ICPAK Audit Quality Assurance Workshop-Mt. Kenya Branch
15th – 16th March 2018
Audit Planning & Risk Assessment (ISA 300)
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Session 1 (Day 1)

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Scope

1. Audit planning considerations (ISA 300)
2. Assessing risk of material misstatement (ISA 315)
3. Materiality in Planning and Performing an Audit (ISA 320)

1.0 Audit planning considerations

- Audit planning for audit of financial statements is guided by **ISA 300**, and specifically covers recurring audits. Initial engagements planning have additional considerations.

- Planning end result is the **audit strategy and audit plan** for the engagement to ensure it is performed in an effective and efficient manner

1.1 Why plan:

i. Focus on important areas.
ii. Timely identification and resolution of potential issues.
iii. Effective and efficient performance of the assignment.
iv. Identification of required skills and allocation of work.
v. Supervision and review of work.
vi. Coordination of work done by other component auditors and experts.

1.2. Key requirements

1. Involvement of key engagement team members (Team discussions)
2. Preliminary activities (Continuance procedures; ethical requirements; terms of the engagement)
3. Planning activities: (Audit strategy; audit plan; direction and supervision of audit team)
4. Documentation (Strategy; Audit plan;any changes and reasons for such)

1.3 Specific considerations on Audit Strategy

(i) Characteristics of the engagement

- Reporting framework;
- Regulatory/industry-specific reporting requirements; Existence of internal audit;
- Service organizations; information technology;
- Components and subsidiaries (other auditors)

(ii) Reporting objectives; timing of audit & communications

- Reporting timetable
- Meetings with management and TCWG
- Deliverables (nature and timing of reports)
- Nature and timing of communications (team; management; other auditors)

1.3 Specific considerations on Audit Strategy (Cont…)

(iii) Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements

- Materiality considerations
- Identifying materials classes of transactions, balances and disclosures
- Areas of higher risk of material misstatements
- Significant developments – change of system; business process; key personnel;acquisitions; mergers;divestments
- Changes in financial reporting framework/standards
- Changes in legal environment

1.3 Specific considerations on Audit Strategy (Cont…)

(iv) Nature, Timing and Extent of Resources

- Selection of team members
- Quality control reviews
- Engagement team budgeting – time set aside for areas with high risk of material misstatement

2. Assessing risk of material misstatement (ISA 315)

Objective:

To **identify and assess the risks of material misstatement** in the financial statements, through understanding the entity and its environment, including the entity's internal control.

The aim of the assessment is to provide a basis for **designing and implementing responses** to the assessed risks of material misstatement. (Audit plan)

2.1 Key requirements

(i) Risk Assessment Procedures and Related Activities

- Inquiries of management; internal audit; others within the organisation
- Engagement team discussions led by partner
- Previous experience of the audit team
- Information from client acceptance procedures

2.1 Key requirements (Cont..)

(ii) Understanding of the Entity and Its Environment, Including the Entity's Internal Control

(a) Entity & Its environment:

- Industry, regulatory; financial reporting framework
- Nature of the entity (operations; ownership; governance; investments; financing;
- Accounting policies
- Measurement and review of financial performance

2.1 Key requirements (Cont..)

(ii) Understanding of the Entity and Its Environment, Including the Entity's Internal Control (cont..)

(b) Entity internal control:

- Understand all controls relevant to the audit
- Establish whether the controls have been implemented (inquiry & testing)
- Understand components of internal control (Control environment; risk assessment process; information systems; control activities; monitoring of internal controls)

2.1 Key requirements (Cont..)

(iii) Identifying and Assessing the Risks of Material Misstatement:

Identify significant risks, e.g:

- Risk of fraud
- Risk related to a recent economic/accounting development
- Complexity of transactions
- Transactions with related parties
- Degree of subjectivity in measuring financial information
- Significant transactions outside the normal course of business.

Understand the controls relevant to the identified risks.

2.1 Key requirements (Cont..)

(iv) Documentation:

- Discussion among team members
- Elements of understanding obtained; sources of information; risk assessment procedures
- Identified and assessed risks of misstatements
- Risks and related controls

2.2 Group work – Audit planning (20 mins)

For sample FS provided:

i. Identify risks of material misstatements at the financial statement level.
ii. Identify risks of material misstatements at the assertion level.
iii. Link the risks to expected controls.

2.2 Group work – Audit planning (20 mins)

Assertions – Transactions:

Occurrence
Completeness
Accuracy
Cut off
Classification

Assertions – Balances

Existence
Rights & Obligations
Completeness
Valuation

Assertions- Disclosures

Occurrence
Completeness
Classification/understandability
Accuracy

3. Materiality in Planning and Performing an Audit (ISA 320)

Materiality is a key considerations in planning and performance of an audit.

In planning, materiality levels guide the risk identification and assessment procedures and nature and extent of further audit procedures.

Materiality: – Is set for the financial statement as a whole (bases used depend on nature of operations)

Performance Materiality (PM): – Amount set below materiality level to reduce the probability of uncorrected/undetected misstatements exceeding materiality of the financial statements as a whole.

3. 1 Use of benchmarks to determine materiality:

A percentage is usually applied to a chosen benchmark **(Professional Judgement)**.
The choice of a benchmark is guided by below criteria:

- Elements of financial statements (Assets liabilities, equity,revenue, expenses)
- Items for which users of financial statements
- give more focus (revenue; profit; net assets)
- Structure of the entity and financing
- Volatility of the benchmark

Examples of benchmarks include:

- Profit before tax,
- Revenue,
- gross profit
- Total expenses
- Total equity or net asset value.
- Profit before tax for profit-oriented entities.
- Gross profit or total revenues

3.2 Documentation required

Documentation:

(i) Materiality for the financial statements as a whole
(ii) Performance materiality
(iii) Any revisions done.

3.3 Group work – Materiality (10 mins)

As per sample FS provided:

1. Identify the appropriate materiality benchmark, list reasons for choice of benchmark
2. Identify and justify an appropriate percentage
3. Compute performance materiality

Interactive Session