

Identification of Risks & Controls along with insights into SA 315 & SA 330

June 2023

CA Neeraj Sharma
CA Disha Maheshwari

ABC Ltd [Car Manufacturer] – Financial Statements

About the Company:

- Manufacturer of cars - petrol and diesel with HC of 5000 employees
- Sales to mainly US and Europe (bill and hold arrangement)
- Manufacturing location – India, China and Europe
- R&D center - new product development
- Vendor Financing arrangement
- Supply chain – 50% import from China

	Rs' Mio	
Profit and Loss for the year ended	31/03/20XX	31/03/20XX
Sale of Product	34,002	37,018
Other Operating Revenue	344	389
Total Revenue from Operations	34,346	37,407
Other Income	433	545
Total Income	34,779	37,952
Cost of sales	21,636	23,094
Purchase of Stock in Trade	2,008	1,981
Changes in inventories of WIP & FG	(830)	(103)
Employee benefit expense	1,850	1,856
Depreciation and amortisation expense	1,117	910
Other expenses	4,737	4,752
Finance Cost	135	157
Total Expenses	30,653	32,647
Profit Before Tax	4,127	5,305
Income taxes		
- Current Tax	1,117	1,826
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Profit after tax	3,157	3,452

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Total liabilities	11,541	12,031
Total liabilities and owners' equity	20,280	20,743

Introduction - Identification of Risks

- ✓ *Risk is defined as “Possibility that an event will occur which will impact the organisations achievement of **objectives**”.*
- ✓ *Objectives are derived from an organisations mission and strategy.*
- ✓ *COSO Framework provides a way to categorise objectives*
- **Operations** –efficient and effective use of organisations resources, Operational and financial performance, compliance with entities policies, safeguarding of assets
- **Compliance** - organisations compliance with applicable laws and regulations
- **Reporting** –preparation of financial /non-financial information *which is reliable and timely*
- ✓ *Risk to objectives*

Risk Identification

- It is a process of finding, recognizing and describing risks. It involves identification of risk sources, events, their causes and their potential consequences

Enterprise Level Risk

- Exist due to the nature of the organization and what it does.
 - Would have a pervasive impact on the organization.
 - To identify enterprise level risk, analyze internal and external drivers
- Eg. Political change, technology change, regulatory changes, strategy change etc

Process Level Risk

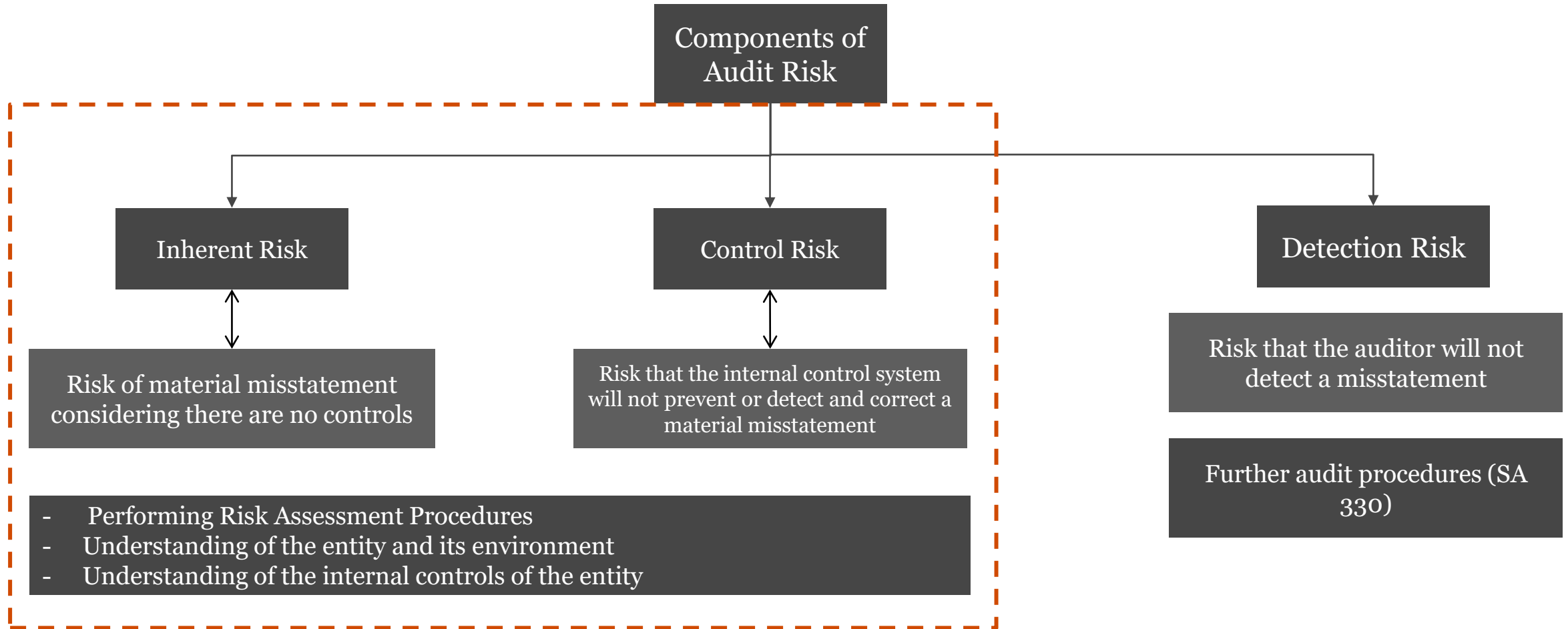
- Exist due to the types of process implemented.
- Provides specificity needed to effectively identify and evaluate process level controls.
- The key to identify process level risk is to consider “what can go wrong” in the process that would lead to failure to achieve the relevant objective

