

Chapter no 2 : Audit Planning, Procedures and Documentation

2.1 Audit Planning

Audit Planning (AAS 8):

1. Basis:

"The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business.

Plans should be made to cover, among other things:

- (a) Acquiring knowledge of the client's accounting systems, policies and internal control procedures;
- (b) Establishing the expected degree of reliance to be placed on internal control;
- (c) Determining and programming the nature, timing, and extent of the audit procedures to be performed; and
- (d) Coordinating the work to be performed.

Plans should be further developed and revised as necessary during the course of the audit."

The purpose of this Statement is to amplify the basic principle outlined above.

2. Why audit planning?

Adequate audit planning helps to:

- * ensure that appropriate attention is devoted to important areas of the audit;
- * ensure that potential problems are promptly identified;
- * ensure that the work is completed expeditiously;
- * utilize the assistants properly; and

- * co-ordinate the work done by other auditors and experts

3 Knowledge of the Client's Business

Normally, however, internal audit operates in one or more of the following areas:

The auditor needs to obtain a level of knowledge of the client's business that will enable him to identify the events, transactions and practices that, in his judgment, may have a significant effect on the financial information. Among other things, the auditor can obtain such knowledge from:

- * The client's annual reports to shareholders.
- * Minutes of meetings of shareholders, board of directors and important committees.
- * Internal financial management reports for current and previous periods, including budgets, if any.
- * The previous year's audit working papers, and other relevant files.
- * Firm personnel responsible for non-audit services to the client who may be able to provide information on matters that may affect the audit.
- * Discussions with client.
- * The client's policy and procedures manual.
- * Relevant publications of the Institute of Chartered Accountants of India and other professional bodies, industry publications, trade journals, magazines, newspapers or text books.
- * Consideration of the state of the economy and its effect on the client's business.
- * Visits to the client's premises and plant facilities.

With respect to the previous year's audit working papers and other relevant files, the auditor should pay particular attention to matters that required special consideration and decide whether they might affect the work to be done in the current year.

4. Matters to be discussed with the client:

Discussions with the client might include such subjects as:

- * Changes in management, organizational structure, and activities of the client.
- * Current Government legislation, rules, regulations and directives affecting the client.
- * Current business developments affecting the client.
- * Current or impending financial difficulties or accounting problems.
- * Existence of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
- * New or closed premises and plant facilities.
- * Recent or impending changes in technology, type of products or services and production or distribution methods.
- * Significant matters arising from previous year's financial statements, audit report and management letters, if any.
- * Changes in the accounting practices and procedures and in the system of internal control.
- * Scope and timing of the examination.
- * Assistance of client personnel in data preparation.
- * Relevance of any work to be carried out by the client's internal auditors.

5 Development of an Overall Plan

The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit:

- * The terms of his engagement and any statutory responsibilities.
- * The nature and timing of reports or other communication.

- * The applicable legal or statutory requirements.
- * The accounting policies adopted by the client and changes in those policies.
- * The effect of new accounting or auditing pronouncements on the audit.
- * The identification of significant audit areas.
- * The setting of materiality levels for audit purposes.
- * Conditions requiring special attention, such as the possibility of material error or fraud or the involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
- * The degree of reliance he expects to be able to place on accounting system and internal control.
- * Possible rotation of emphasis on specific audit areas.
- * The nature and extent of audit evidence to be obtained.
- * The work of internal auditors and the extent of their involvement, if any, in the audit.
- * The involvement of other auditors in the audit of subsidiaries or branches of the client.
- * The involvement of experts.
- * The allocation of work to be undertaken between joint auditors and the procedures for its control and review.
- * Establishing and coordinating staffing requirements.

2.2. Audit Programme:

1 Meaning:

AAS 8 says that the auditor should prepare a written audit programme setting forth the procedures that are needed to implement the audit plan. The programme may also contain the audit objectives for each area and should have sufficient details to serve as a set of instructions to the assistants involved in the audit and as a means to control the proper execution of the work.

