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Hong Kong Standard on Auditing 300

Planning an Audit of Financial Statements



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

HONG KONG STANDARD ON AUDITING 300
PLANNING AN AUDIT OF FINANCIAL STATEMENTS

(Effective for audits of financial statements
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Hong Kong Standard on Auditing (HKSA) 300, "Planning an Audit of Financial Statements" should be read in the context of the "Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services" which sets out the application and authority of HKSA's.

Introduction

1. The purpose of this Hong Kong Standard on Auditing (HKSA) is to establish standards and provide guidance on the considerations and activities applicable to planning an audit of financial statements. This HKSA is framed in the context of recurring audits. In addition, matters the auditor considers in initial audit engagements are included in paragraphs 28 and 29.
2. **The auditor should plan the audit so that the engagement will be performed in an effective manner.**
3. Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan, in order to reduce audit risk to an acceptably low level. Planning involves the engagement partner and other key members of the engagement team to benefit from their experience and insight and to enhance the effectiveness and efficiency of the planning process.
4. Adequate planning helps to ensure that appropriate attention is devoted to important areas of the audit, that potential problems are identified and resolved on a timely basis and that the audit engagement is properly organized and managed in order to be performed in an effective and efficient manner. Adequate planning also assists in the proper assignment of work to engagement team members, facilitates the direction and supervision of engagement team members and the review of their work, and assists, where applicable, in coordination of work done by auditors of components and experts. The nature and extent of planning activities will vary according to the size and complexity of the entity, the auditor's previous experience with the entity, and changes in circumstances that occur during the audit engagement.
5. Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. However, in planning an audit, the auditor considers the timing of certain planning activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, the auditor plans the discussion among engagement team members¹, the analytical procedures to be applied as risk assessment procedures, the obtaining of a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework, the determination of materiality, the involvement of experts and the performance of other risk assessment procedures prior to identifying and assessing the risks of material misstatement and performing further audit procedures at the assertion level for classes of transactions, account balances, and disclosures that are responsive to those risks.

Preliminary Engagement Activities

6. **The auditor should perform the following activities at the beginning of the current audit engagement:**
 - **Perform procedures regarding the continuance of the client relationship and the specific audit engagement** (see HKSA 220, "Quality Control for Audits of Historical Financial Information"² for additional guidance).
 - **Evaluate compliance with ethical requirements, including independence** (see HKSA 220 for additional guidance).
 - **Establish an understanding of the terms of the engagement** (see HKSA 210, "Terms of Audit Engagements" for additional guidance).

¹ HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement" paragraphs 14-19 provide guidance on the engagement team's discussion of the susceptibility of the entity to material misstatements of the financial statements. HKSA 240, "The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements" paragraphs 27-32 provide guidance on the emphasis given during this discussion to the susceptibility of the entity's financial statements to material misstatement due to fraud.

² HKSA 220 is effective for audits of historical financial information for periods beginning on or after 15 June 2005.

The auditor's consideration of client continuance and ethical requirements, including independence, occurs throughout the performance of the audit engagement as conditions and changes in circumstances occur. However, the auditor's initial procedures on both client continuance and evaluation of ethical requirements (including independence) are performed prior to performing other significant activities for the current audit engagement. For continuing audit engagements, such initial procedures often occur shortly after (or in connection with) the completion of the previous audit.

7. The purpose of performing these preliminary engagement activities is to help ensure that the auditor has considered any events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement to reduce audit risk to an acceptably low level. Performing these preliminary engagement activities helps to ensure that the auditor plans an audit engagement for which:
 - The auditor maintains the necessary independence and ability to perform the engagement.
 - There are no issues with management integrity that may affect the auditor's willingness to continue the engagement.
 - There is no misunderstanding with the client as to the terms of the engagement.

Planning Activities

The Overall Audit Strategy

8. **The auditor should establish the overall audit strategy for the audit.**
9. The overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan. The establishment of the audit strategy involves:
 - (a) Determining the characteristics of the engagement that define its scope, such as the financial reporting framework used, industry-specific reporting requirements and the locations of the components of the entity;
 - (b) Ascertaining the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required, such as deadlines for interim and final reporting, and key dates for expected communications with management and those charged with governance; and
 - (c) Considering the important factors that will determine the focus of the engagement team's efforts, such as determination of appropriate materiality levels, preliminary identification of areas where there may be higher risks of material misstatement, preliminary identification of material components and account balances, evaluation of whether the auditor may plan to obtain evidence regarding the effectiveness of internal control, and identification of recent significant entity-specific, industry, financial reporting or other relevant developments.

