

ROBUST AUDIT PLANNING (PART 2)

Essential Activities to Facilitate an Efficient Audit



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In Part 1 of this two-part series, published in *IS Chartered Accountant*, May 2015 issue, we emphasised that planning is imperative to the effective conduct of an audit engagement and issuance of appropriate audit opinion. It is a critical, if not the most critical, process of the entire audit cycle. In this second part, we will highlight some of the planning activities public accountants (PAs) should engage their auditees and their staff in. This list is by no means exhaustive, but it would serve to dispel some common misconceptions about audit planning.

ENGAGE CLIENTS EARLY

Engagement of auditees by the PAs should not be limited to only good paymasters and those which the PAs have a good relationship with. While it is important to continue to engage such auditees, there is also a need to engage other auditees in their portfolio to make retention decisions and to assess the risks of the respective auditees.

Some PAs, especially the sole proprietors, shared that it is challenging to engage all their auditees when planning for their audits due to the

sheer number of auditees in their portfolio. Other PAs also think that planning meetings are redundant, especially for recurring engagements. But a word of caution: Although it is undeniably challenging for PAs to engage with all their auditees, this is not a process PAs can just do away with.

The solution really is to segment

their auditees into those which they should have physical meetings with and those which they could just communicate with over the phone. The segmentation decision would be based on the size, complexity and whether the auditee is new or recurring, among other criteria. The PAs should, at a minimum, visit and have physical meetings with a new





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auditee and recurring auditees with high-risk rating. An office visit and a face-to-face meeting would facilitate the PA's understanding of not only the new auditee's business and operations but also, to a certain extent, obtain some comfort over the integrity of the management team as well as the competence of the finance team. For recurring high-risk auditees, physical

engagements would help PAs identify and assess additional risks more effectively. Lower-risk auditees are those which the PAs can engage with over the phone on any changes and developments specific to each auditee and its industry.

Whichever approach a PA takes, the main objective is to make sure that all significant risks are identified

and assessed, and appropriate audit procedures are designed to address the risks. The last thing a PA would want is a nasty surprise sprung on him near the audit report sign-off date, such as changes to the auditee which he had no prior knowledge of.

Planning also helps the engagement team to reduce re-works, and sets expectations with the auditee upfront in terms of audit timeline and the list of schedules to be provided by the management.

DOCUMENT MEETING MINUTES AND THE RISKS IDENTIFIED AND ASSESSED

PAs may have performed the necessary planning, but many still fail to prepare the planning notes for their audit files. Planning notes are important to confirm the PA's understanding of the auditee's business and all the risks identified and assessed by him. These notes would also serve as a reference point for the engagement team to develop and execute audit procedures. A set of properly-documented planning notes would also facilitate the sharing of knowledge among the engagement team members, especially the new team members. This is especially crucial in an industry segment like auditing, which experiences high staff turnover.

TECHNICAL EXCELLENCE

AUDIT PLANNING

DOCUMENT THE REVIEW OF INTERNAL CONTROL RELEVANT TO THE AUDIT

There seems to be a misconception that when a full substantive approach is adopted for the audit of a small and medium-sized enterprise (SME) – which is the common strategy adopted by small and medium-sized practices (SMPs) – it is not necessary to channel efforts into understanding the auditee’s control relevant to the audit, since the controls will not be relied upon. This is a misconception that needs to be dispelled.

Singapore Standards on Auditing (SSA) require consideration of internal controls of the auditee as part of the risk identification and assessment process even when the PA decides not to rely on the auditee’s controls and consequently, will not be testing the operating effectiveness of any of the controls. There is therefore the need to evaluate the design and implementation of key controls relevant to the audit in order to identify financial statement areas which carry a risk of misstatement.

Auditors should also be mindful that control design, implementation and operating effectiveness are three different conditions which require separate consideration. These three conditions must be satisfied before any reliance can be placed on a control. To elaborate, when the design of a control does not meet the control objective (that is, it is not effective in preventing a misstatement), even if a control is found to be operating effectively, the control is of no value. A poorly-designed control, regardless of its operating effectiveness, is a deficiency in the financial reporting process and should be an area of concern for the auditors.

Another point to clarify is that tracing of transactions through the system to obtain assurance on effective control implementation cannot be relied upon to confirm operating effectiveness of the control itself without any regard to the type of control (that is, manual or automated).

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Just because the nature of testing for control implementation could be similar to testing for operating effectiveness, the former does not automatically qualify as a test of controls. Testing of controls would require the PA to first understand the type and objective of a control before designing the test and selecting the samples. Such understanding will drive the decision on the population for sample size determination and sample selection, and is likely to result in a different set of samples for testing.

In summary, the evaluation of control design and implementation is intended to confirm the auditor’s understanding of the entity’s internal controls and risks of material misstatement. It does not provide any form of assurance over the effectiveness of the controls. As part of their audit strategy, the PAs may of course choose to design and perform audit procedures to test the operating effectiveness of their auditees’ controls so as to reduce the amount of substantive work required.

AUDIT PLAN SHOULD BE CUSTOMISED BASED ON RISK ASSESSMENT

Audit plans are often found to be generic without any link to the risks identified and assessed, if this step is even performed at all. The nature, timing

and extent of the planned procedures should be customised to address the risks identified and confirmed.

A PA may have performed proper risk identification and assessment, but if the audit procedures are not developed and customised to address those risks, it would not reduce the PA’s risk of issuing inappropriate audit opinion. Hence, a proper follow-through from risk identification to the audit plan and eventually the audit plan execution is critical to every audit.

SETTING AND DOCUMENTING APPROPRIATE MATERIALITY LEVEL

The determination of the materiality level requires professional judgement and is not a simple mathematical calculation. There should be sufficient documentation of the basis used for such determination. It is crucial that materiality is appropriately set as it





drives the scope and extent of audit work. A materiality level that is set too high will result in inadequate work performed and conversely, will result in an excessive or inefficient audit.

PAs should also determine the appropriate performance materiality level (that is, the amount used to perform work) and the trivial threshold. Sufficient headroom should be given when determining the performance materiality to ensure that the actual level of uncorrected misstatements does not exceed the anticipated level of uncorrected misstatements.

COMMUNICATE AUDIT STRATEGY AND PLAN WITH TEAM

For recurring engagements that are relatively less complex in an SMP setup, the engagement team may comprise only the engagement partner and another professional staff. It is also quite common for certain PAs

to instruct their assistants to follow prior year's working papers instead of providing the relevant briefing to their staff about the audit engagement. This should not be the case. Although the audit may be straightforward, it is still important for the PA to meet with his staff to confirm the audit strategy and take the staff through the entire audit plan. Otherwise, even if there is an audit plan, the staff, who has insufficient audit experience, may not be able to properly execute the audit plan.

For higher-risk audit engagements with larger audit teams, each team should meet with the PA to go through the planning documents. Risks identified and assessed should be reiterated at the meetings and detailed briefing of the audit plan should be provided by the PA to ensure that the entire team fully comprehends the risks, the audit plan and the audit procedures. The time to be taken for each of such meetings would again

depend on the size and complexity of each engagement. It is worthwhile for the PAs to have extensive briefings for high-risk or complex engagements.

YES, THERE IS CERTAINLY A NEED TO PLAN

In conclusion, a well-established audit strategy and well-developed audit plan, when properly executed, would reduce the risk of a PA forming an inappropriate opinion on the financial statements. A good audit plan also helps the engagement team to devote appropriate attention to important areas of the audit, resulting in an efficient and effective audit. Concerted effort should therefore be made by a PA in the planning of each and every one of his audit engagements. ISCA

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