Inspection 31 July 2023

Audit Focus

Effective Planning: The Key to High-Quality Audits

Introduction

Effective audit planning is fundamental to ensuring a high-quality audit. It is of paramount importance as it enables auditors to focus their efforts on identifying and addressing areas where potential risks or issues are most likely to arise. However, our 2020-22 inspection results reveal that many auditors underestimated the significance of effective audit planning which should have begun shortly after (or in connection with) the completion of the previous audit. Engagements for which auditors failed to allocate sufficient time and resources to planning were more prone to significant audit deficiencies and poor audit quality, and this was particularly evident among those audits that started late in the financial year or even after year-end.

Our concerns

Ineffective audit planning could potentially result in:

(i) **Failure to identify relevant risks:** Auditors may overlook key areas that require attention, such as areas of higher risk or potential fraud. This can lead to incomplete identification of relevant risks and inadequate design of audit procedures to address them, ultimately resulting in an unsupported or even inaccurate audit opinion.

(ii) **Failure to fully address audit issues:** Auditors may not have the necessary resources or sufficient time to address potential audit issues that could arise during an audit. In such cases, auditors may compromise the quality of the audit in order to meet the listed entity's deadline for announcing their audited results.

To address our concerns, we urge auditors to take a proactive approach and commence their audit planning process well in advance of the financial year-end. Auditors should pay particular attention and effort to those medium and high-risk issuers (such as entities in financial distress, those that have undergone significant acquisitions or disposals, and those with complex or judgemental accounting estimates) and commence audit planning in the third quarter of the financial year.

Key areas that require special consideration in audit planning

Auditors should heighten their professional skepticism in the following areas when developing an audit plan and work collaboratively with management to resolve any issues in a timely manner.

Volatile economic environments and market conditions, e.g., continuously rising interest rates and inflation

- Stay alert for any changes in the environments or conditions that could potentially impact the entity.
- Discuss with management to understand the potential impact on financial statements.
- Exercise professional skepticism when evaluating the potential impact of these conditions on the entity's financial performance and liquidity, particularly in areas involving significant accounting estimates and judgements such as impairment assessment, estimation of expected credit losses, and going concern assessment.

Significant changes in business operations, e.g., acquisitions or disposals of business or assets

- Understand the nature and reasons behind the changes, as well as their impact on the entity's financial reporting and internal controls.
- Evaluate the impact of the changes on the entity's financial statements and disclosures.

Significant non-routine transactions or unusual trends

- Investigate the nature and business rationale for the non-routine transactions or trends. Understand why the entity entered into these non-routine transactions or what caused the unusual trends.
- Heighten professional skepticism and assess the indicators of management bias or fraud.

Group audits

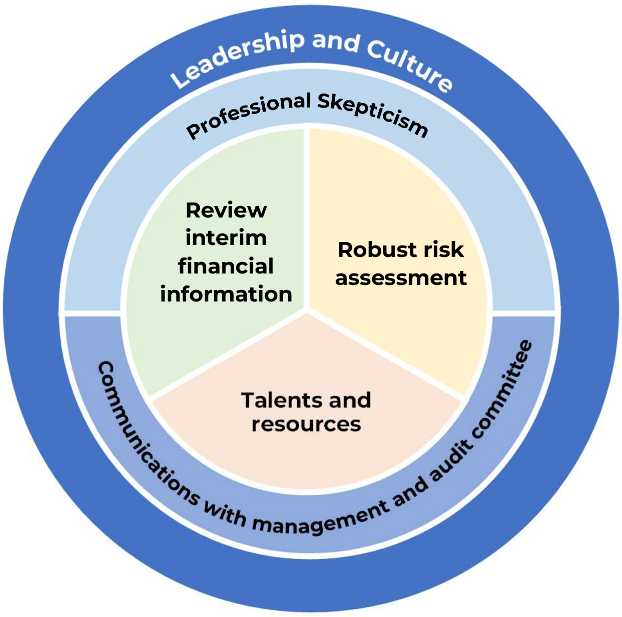
- Evaluate component auditors' competence and capabilities, including time and resources, for performing the audit procedures.
- Ensure component auditors comply with the applicable ethical requirements.
- Maintain ongoing and effective two-way communication with component auditors.
- Be responsible for directing and supervising component auditors.