In developing the audit strategy, the auditor also considers the results of preliminary engagement activities (see paragraphs 6 and 7) and, where practicable, experience gained on other engagements performed for the entity. The Appendix to this HKSA lists examples of matters the auditor may consider in establishing the overall audit strategy for an engagement.

10. The process of developing the audit strategy helps the auditor to ascertain the nature, timing and extent of resources necessary to perform the engagement. The audit strategy sets out clearly, in response to the matters identified in paragraph 9, and subject to the completion of the auditor's risk assessment procedures:
 - (a) The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters;
 - (b) The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of

review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas;

- (c) When these resources are deployed, such as whether at an interim audit stage or at key cut-off dates; and
 - (d) How such resources are managed, directed and supervised, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews.
11. Once the audit strategy has been established, the auditor is able to start the development of a more detailed audit plan to address the various matters identified in the audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources. Although the auditor ordinarily establishes the audit strategy before developing the detailed audit plan, the two planning activities are not necessarily discrete or sequential processes but are closely inter-related since changes in one may result in consequential changes to the other. Paragraphs 14 and 15 provide further guidance on developing the audit plan.
 12. In audits of small entities, the entire audit may be conducted by a very small audit team. Many audits of small entities involve the audit engagement partner (who may be a sole practitioner) working with one engagement team member (or without any engagement team members). With a smaller team, co-ordination and communication between team members are easier. Establishing the overall audit strategy for the audit of a small entity need not be a complex or time-consuming exercise; it varies according to the size of the entity and the complexity of the audit. For example, a brief memorandum prepared at the completion of the previous audit, based on a review of the working papers and highlighting issues identified in the audit just completed, updated and changed in the current period based on discussions with the owner-manager, can serve as the basis for planning the current audit engagement.

The Audit Plan

13. **The auditor should develop an audit plan for the audit in order to reduce audit risk to an acceptably low level.**
14. The audit plan is more detailed than the audit strategy and includes the nature, timing and extent of audit procedures to be performed by engagement team members in order to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. Documentation of the audit plan also serves as a record of the proper planning and performance of the audit procedures that can be reviewed and approved prior to the performance of further audit procedures.
15. The audit plan includes:
 - A description of the nature, timing and extent of planned risk assessment procedures sufficient to assess the risks of material misstatement, as determined under HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement";
 - A description of the nature, timing and extent of planned further audit procedures at the assertion level for each material class of transactions, account balance, and disclosure, as determined under HKSA 330, "The Auditor's Procedures in Response to Assessed Risks". The plan for further audit procedures reflects the auditor's decision whether to test the operating effectiveness of controls, and the nature, timing and extent of planned substantive procedures; and
 - Such other audit procedures required to be carried out for the engagement in order to comply with HKSAs (for example, seeking direct communication with the entity's lawyers).

Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment

procedures ordinarily occurs early in the audit process. However, planning of the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before completing the more detailed audit plan of all remaining further audit procedures.

Changes to Planning Decisions During the Course of the Audit

16. **The overall audit strategy and the audit plan should be updated and changed as necessary during the course of the audit.**
17. Planning an audit is a continual and iterative process throughout the audit engagement. As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan, and thereby the resulting planned nature, timing and extent of further audit procedures. Information may come to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures. For example, the auditor may obtain audit evidence through the performance of substantive procedures that contradicts the audit evidence obtained with respect to the testing of the operating effectiveness of controls. In such circumstances, the auditor re-evaluates the planned audit procedures, based on the revised consideration of assessed risks at the assertion level for all or some of the classes of transactions, account balances or disclosures.

Direction, Supervision and Review

18. **The auditor should plan the nature, timing and extent of direction and supervision of engagement team members and review of their work.**
19. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including the size and complexity of the entity, the area of audit, the risks of material misstatement, and the capabilities and competence of personnel performing the audit work. HKSA 220 contains detailed guidance on the direction, supervision and review of audit work.
20. The auditor plans the nature, timing and extent of direction and supervision of engagement team members based on the assessed risk of material misstatement. As the assessed risk of material misstatement increases, for the area of audit risk, the auditor ordinarily increases the extent and timeliness of direction and supervision of engagement team members and performs a more detailed review of their work. Similarly, the auditor plans the nature, timing and extent of review of the engagement team's work based on the capabilities and competence of the individual team members performing the audit work.
21. In audits of small entities, an audit may be carried out entirely by the audit engagement partner (who may be a sole practitioner). In such situations, questions of direction and supervision of engagement team members and review of their work do not arise as the audit engagement partner, having personally conducted all aspects of the work, is aware of all material issues. The audit engagement partner (or sole practitioner) nevertheless needs to be satisfied that the audit has been conducted in accordance with HKSA's. Forming an objective view on the appropriateness of the judgments made in the course of the audit can present practical problems when the same individual also performed the entire audit. When particularly complex or unusual issues are involved, and the audit is performed by a sole practitioner, it may be desirable to plan to consult with other suitably-experienced auditors or the auditor's professional body³.

