How to Plan an Audit

Presented by:
Vaibhav Jain
Partner
Mehra Goel & Co

Audit Planning – discussion matters

- Need for an audit planning
- Facets of an effective audit plan
  - Knowledge of client business
    - Governance level understanding – Tone of the management
    - Industry level understanding – economics, regulatory
    - Operational understanding – operation, structure, controls, financial
    - Impact of computer systems on business and an audit
    - Consideration of manipulation – pervasive to the entire process
- Scope of Audit: written terms of an engagement

Audit Planning

Need of the hour

—Increasingly large organizations, transactions

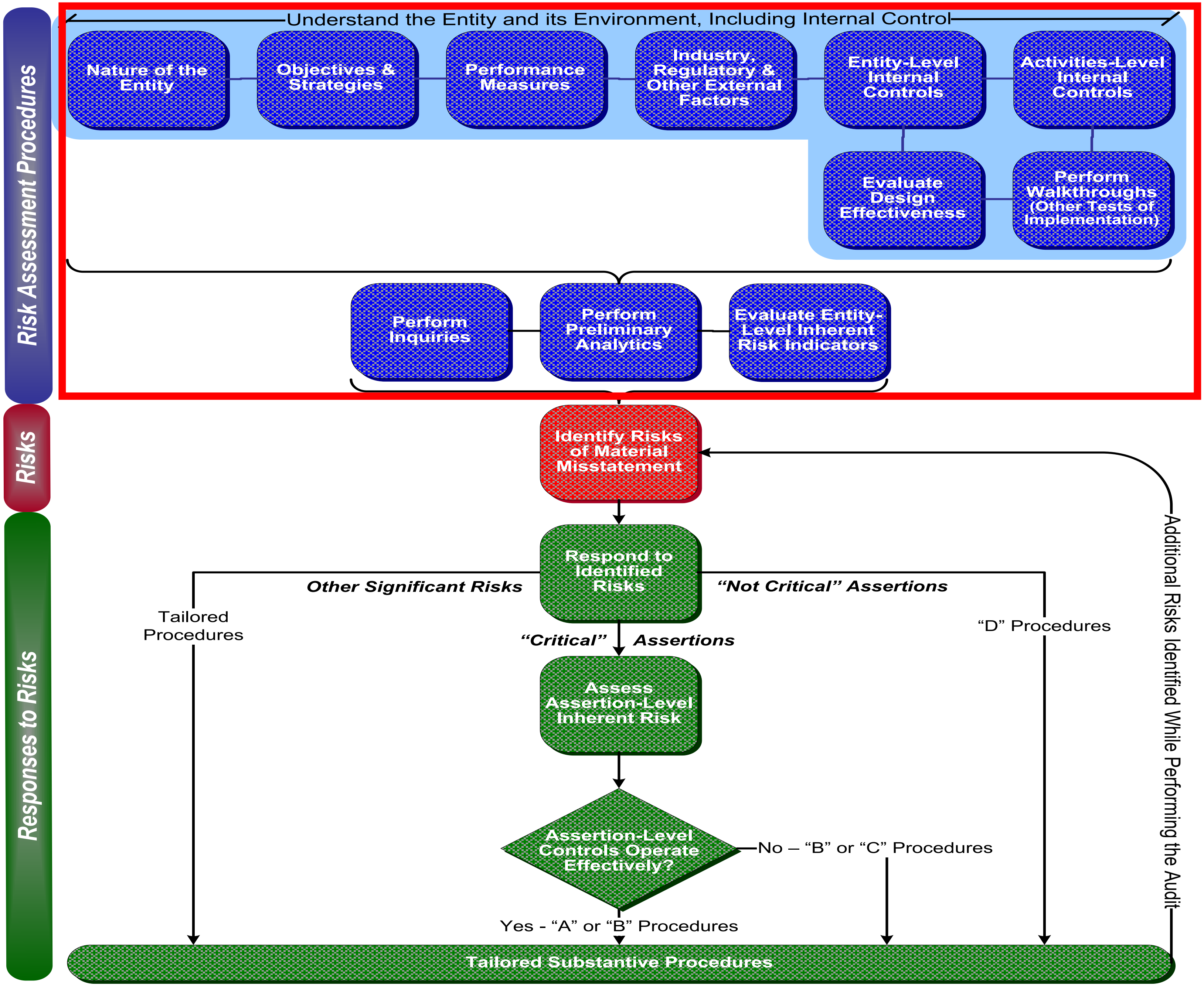
—Increasingly complex nature of transactions

—Reducing timelines for financial reporting

—Ensure efficiency and effectiveness of an audit

—Over all project management

Overview of Phases of Audit Planning



Facets of an Effective audit plan

Knowledge of client business – Why critical

—Understanding a precursor to a informed audit

—Helps to know areas that require special attention

—Helps determine key business risks

—Helps determine sources of audit evidences

—Ensures effective communication with the client

—Provides initial assessment about management

Knowledge about the client is KEY to obtaining appropriate and sufficient audit evidence

Facets of an Effective audit plan

Knowledge of client business –Sources of audit knowledge

- previous working experience with the entity and its industry.
- site visit including client's premises and plant facilities.
- the client's minutes of meetings and other legal and non-legal documents.
- the entity's directors and other personnel.
- the audit committee of the entity.