2 Points to be consider while preparing audit programme :

1. **Internal control:** In preparing the audit programme, the auditor, having an understanding of the accounting system and related internal controls, may wish to rely on certain internal controls in determining the nature, timing and extent of required auditing procedures. The auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit.

However, the auditor may decide not to rely on internal controls. When there are other more efficient ways of obtaining sufficient appropriate audit evidence. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts.

2. **Flexibility:** The auditor normally has flexibility in deciding when to perform audit procedures.

However, in some cases, the auditor may have no discretion as to timing, for example, when observing the taking of inventories by client personnel or verifying the securities and cash balances at the year-end

3. **Commencement of audit:** The audit planning ideally commences at the conclusion of the previous year's audit, and along with the related programme, it should be reconsidered for modification as the audit progresses. Such consideration is based on the auditor's review of the internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures.

3. Advantages of audit program

1. Supervision of work:

The auditor can judge the efficiency of his audit team with the held of all audit programs. He is in a position to know the progress of the work. He can

see at any time that what part of the work has been completed and what remains to be done.

2. Division / distribution of audit work:

The division of audit works is very useful for the audit staff for maintaining the difference of works among senior or junior clerks according to their ability and skill so that the work is divided to get better results.

3. Systematic uniformity of work:

Audit program helps in settling all the things in advance, so the systematic uniformity of work is necessary to achieve the desircice.

4. Basic instrument for training:

Audit program is infect a training instruments for the audit staff and also very useful for the new auditors. It provides training and guidance to him. So it is rightly called the basic instrument for training for the staff at the time of need.

5. Solid legal evidence:

Audit program and audit working papers are solid legal evidence of work done by every assistant of the audit team. It can be presented in the court of law if any action is taken against the auditor for negligence. These programmes and papers proves that the auditor has used his skills and due care in the audit of the firm so his liability can be reduced.

6. Fixation of responsibility:

Audit programmes fixed the responsibilities of the staff. If any error or fraud remains undetected, the responsibility of negligence will fall on that particular assistant who has performed that job and no one can blame on each other.

7. Several audits may be controlled:

The auditor controls the audit of various companies at the same time. In the absence of audit program he cannot supervise them effectively.

8. Easy transfer:

The principle auditor can transfer to the any other person easily. If one assistant is unable to continue the work given to him it can be given to another person. Audit program guides him that what is done and what is remaining.

9. Final review:

Before signing the report, final Review is made and for this purpose also auditing program is very useful and any deficiency or missing in steps can be identified and completed.

10. Useful for future:

The audit programme is very useful in the future. On completion of an audit, it serves the purpose of audit record that may be useful for future reference. In case of auditor is appointed for the same concern in any future time the auditor can use the same audit programme with some changes.

11. Proress of audit work:

Audit programme is helpful to note the progress of work. Audit programme is a timetable, which can show the work done on any particular date. The pace of work is going on with the passage of time. The adjustment can be made if there is more work and less time and vice versa. In this way work can be completed in time.

12. Supervision of audit staff:

Audit programme is beneficial for auditor. He can supervise the activities of audit staff. He can use the audit programme as basis of supervision. Every part of audit work can be complete as per schedule. He can control the activities of audit staff through observation and direction when the audit work can be complete in time:

13. Audit staff needed:

Audit programme is helpful to determine the number of persons needed to do the work. The staff requirement is essential for every auditor. The shortage of staff means slow progress. The exact number of senior and junior audit clerk can be determined. In this way an auditor is able to handle the audit work properly.

14. Same work:

The benefit of audit programme is that new instructions are not issued due to change in staff. The nature of work remains the same. The audit clerks can know their job just by reading the written programme: The time is saved due to written instructions.

15. Timetable:

The benefit of audit programme is that work is complete with in stated time period, the saving of time means saving of labour. The saving of time means saving can control the cost of audit due to fixed time. He can arrange audit work of other business concerns.

16. Reponsibility for poor work:

The benefit of audit programme is that auditor can fix responsibility for negligence. Audit programme is a timetable of whole audit work to be done by auditors. Every staff member is given some sort of duty to do the audit work. The staff is responsible for completing of work. The performance is noted and responsibility if fixed poor work.

