Audit strategy, audit plan and assertions

MODULE 2 | 2.3.1 | STUDENT COMPANION

Planning is **continuous**: it starts before fieldwork and is revised whenever new information arrives. The **overall audit strategy** decides the audit's scope, timing and direction; the **audit plan** maps each procedure in detail: what, when and how much. The approach to evidence ranges from relying on tested controls to a **predominantly substantive** approach. The **assertions** describe exactly what could be wrong, and the **direction** of a test decides which assertion it addresses.

Why planning matters

The planning standard requires the auditor to plan so that the audit is performed effectively. Good planning helps the team focus on the important areas, spot and resolve problems early, organise the work and the people, and direct and supervise the team properly. How much planning is needed depends on the entity's size and complexity, the team's past experience with it, and changes in its circumstances, and the plan keeps changing as new information emerges.

The audit strategy and the detailed plan

Overall audit strategy
Decides the audit's scope, timing and direction

- **Characteristics of the engagement:** the reporting framework, the locations to visit
- **Reporting objectives and deadlines**
- **Significant factors that direct the effort:** materiality, the areas of highest risk
- **Resources:** who's on the team, and whether experts are needed

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Audit plan
What, when and how much (nature, timing and extent) for:

- Planned **risk assessment procedures**
- **Further audit procedures** for each relevant assertion
- Any **other procedures** the standards require

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Audit program
A checklist of procedures for each area, signed off as each is done

The strategy decides where the audit is going and with whom; **the plan** maps every step of the route. Both are documented, with any significant changes

Two approaches to evidence

Most audits mix the two, area by area. At Voltana, the new system went live in February, so relying on controls would mean testing them in both the old and the new system; a mostly substantive approach to revenue may be more efficient this year.

	Combined (lower control risk) approach	Predominantly substantive approach
Understanding of controls	Thorough	Only what the standards require
Tests of controls	Yes, for the controls the auditor intends to rely on	None
Assessed control risk	Below high, if the tests support it	High
Substantive testing	Reduced, because tested controls supply part of the evidence	Most of the evidence comes from testing transactions and balances directly

Early decisions at Voltana (imagined)

Decision	Why it can't wait
Interim visit in May	Update the understanding of the business, and test the controls the team plans to rely on
Staff booked to attend the 30 June stocktakes at the factory and the main warehouse	Nobody can count last June's batteries in September
An engineer arranged to help with the warranty provision	Experts need to be engaged before the work starts
Final visit planned for August	So the report can be signed before the deadline for Voltana's annual report
Team planning discussion; the partner assigns the most experienced people to the riskiest areas	Direction and supervision follow the risks

The financial statement assertions

Classes of transactions and events For example, sales	
Occurrence	Recorded transactions really happened and relate to the entity
Completeness	Nothing that should have been recorded was left out
Accuracy	Amounts and details were recorded correctly
Cut-off	Recorded in the right period
Classification	Recorded in the right accounts
Presentation	Suitably grouped or separated, clearly described and understandably disclosed

Account balances at the period end For example, receivables	
Existence	The recorded assets, liabilities and equity really exist
Completeness	Nothing that should have been recorded was left out
Accuracy, valuation and allocation	Carried at appropriate amounts, with any adjustments recorded
Rights and obligations	The entity controls the assets and owes the liabilities
Classification	Recorded in the right accounts
Presentation	Suitably grouped or separated, clearly described and understandably disclosed

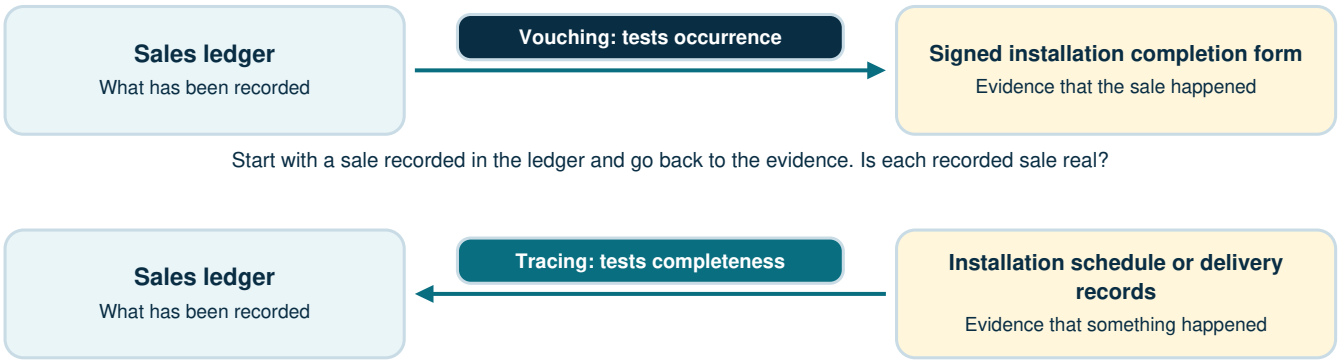
Occurrence is the transactions' version of existence; completeness, classification and presentation appear in both groups

Assertions are the claims, explicit or implied, that management makes when it presents financial statements. The auditor uses them to think about the different ways the statements could be misstated, and then designs procedures aimed at the assertions most at risk.