Level of Risk – Likelihood of risk * Consequence

- ✓ **Process Enablers** - Information Technology plays an important role in today’s environment.
- ✓ **Identifying Key Processes**
- ✓ **Risk Treatment/management**
- **Reduce Risk** by changing the likelihood eg by implementing controls
- **Avoid the risk** by deciding not to start or continue with the activity likely to give rise to the risk
- **Remove the source of the risk** – eg by redesigning processes that give rise to the risk
- **Sharing the risk with another party** – eg insuring against the losses
- **Accept the risk**

Audit Risk

Audit risk is the risk of issuing an inappropriate audit opinion on financial statements that are materially misstated.



Objective : Reduce the audit risk to an acceptably low level

Introduction – Overview of SA 315 and SA 330



SA 315 - Identifying and Assessing the ROMM through Understanding the Entity and Its Environment

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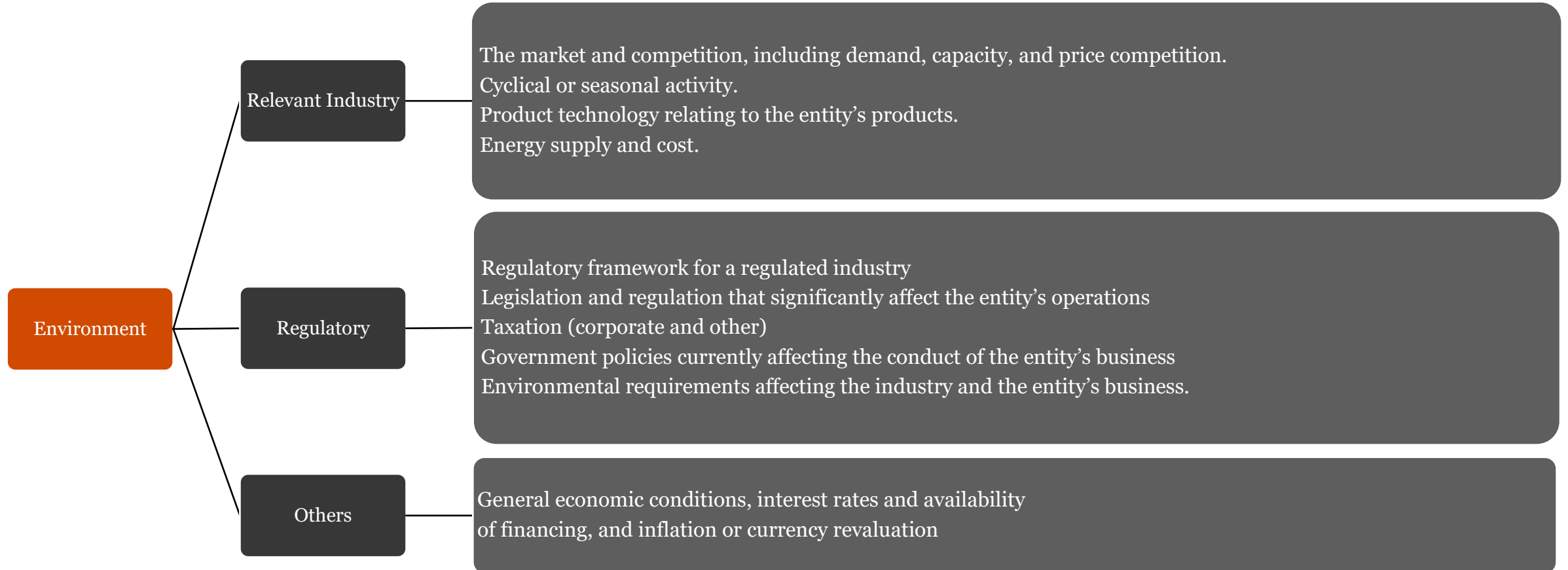
SA 315 - Identifying and Assessing the ROMM through Understanding the Entity and Its Environment