17. Guide to audit assistants:

The merit of audit programme is that it serves as a guide to audit assistants. The junior audit staff can start and complete the audit work with the help of audit programme. There is no need to repeat the instructions every time. More ever it serves as a guide for future. The new audit programme can be developed on the basis of old work.

18. Dealing with new clients:

The merit of audit programme is that it helps to deal with client. The spare time of audit staff can be used for doing with new clients. The whole year time can be divided. The auditor can audit the accounts if various concerns under audit programme.

19. Proof for audit work done:

The merit of audit programme is that auditor can use it as proof for work done. In court of law the auditor can avoid liability for negligence. Audit programme is a permanent record of an audit process. The audit programme shows the work performed date-wise. In this way he cannot be held responsible for carelessness.

4 Disadvantage of Audit Programme:**1. Not comprehensive:**

Auditors may have covered the whole tie but I cannot be said with certainty that all the necessary work has been done.

2. Rigidity:

Audit program loses its flexibility. While each business has a separate problem. So audit program cannot be laid down for each type of business.

3. No initiative:

It kills the initiative of capable persons. The assistant cannot suggest any improvement in the plan.

4. Too mechanical:

Such audit program is too mechanical that it ignores many other aspects like internal control.

5. Large concerns / not suitable for small concerns:

Audit programme is helpful in large business concerns. It has been proved that audit program is not suitable for small business concerns.

6. New problems over looked:

In the audit programme there is no chances to accept the changes with the

passage of time new problems arise that may be overlooked.

7. Changes:

The drawback of audit programme is that changes in it are not acceptable. The nature of activities of concern may change. There is a need to adjust the changes in the programme. A master programme cannot be drafted.

8. Revision:

The demerit of audit programme is that there is no revision in it. The business changes from year to year. The working may expand or contract. The audit programme requires adjusting itself to the changing circumstances.

9. Types:

The demerit of audit programme is that it is not suitable for all types of business concerns. A small business may have few books of accounts. It is not necessary to prepare audit programming for small concerns.

10. Staff:

The accounting staff can know the working of audit. The auditor applies various methods for checking the accounting books. Having knowledge of auditing the accounting staff can devise means to record the transaction. In this way they can avoid their responsibility

5. Audit Procedure for obtaining audit Evidences:

There are some of the methods to obtain the audit evidences they are as follows

- **Inspection:** Inspection involves examining records or documents, whether internal or external, in paper form, electronic form or other media or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability. Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets in such case inspection by vouching can be done to get a clear idea. Same way inspection of individual inventory items may accompany the observation of inventory counting.
- **Observation:** Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of

inventory counting by the entity's employees. Observation provides evidence about the performance of a process or procedure, but is limited to point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.

- **Inquiry:** Inquiry consists of seeking information of organization either form within the entity or outside the entity. Inquiry is used throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries.
- **Analytical Procedures:** Analytical procedures consist of evaluations of financial information made by a study ratio or comparisons between the firms or comparisons between the two years.
- **External Confirmation:** An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party for example auditor will take confirmation form the debtors directly for the balance.

2.3 Audit Working Paper:

“The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles.” The purpose of Standard 3 is to amplify the basic principle outlined below:

Documentation, for purposes of this Standard, refers to the working papers prepared or obtained by the auditor and retained by him, in connection with the performance of his audit.

Working papers means: a) Aid in the planning and performance of the audit; b) Aid in the supervision and review of the audit work; and c) Provide evidence of the audit work performed to support the auditor's opinion.

1 Content required for audit working paper:

- Working papers should record the audit plan, the nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained.