The assertions at work at Voltana

Situation	Assertions at risk
Sales staff earn commission when a contract is signed, but revenue should be recognised when the battery is installed	Occurrence (sales recorded before any installation) and cut-off around 30 June
The ten-year warranty provision	Valuation and allocation
Battery cells shipped from overseas but still at sea on 30 June	Cut-off, and rights and obligations, depending on when ownership passes under the shipping terms
Stock sitting in the warehouse	Existence, and valuation if newer designs make older stock harder to sell
The factory lease from the chief executive's company	Presentation: the related party relationship must be disclosed

Why the direction of testing matters



Vouching only ever looks at what's recorded, so it can never find a sale that was left out. To test completeness, reverse the direction.

Vouching starts with an item in the records and looks back for the evidence behind it, so it tests whether recorded items are real (occurrence or existence). **Tracing** starts with evidence that something happened and follows it forward into the records, so it tests completeness. Tracing a delivery record into the sales ledger is therefore a test of completeness: the direction is the whole point.

Practice questions

MODULE 2 | 2.3.1 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Strategy or plan?

Southfin Seafoods Ltd (imagined) processes and exports seafood. Sort each of its auditor's eight planning decisions into the overall audit strategy or the audit plan, and say why.

Planning decision	Strategy or plan?	Why
(a) The audit will cover the parent company and its two subsidiaries, with visits to the processing plants at Port Lincoln and Hobart.		
(b) Overall materiality will be based on profit before tax.		
(c) Select 40 sales invoices from the last two weeks of June and agree each to a signed delivery docket dated on or before 30 June.		
(d) The board wants the signed auditor's report by 28 August, and the audit committee meets on 20 August.		
(e) An independent valuer will help the team assess the value of the company's fishing quota.		
(f) Send confirmation requests to the ten largest export customers at 30 June.		
(g) During planning, compare each month's gross margin by product with last year's, looking for unusual movements.		
(h) The manager with the most seafood industry experience will lead the inventory work, the riskiest area.		

Question 2 - Which assertion?

Hushpanel Industries Pty Ltd (imagined) makes acoustic wall and ceiling panels. For each possible misstatement, name the assertion or assertions it affects, and explain why.

Possible misstatement	Assertion(s) affected	Why
(a) Freight on June deliveries, invoiced by the carrier in July, was never accrued.		
(b) A forklift hired for a month from an equipment hire company, and returned in July, is recorded in plant and equipment as if the company owned it.		
(c) A $180,000 government grant towards a new production line was recorded as sales revenue.		
(d) The note on the bank loan doesn't mention the bank's charge over the factory or the loan's conditions.		
(e) Depreciation on a new cutting machine expected to last eight years is being charged over forty years.		
(f) An order the customer cancelled before production is still recorded as a sale and a receivable.		

Question 3 - Two tests, two directions

Design one test of occurrence and one test of completeness for Hushpanel's sales. For each test, say where you start, where you finish, and why that direction tests that assertion.

Worked answers

MODULE 2 | 2.3.1 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Southfin Seafoods

	Answer	Why
(a)	Strategy	Scope: the entities and locations the audit covers
(b)	Strategy	Materiality is a significant factor that directs the team's effort
(c)	Plan	A further audit procedure, with its nature (inspection), timing (year end) and extent (40 items)
(d)	Strategy	Reporting objectives and deadlines set the timing of the audit
(e)	Strategy	Resources, including whether experts are needed
(f)	Plan	A further audit procedure (confirmation) aimed at the existence of receivables
(g)	Plan	A planned risk assessment procedure (an analytical procedure)
(h)	Strategy	Direction and resources: matching experience to the riskiest area

Question 2 - Hushpanel Industries

	Assertion(s)	Why
(a)	Completeness; cut-off	A June expense and the amount owed are missing from this year's accounts, and the cost lands in the wrong period
(b)	Rights and obligations	The company doesn't own or control the hired forklift, so it isn't the company's asset
(c)	Classification (and presentation)	A grant isn't a sale; it belongs in other income or as deferred income, not in revenue
(d)	Presentation	The charge and the loan conditions are disclosures users need to understand the debt
(e)	Accuracy, valuation and allocation	Plant is carried at too high an amount, and depreciation expense is understated
(f)	Occurrence (sales); existence (receivables)	The sale never happened, so the receivable doesn't exist

Question 3 - Two tests (sample answer)

- **Occurrence (vouching):** start in the sales ledger, select a sample of recorded sales (including some large ones near 30 June), and finish at the evidence: the customer's order, the signed delivery docket and the later payment. Starting from the records proves that recorded sales really happened.
- **Completeness (tracing):** start with the dispatch log of pre-numbered delivery dockets, check the sequence for gaps, select a sample, and finish in the sales ledger, checking that each delivery was invoiced and recorded in the right period. Starting from what happened can reveal sales that were never recorded.
- **Why direction matters:** vouching can't find an omission, because it only looks at what's recorded; tracing can't find a fictitious sale, because a fake invoice has no delivery behind it to start from.