Updates to audit plans

- Auditors should remain alert for any new information that may affect the audit, such as changes in the entity's operations or risks, and update their risk assessment and planned audit procedures as needed.

Our expectations of auditors

Planning is not a discrete phase of an audit, but rather a continual and iterative process that serves as the cornerstone of achieving high-quality audits. Audit firms should recognise the significance of this process and ensure that they have proper firm-wide policies in place to support their performance.



<table>
<tr><td colspan="3">Audit firms’ leadership, including Chairpersons and Managing Partners, should set the tone from the top and foster a culture that promotes timely and comprehensive audit planning and require their staff to commence audit planning shortly after (or in connection with) the completion of the previous audit.</td></tr>
<tr><td colspan="2">Auditors should heighten their professional skepticism for any indicators of management bias or potential fraud during the planning process. This is especially important in areas involving significant accounting estimates and judgements, non-routine transactions, or unusual trends.</td><td>Auditors should communicate the audit plan to management and audit committees early on to ensure it is well understood and supported. They should also maintain regular and effective dialogues to communicate and address any potential issues in a timely manner.</td></tr>
<tr><td>Auditors should review the interim financial information to identify any non-routine transactions or unusual trends that may require further audit procedures and investigation.</td><td>Auditors should have a comprehensive understanding of the entity's business operations, internal controls, and external factors that may have an impact on the financial statements. Engagement partners should be actively involved in supervising the entire process.</td><td>Auditors should ensure they have sufficient and appropriate talents and resources, including the necessary skills and time, at all levels to conduct a quality audit. They should also identify and engage with the appropriate experts or specialists.</td></tr>
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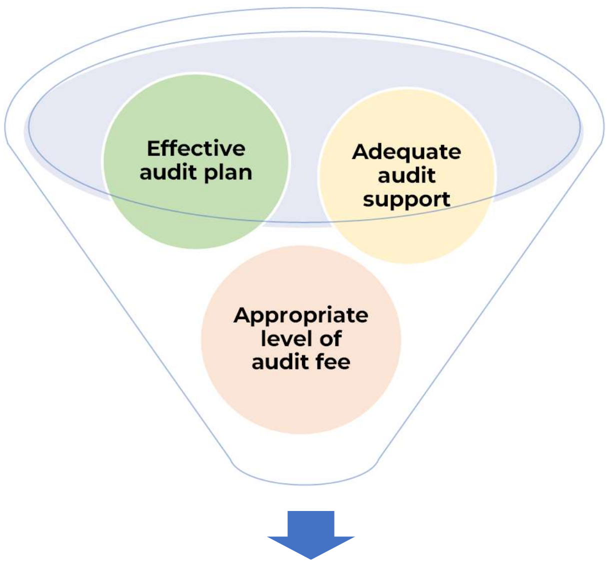
Our expectations of management and audit committees

A well-planned audit plays a crucial role in assuring the quality of financial reporting. It allows management to identify and address potential issues pre-emptively before they become too costly, both legally and economically, or too late to manage. Moreover, it assists entities in identifying weaknesses and making improvements to their financial reporting processes, providing benefits beyond compliance. Therefore, it is imperative for management and audit committees to engage auditors earlier and develop a comprehensive audit plan.



High-quality financial reporting

Audit committees should **review and approve the audit plans** to ensure that the proposed audit procedures are sufficiently and appropriately designed to address the identified risks.

This includes inquiring whether audits of their companies have been subject to our inspections and if so, discussing the deficiencies identified in our inspections and challenging how they are going to be addressed in the coming audits.

Management should **provide auditors with timely access to all necessary information and personnel** and maintain an open and receptive attitude towards any challenges raised by the auditors.

Audit committees should provide support to auditors as needed to facilitate the resolution of any contentious matters with management.

Management is responsible for **preparing high-quality financial information** and implementing necessary internal controls, the quality of which would have an impact on the extent of audit work required and, consequently, the audit fee.

Management and audit committees should ensure that the **audit fee is set at an appropriate level** without compromising the quality of audits. They should also ensure that the progress payments of the audit fees are proportional to the level of work required at different stages of the audit.