- Working papers should be designed and properly organized to meet the circumstances of each audit and the auditor's needs in respect thereof.
- Working papers should be sufficiently complete and it should be in detailed for an auditor to obtain overall understanding of the audit.
- All significant matters which require the exercise of judgment, together with the auditor's conclusion thereon, should be included in the working papers.
- To improve audit efficiency, the auditor normally obtains and utilizes schedules, analyses and other working papers prepared by the client. In such circumstances, the auditor should satisfy himself that these working papers have been properly prepared.
- In the case of recurring audits, some working paper files may be classified as permanent audit files, which are updated currently with information of continuing importance to succeeding audits, as distinct from current audit files, which contain information relating primarily to the audit of a single period.

2.A permanent Audit file normally includes:

- Information concerning the legal and organizational structure of the entity. In the case of a company, this includes the Memorandum and Articles of Association. In the case of a statutory corporation, this includes the Act and Regulations under which the corporation functions.
- Extracts or copies of important legal documents, agreements and minutes relevant to the audit.
- A record of the study and evaluation of the internal controls related to the accounting system. This might be in the form of narrative descriptions, questionnaires or flow charts, or some combination thereof.
- Copies of audited financial statements for previous years.
 - Analysis of significant ratios and trends.
- Copies of management letters issued by the auditor, if any.
- Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor.
- Notes regarding significant accounting policies.
- Significant audit observations of earlier years.

3 The Current File Normally Includes

- Correspondence relating to acceptance of annual reappointment.
- Extracts of important matters in the minutes of Board Meetings and General Meetings, as are relevant to the audit.
- Evidence of the planning process of the audit and audit programme.
- Analysis of transactions and balances.

- A record of the nature, timing and extent of auditing procedures performed, and the results of such procedures.
- Evidence that the work performed by assistants was supervised and reviewed.
- Copies of communications with other auditors, experts and other third parties.
- Copies of letters or notes concerning audit matters communicated to or discussed with the client, including the terms of the engagement and material weaknesses in relevant internal controls.
- Letters of representation or confirmation received from the client.
- Conclusions reached by the auditor concerning significant aspects of the audit, including the manner in which exceptions and unusual matters, if any, disclosed by the auditor's procedures were resolved or treated.
- Copies of the financial information being reported on and the related audit reports.

4 Ownership and Custody of Working Papers

Working papers are the property of the auditor. The auditor may, at his discretion, make portions of or extracts from his working papers available to his client.

The auditor should adopt reasonable procedures for custody and confidentiality of his working papers and should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirements of record retention.

2.4 Audit Note Book:

Defintion:

Audit notebook is a diary on which auditor scribble down all important inquiries to avoid the possibility of unquestioned material facts.

Importance

Justice William throws light on the importance of audit notebook in the following words,

The audit notebook that contained detailed information proved to be very helpful to the auditor in every critical moment.

For preparing the audit report it is very useful for that auditor.

In case of negligence charge against the auditor, but note book good evidence can be presented. It may be also used for future guidance and reference. It also enables to auditor to know that what work his assistant at each audit has done.

Advantages of Audit Note Book

1. Audit Report

The audit notebook is helpful to prepare audit report. The auditor can record the weakness of accounting records. The queries not properly answered are started in the audit report when the auditor is satisfied he can submit a clear report.

2. Staff Honesty

The audit notebook is used to determine the integrity and honesty of audit clerks. The moral and ethical value can be examined through audit work. When a person completes his work in time. Time period auditor can appreciate him. If there is pending work after the expiry of time period, he can be held responsible for it. The audit staff must be honest in his work.

3. Helpful for Memory

The audit notebook is help to keep things fresh in memory. The auditor can read the book on daily basis. He can note the weakness on fingertips. The auditor can retain the data in his memory for a longer period of time. He can ask the management to clear the doubtful points before preparing audit report.

4. Reference

The audit notebook is useful for reference. In future it can provide information to the audit staff. The past data gives an insight into business matters. The auditor can note the changes. He can form an opinion about the changes in the nature and size of the business.

5. New Auditor

The audit notebook is useful for new auditor. They can see the weakness of previous years. The old weak points may not be repeated this year.

6. Court Cases:

the audit notebook is helpful to defend an auditor in court cases. The people can go to court of law in order to fix liability for negligence of duty. The audit notebook is a written proof of work performed by an auditor.