³ The Institute's policy in relation to dealing with members' technical enquiries is set out in "HKICPA Staff Policy on Handling Members' Technical Queries" < <http://www.hkicpa.org.hk/professionaltechnical/policy/techqs.pdf> >.

Documentation

22. **The auditor should document the overall audit strategy and the audit plan, including any significant changes made during the audit engagement.**
23. The auditor's documentation of the overall audit strategy records the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team. For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit.
24. The auditor's documentation of the audit plan is sufficient to demonstrate the planned nature, timing and extent of risk assessment procedures, and further audit procedures at the assertion level for each material class of transaction, account balance, and disclosure in response to the assessed risks. The auditor may use standard audit programs or audit completion checklists. However, when such standard programs or checklists are used, the auditor appropriately tailors them to reflect the particular engagement circumstances.
25. The auditor's documentation of any significant changes to the originally planned overall audit strategy and to the detailed audit plan includes the reasons for the significant changes and the auditor's response to the events, conditions, or results of audit procedures that resulted in such changes. For example, the auditor may significantly change the planned overall audit strategy and the audit plan as a result of a material business combination or the identification of a material misstatement of the financial statements. A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains the overall strategy and audit plan finally adopted for the audit and demonstrates the appropriate response to significant changes occurring during the audit.
26. The form and extent of documentation depend on such matters as the size and complexity of the entity, materiality, the extent of other documentation, and the circumstances of the specific audit engagement.

Communications With Those Charged With Governance and Management

27. The auditor may discuss elements of planning with those charged with governance and the entity's management. These discussions may be a part of overall communications required to be made to those charged with governance of the entity or may be made to improve the effectiveness and efficiency of the audit. Discussions with those charged with governance ordinarily include the overall audit strategy and timing of the audit, including any limitations thereon, or any additional requirements. Discussions with management often occur to facilitate the conduct and management of the audit engagement (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor's responsibility. When discussions of matters included in the overall audit strategy or audit plan occur, care is required in order to not compromise the effectiveness of the audit. For example, the auditor considers whether discussing the nature and timing of detailed audit procedures with management compromises the effectiveness of the audit by making the audit procedures too predictable.

Additional Considerations In Initial Audit Engagements

28. **The auditor should perform the following activities prior to starting an initial audit:**
 - (a) **Perform procedures regarding the acceptance of the client relationship and the specific audit engagement (see HKSA 220 for additional guidance).**
 - (b) **Communicate with the previous auditor, where there has been a change of auditors, in compliance with relevant ethical requirements.**
29. The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with

the entity that is considered when planning recurring engagements. For initial audits, additional matters the auditor may consider in developing the overall audit strategy and audit plan include the following:

- Unless prohibited by law or regulation, arrangements to be made with the previous auditor, for example, to review the previous auditor's working papers.
- Any major issues (including the application of accounting principles or of auditing and reporting standards) discussed with management in connection with the initial selection as auditors, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.
- The planned audit procedures to obtain sufficient appropriate audit evidence regarding opening balances (see paragraph 2 of HKSA 510, "Initial Engagements—Opening Balances").
- The assignment of firm personnel with appropriate levels of capabilities and competence to respond to anticipated significant risks.
- Other procedures required by the firm's system of quality control for initial audit engagements (for example, the firm's system of quality control may require the involvement of another partner or senior individual to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance).

Effective Date

30. This HKSA is effective for audits of financial statements for periods beginning on or after 15 December 2004.

Conformity and Compliance with International Standards on Auditing

31. As of November 2004 (*date of issue*), this HKSA conforms with International Standard on Auditing (ISA) 300 (Revised), "Planning an Audit of Financial Statements". Compliance with the requirements of this HKSA ensures compliance with ISA 300 (Revised).
32. Additional local explanation is provided in footnote 3.