Risks Assessment Procedures

1. The auditor shall Perform Risk Assessment procedures to provide a basis for identification and assessment of risks of material misstatement at the financial statement and assertion level.
2. Risk Assessment procedure shall include:
 - a) **Inquiry of the Management**,
 - Inquiries with internal auditor, inhouse legal counsel, marketing and sales personnel
 - a) **Analytical Procedures**
 - existence of unusual transactions or unexpected relationships
 - may include both financial and non financial information eg sales and volume of goods sold
 - a) **Observation & Inspection**
 - to support inquiries of management and others
3. Consider whether information obtained from the auditor's client acceptance or continuance process relevant to identifying risks of material misstatement.
4. Information obtained from other engagements performed by the engagement partner
5. Information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits eg past misstatements, deficiencies noted in internal controls etc.
6. The engagement partner and other key engagement team members shall discuss the susceptibility of the entity's financial statements to material misstatement, and the application of the applicable financial reporting framework to the entity's facts and circumstances.

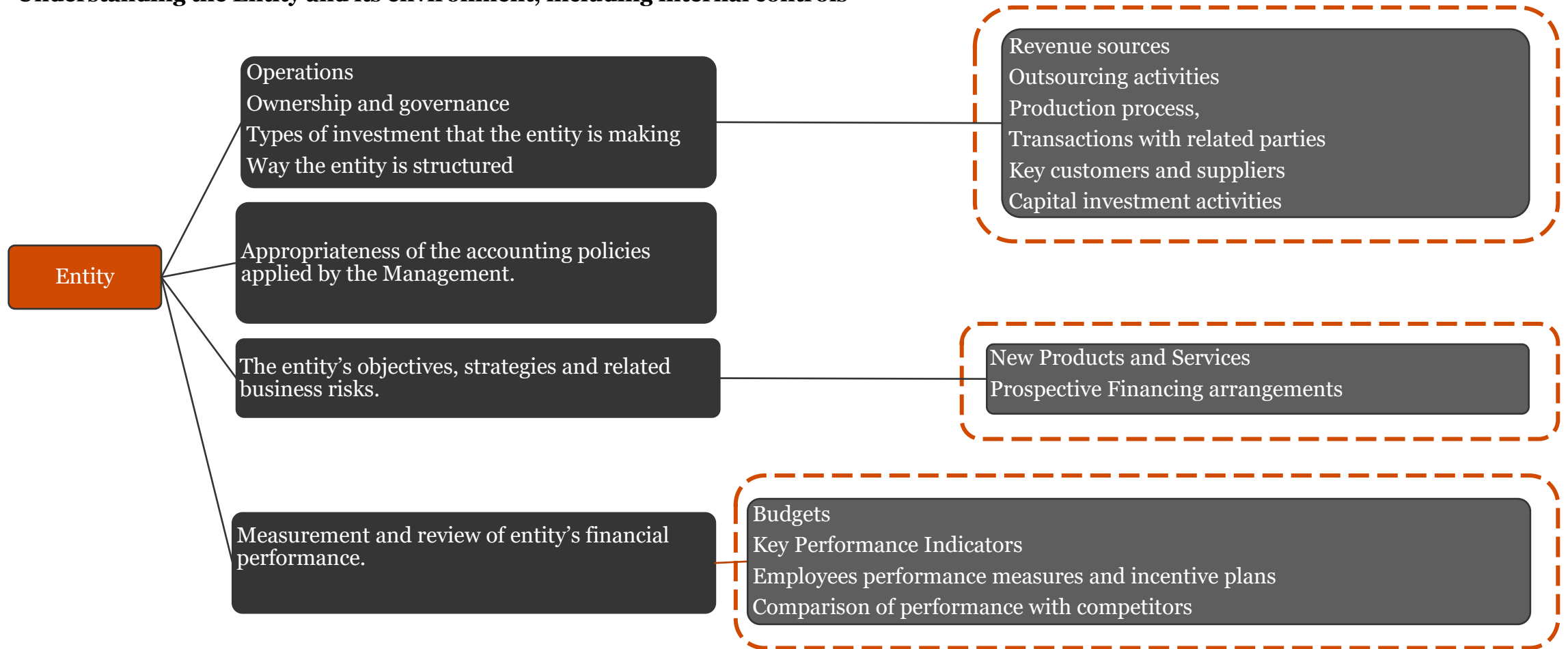
SA 315 - Identifying and Assessing the ROMM through Understanding the Entity and Its Environment