Facets of an Effective audit plan

Knowledge of client business –Sources of audit knowledge

- the lawyers, surveyors and other experts who provided services to the entity.
- the previous auditors and audit working papers.
- the previous financial reports, budgets, internal control reports and .
- the client's business partners including customers, suppliers and bankers.
- economists, news reporters, regulators, and so on.

Knowledge of client business

Governance level understanding - Tone

- Why do we need to do this?
  - Provides insights into intent of the management
  - Provides comfort on the management representations
  - Provides comfort on the quality of the audit evidences
  - Helps audit team define the scope of an engagement

- When should we do this?
  - Prior to acceptance/re-acceptance procedures
  - Pervasive through the audit – needs re-assessment

Knowledge of client business

Governance level understanding - Tone

- Procedures to governance level understanding
  - Understand the management: Who governs the Company/entity
  - Perform preliminary enquiry and background check procedures (press articles, news reports etc)
  - If a continuing client, review prior working papers, hold discussions with the previous team members
  - Review the overall management policies of the entity: risk, HR strategies, business initiatives
  - Review the composition of committees of directors, frequency of their meetings & matters discussed

Knowledge of client business

Industry level understanding

- What should one understand about Industry

  - Key operating characteristics: seasonal, capital etc
  - Key practice norms: terms of the trade etc
  - Key regulatory oversight: extent of laws, government intervention
  - Industry driven accounting practices
  - Key competitors of the Company

- How does it impact an audit
  - Pervasive to performing audit tests: analytical procedures, expectations, test of details etc.

Knowledge of client business

Industry level understanding - Regulatory

- Regulatory framework – key aspects
  - Understand the key regulatory compliances – industry (telecom, aviation, pharma etc), taxes, labor, others
  - Understand the framework designed by management to adhere to compliances
  - Assess and determine material laws and regulations that effect the existence of the entity
  - Assess and determine material laws and regulations that effect the financial statements of the entiy

Knowledge of client business

Operational understanding

- What should one understand about operations
  - Understand the organization structure: how is the entity designed, key roles and responsibilities
  - Understand the operational goals, objectives :Short term, Medium term & long term
  - Understand the operating units – plants, key sales units, geographical spread
  - Understand the revenue sources & key customers
  - Understand the supply sources & key vendors

Knowledge of client business

Operational understanding

- What should one understand about operations
  - Determine & understand the sources of financing – debt, equity, convertible bonds, preference shares etc
  - Understand investment composition: subsidiaries, joint ventures, equity affiliates, other business interests
  - Understand key client personnel: authority matrix
  - Understand the financial reporting structure

Knowledge of client business

Operational understanding

- What should one understand about operations
  - Determine & understand employee contracts, labor agreements, benefit plans
  - Understand related parties - KEY
    - Obtain declarations from directors 24AA etc
    - Review terms with key customers
    - Coordinate procedures on understanding investment and equity procedures to determine related parties
  - Review key processes and controls (covered in session III)

Knowledge of client business

Operational understanding

- How would operational understanding influence audit
  - Provide direction to the audit:
    - key areas of risk
    - materiality (qualitative)
    - timing and extent of procedures on various financial statement captions
  - Provide information pertinent for pervasive fraud procedures

Knowledge of client business

Impact of computer systems on business and audit

- Classify your client in terms of following:
  - Entire operations driven through systems – integrated with financial reporting [SAP BAAN etc]: Complex
  - Operations through system – not integrated with financial reporting [different applications]: Significant
  - Computer systems not key to financial reporting (limited use of computer systems) – standalone PC used for financial reporting: Limited

Knowledge of client business

Impact of computer systems on business and audit

- Understand the role of computer systems on financial reporting through the following:

  - In a Complex & Significant environment:
    - understand security administration policies
    - database management systems
    - extent of integration of applications
    - Overall IT strategy, expansion plans
    - Roles & responsibilities of IT administrators and users
    - User role (financial & non-financial)

Knowledge of client business

Consideration of manipulation

- Consideration of manipulation (fraud) pervasive to entire process
- Senior engagement team members should be involved in the understanding of business to determine key risks of fraud
- During the process of understanding the client perform the following:
  - Prepare minutes of update and discuss implications from fraud perspective [weak internal controls, goals of management aggressive, management incentive plan skewed etc]

Knowledge of client business

Consideration of manipulation

- During the process of understanding the client perform the following:
  - Meet at least once every week with audit partners to discuss the following:
    - Level of management involvement in financial reporting
    - How authority matrix are designed
    - Weak internal controls
    - Geographical spread of operations
    - Highly complex IT environment
    - Typical industry practices (eg Sanitaryware)

Scope of Audit

Written terms of an engagement

- Increasingly complex regulatory environment of auditors: shareholder bodies, client expectations, government departments

- General perception about an audit – it is a certificate

- What should be documented in an engagement letter
  - Scope of the engagement & fee
  - Management responsibilities
  - Indemnification for management misrepresentations
  - Limitation of liability (unless prohibited by law)
  - Unrestricted access to information
  - Management consent for review of working papers

Practice Tips

- Involve the senior audit team members
- Document all the minutes of discussions, meetings, notes etc
- Ensure all the minutes are signed by the client (physically)
- Do not create perceptions – what looks right may not be right
- Remember always, these are audit planning procedures – DO NOT CONCLUDE

Thank You