounts from the values that is acceptable without further investigation and if analytical procedures performed In accordance with SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:
 - i. Inquiring of management and obtaining appropriate audit evidence relevant to management’s response; and
 - ii. Performing other audit procedures as necessary in the circumstances.

Audit engagement letter

As per SA 210 “agreeing the Terms of audit engagements” the form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor’s responsibilities may be based on description of the responsibilities of management. Other points which are inconsideration are as follows

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, SAs and ethical and other pronouncements of professional bodies to which the auditor adhere.
- The form of any other communication of results of the audit engagement.
- The fact that because of the inherent limitations of an audit, together with the inherent limitation of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with SAs.
- Arrangements regarding the planning and performance of the audit, including the composition of audit team.
- The expectation that management will provide written representations
- The agreement of management to make available to the auditor draft financial statements and any accompanying other information in time to allow the auditor to complete the audit in accordance with the proposed timetable.
- The agreement of management to inform the auditor of facts that may affect the financial statements, of which management may become aware during the period from the date of the auditor’s report to the date the financial statements are issued.
- The basis on which fees are computed and any billing arrangements.

- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein.
- The fact that the audit process may be subjected to a peer review under the chartered accountants act, 1949.

Audit Programme

When an auditor appointed to audit the accounts of an entity for first time, the audit programme should be developed in three stages stated below:

- To begin with, a broad outline of the audit programme should be drawn up.
- 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.
- 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 debtors and creditors, physical inspection of fixed assets, personal inspection of various items of stock etc.

Management representation letter

Representations by management are the single most important source of audit evidence and thus, have significant implication for an auditor to formulate his opinion on the financial information. Basic elements of a MRL are as follows

- A MRL should be addressed to the auditor containing the relevant information and be appropriately dated and signed.
- A MRL would normally be dated the same date as the auditor's report on the financial information or a date prior thereto.
- A MRL should be ordinarily signed by the members of the management who have primary responsibility for the entity and its financial aspects.
- If management refuses to provide representations on any matter that the auditor considers necessary, this will constitute a limitation on the scope of his examination. In such circumstances, the auditor should evaluate any reliance he has placed on other representation made by management during the course of his examination and consider if the refusal may have additional effect on his report.