Understanding the Entity and its environment, including internal controls



SA 315 - Identifying and Assessing the ROMM through Understanding the Entity and Its Environment

Understanding the Entity and its environment, including internal controls



The understanding obtained by the Auditor can also be used for:-



Introduction - Identification of Controls

Internal control – The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity’s objectives

Enterprise Level Controls

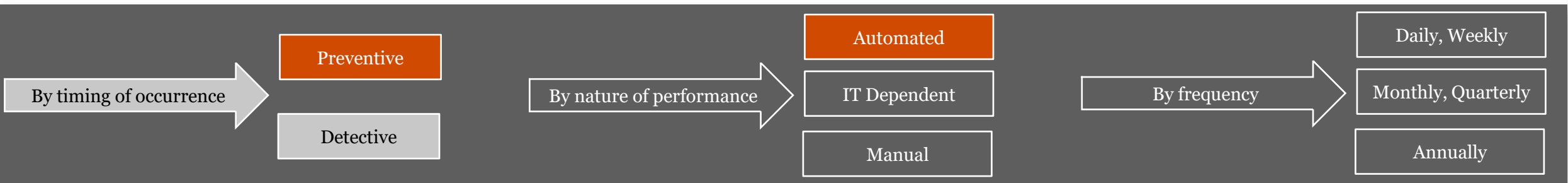
- Direct controls are enterprise level controls that directly prevent or detect the occurrence of risk eg whistleblower program or customer complaint program set to directly detect product failures or errors
- Indirect controls are enterprise controls that do not prevent or detect the occurrence of risks but rather they mitigate risk through their influence or monitoring of other controls eg code of conduct, and enterprise risk management program and internal audit

Process level controls

Process pervasive controls

- Organisation controls relate to organizational structure authority and responsibility eg : defined roles and responsibilities, defined authority limits, segregation of duties
- IT General Controls – relate to technology infrastructure and environment and ensure integrity of systems eg – systems processing and operational controls, technology change controls

Risk specific controls



SA 315 - Identifying and Assessing the ROMM through Understanding the Entity and Its Environment

Components of the Internal Control

Control environment

SA 315 - Identifying and Assessing the ROMM through Understanding the Entity and Its Environment



Inherent Risk * Control Risk

Determine whether any risk identified are in the auditor's judgment, a Significant Risk

- Whether the risk is the risk of fraud
- Whether it is related to recent significant economic, accounting or other developments and therefore requires special attention
- The complexity of the transactions
- Whether the risk involves significant transactions with related parties
- The degree of subjectivity involved
- Significant transactions outside the normal course of business

Assertions Level

- Class of transactions
- Account balances
- Disclosures

Financial Statement Level

- Pervasive to the financial statement.
- Deficient control environment
- Concerns about integrity of the management
- Conditions and reliability of the entity's records.
- Modification to the audit opinion