Public Sector Perspective

1. *This HKSA is applicable in all material respects to audits of public sector entities.*
2. *Some of the terms used in this HKSA such as "engagement partner" and "firm" should be read as referring to their public sector equivalents.*
3. *Paragraph 6 of this HKSA refers to HKSA 210, "Terms of Audit Engagements" and HKSA 220, "Quality Control for Audits of Historical Financial Information". The Public Sector Perspectives to those HKSAs contain a discussion of their applicability to audits of public sector entities, and are therefore relevant to the application of this HKSA in the public sector.*

Examples of Matters the Auditor May Consider in Establishing the Overall Audit Strategy

This appendix provides examples of matters the auditor may consider in establishing the overall audit strategy. Many of these matters will also influence the auditor's detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. While some of the matters referred to below may be required to be performed by other HKSAAs, not all matters are relevant to every audit engagement and the list is not necessarily complete. In addition, the auditor may consider these matters in an order different from that shown below.

Scope of the Audit Engagement

The auditor may consider the following matters when establishing the scope of the audit engagement:

- The financial reporting framework on which the financial information to be audited has been prepared, including any need for reconciliations to another financial reporting framework.
- Industry-specific reporting requirements such as reports mandated by industry regulators.
- The expected audit coverage, including the number and locations of components to be included.
- The nature of the control relationships between a parent and its components that determine how the group is to be consolidated.
- The extent to which components are audited by other auditors.
- The nature of the business segments to be audited, including the need for specialized knowledge.
- The reporting currency to be used, including any need for currency translation for the financial information audited.
- The need for a statutory audit of standalone financial statements in addition to an audit for consolidation purposes.
- The availability of the work of internal auditors and the extent of the auditor's potential reliance on such work.
- The entity's use of service organizations and how the auditor may obtain evidence concerning the design or operation of controls performed by them.
- The expected use of audit evidence obtained in prior audits, for example, audit evidence related to risk assessment procedures and tests of controls.
- The effect of information technology on the audit procedures, including the availability of data and the expected use of computer-assisted audit techniques.
- The coordination of the expected coverage and timing of the audit work with any reviews of interim financial information and the effect on the audit of the information obtained during such reviews.
- The discussion of matters that may affect the audit with firm personnel responsible for performing other services to the entity.
- The availability of client personnel and data.

Reporting Objectives, Timing of the Audit and Communications Required

The auditor may consider the following matters when ascertaining the reporting objectives of the engagement, the timing of the audit and the nature of communications required:

- The entity's timetable for reporting, such as at interim and final stages.
- The organization of meetings with management and those charged with governance to discuss the nature, extent and timing of the audit work.
- The discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, both written and oral, including the auditor's report, management letters and communications to those charged with governance.

- The discussion with management regarding the expected communications on the status of audit work throughout the engagement and the expected deliverables resulting from the audit procedures.
- Communication with auditors of components regarding the expected types and timing of reports to be issued and other communications in connection with the audit of components.
- The expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed.
- Whether there are any other expected communications with third parties, including any statutory or contractual reporting responsibilities arising from the audit.

Direction of the Audit

The auditor may consider the following matters when setting the direction of the audit:

- With respect to materiality:
 - Setting materiality for planning purposes.
 - Setting and communicating materiality for auditors of components.
 - Reconsidering materiality as audit procedures are performed during the course of the audit.
 - Identifying the material components and account balances.
- Audit areas where there is a higher risk of material misstatement.
- The impact of the assessed risk of material misstatement at the overall financial statement level on direction, supervision and review.
- The selection of the engagement team (including, where necessary, the engagement quality control reviewer) and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas where there may be higher risks of material misstatement.
- Engagement budgeting, including considering the appropriate amount of time to set aside for areas where there may be higher risks of material misstatement.
- The manner in which the auditor emphasizes to engagement team members the need to maintain a questioning mind and to exercise professional skepticism in gathering and evaluating audit evidence.
- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified weaknesses and action taken to address them.
- Evidence of management's commitment to the design and operation of sound internal control, including evidence of appropriate documentation of such internal control.
- Volume of transactions, which may determine whether it is more efficient for the auditor to rely on internal control.
- Importance attached to internal control throughout the entity to the successful operation of the business.
- Significant business developments affecting the entity, including changes in information technology and business processes, changes in key management, and acquisitions, mergers and divestments.
- Significant industry developments such as changes in industry regulations and new reporting requirements.
- Significant changes in the financial reporting framework, such as changes in accounting standards.
- Other significant relevant developments, such as changes in the legal environment affecting the entity.