SA 330 – The Auditor's Response to Assessed Risks

ABC Ltd [Car Manufacturer] – Financial Statements

About the Company:

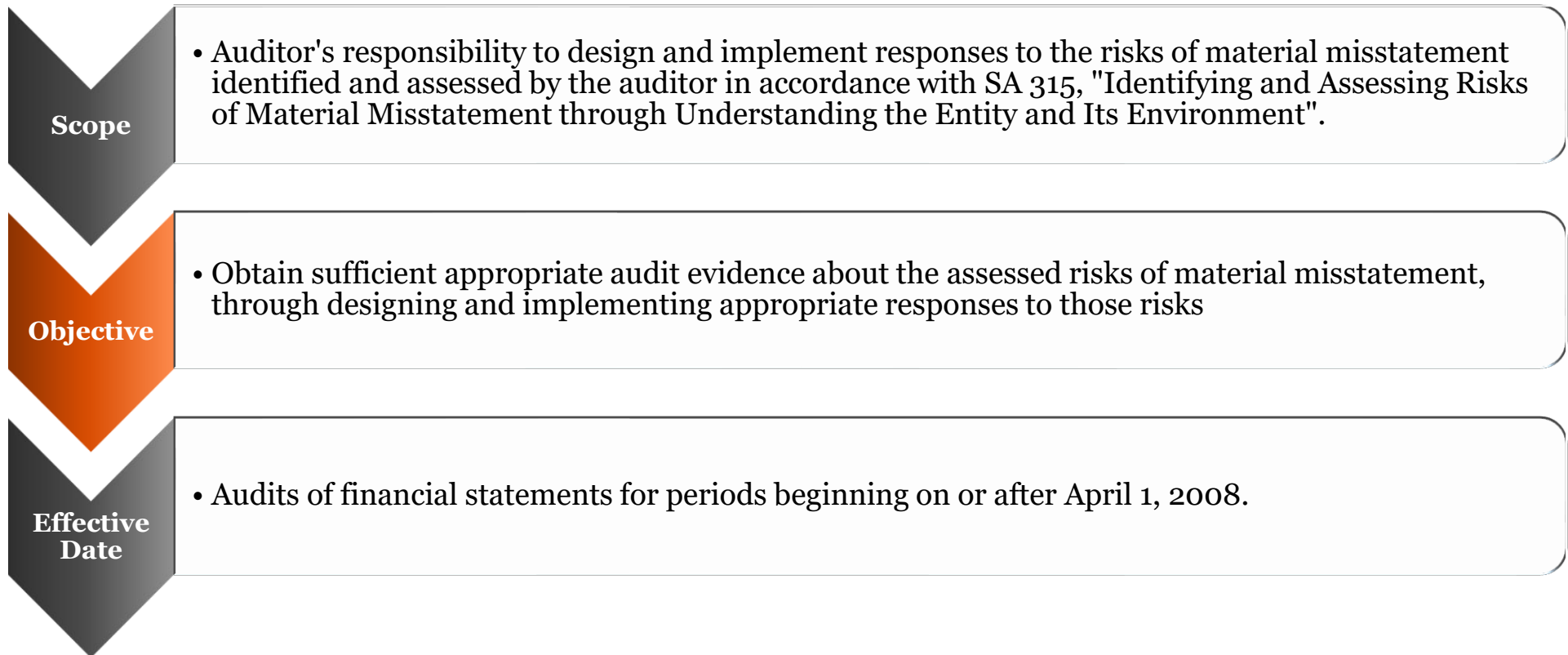
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SA 330 – The Auditor’s Responses to Assessed Risks

Introduction - Scope, Objective and Effective Date



SA 330 – The Auditor’s Responses to Assessed Risks

On an overall basis how do we address the risk of material misstatement?

- maintain professional skepticism
- experienced staff, experts, etc
- enhanced supervision
- unpredictable procedures

Consider the level of confidence in the internal controls. Higher the confidence, more the ability to rely on internally generated evidences and more work at interim stage. Lower the confidence, more evidence required from substantive procedures and towards the end of the period

SA 330 – The Auditor’s Responses to Assessed Risks

Risk assessment should be at assertion level:

Existence, occurrence, valuation, accuracy, disclosures, presentation, rights & obligations

Nature of procedures:

- Test of controls
- Substantive procedures

Either perform only test of controls or perform substantive procedures or both

Types of procedures:

Inspection – documents

Observation – inventory count, management review meeting

Inquiry – with management and corroboration

Confirmation – of bank balances, accounts receivables

Recalculation – of provisions

Reperformance – of calculations, control

analytical procedure – rent and depreciation calculations

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SA 330 – The Auditor’s Responses to Assessed Risks

When to perform

Interim or year end?

For full year or shorter period?

How much testing to perform - Extent

- High level of comfort
- Lower level of comfort

increase the quantity of the evidence, or obtain evidence that is more relevant or reliable

SA 330 – The Auditor’s Responses to Assessed Risks

Test of controls

Test only relevant controls

Evaluating the design and implementation of controls

Test of operating effectiveness

Dual purpose test – test of controls and operating effectiveness

Inquiry, inspection, observation, reperformance (depends on the nature of control)

How much testing to perform - Extent

- High level of comfort
- Lower level of comfort

Consider frequency, relevance and reliability of audit evidence obtained

Automated controls – one test adequate if reliance on ITGC

SA 330 – The Auditor’s Responses to Assessed Risks

Test of controls

Intended period of reliance

Annual control – Inventory count – test once

Revenue transactions – test for operating effectiveness throughout the period

Evidence from previous years

Reliance on audit evidence obtained in previous years if:

- Have not changed since they were last tested; and
- Are not controls that mitigate a significant risk;

Consider frequency, relevance and reliability of audit evidence obtained

SA 330 – The Auditor’s Responses to Assessed Risks

Test of controls

Exceptions noted

Some deviations may be expected – for example due to changes in personnel
Deviation beyond expected rate result in deficiencies

SA 330 – The Auditor’s Responses to Assessed Risks

Substantive procedures

Must be performed, irrespective of the assessed risks of material misstatement, for all material:

- Class of transactions
- Account balances
- Significant estimates
- Disclosures

Nature

- Perform only substantive analytical procedures (large volumes of transactions that tend to be predictable over time)
- Perform only test of details
- A combination of the above

Test of details – Select population carefully – Are you testing existence and accuracy or completeness?

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SA 330 – The Auditor’s Responses to Assessed Risks

Substantive procedures

Extent

Generally, the number of samples.

External confirmations

- Bank balances and other information relevant to banking relationships.
- Accounts receivable balances and terms.
- Inventories held by third parties at bonded warehouses for processing or on consignment.
- Property title deeds held by lawyers or financiers for safe custody or as Security
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- Accounts payable balances and terms

External confirmations are less useful for some assertions – recoverability

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SA 330 – The Auditor’s Responses to Assessed Risks

Substantive procedures

Closing process

Journal entries

Timing

- Previous year evidence not relevant generally
- Legal opinions obtained in previous year with no change in circumstances in CY
- Testing at interim – Perform additional procedures like analytics and comparing results at year end

SA 330 – The Auditor’s Responses to Assessed Risks

Results of testing

- Testing is cumulative and iterative process
- Audit evidence obtained may cause modification in nature, timing and extent of additional testing
 - Extent of misstatement identified
 - Discrepancies in audit records
 - New risks of material misstatements identified
- Error or fraud cannot be considered to be isolated incidence unless there is evidence to support

Documentation

SA 330 – The Auditor’s Responses to Assessed Risks

Evaluating the sufficiency and appropriateness of audit evidence



Auditor shall evaluate that the ROMM considered for audit procedure still remains relevant.

Auditor shall consider whether all the evidence obtained is sufficient and appropriate.

Auditor is unable to obtain sufficient and appropriate audit evidence as to a material financial assertion, the auditor shall reattempt to obtain further audit evidence. If no evidence is obtained, the auditor shall express a qualified or disclaimer of opinion.

Evaluating the sufficiency and appropriateness of audit evidence



➤ The auditor shall document:

- a) the overall responses and the nature, timing, extent of further audit procedures performed
- b) the linkage of those procedures with assessed risks at the assertion level
- c) the results of audit procedures performed

Q&A