

SA 315 - Identifying & Assessing ROMM through understanding entity & its environment

<p>Objective of auditor</p> <p>Identify & assess ROMM, whether due to fraud or error, at FS & assertion levels, through understanding entity & its environment, including entity's IC (RAP), thereby providing basis for implementing responses to assessed ROMM</p> <p>Identifying & Assessing ROMM at –</p> <p>(a) FS level (b) Assertion level for transactions, A/c balances, & disclosures</p> <p>For this purpose, auditor shall –</p> <ul style="list-style-type: none"> • Identify risks throughout process of obtaining understanding of entity & its environment • Assess identified risks, & evaluate whether they relate more pervasively to FS as whole • Relate identified risks to what can go wrong at assertion level • Consider likelihood of misstatement, including possibility of multiple misstatements 	<p>Internal Control</p> <p>Process designed & implemented by TCWG & Mgt to provide reasonable assurance about achievement of entity's objectives with regard to –</p> <ul style="list-style-type: none"> • Effectiveness & Efficiency of operations • Compliance with applicable L&R • Safeguarding of assets • Reliability of FR <p>Limitations of IC</p> <p>IC can provide entity with only reasonable assurance about achieving entity's FR objectives</p> <p>Manual elements in IC may be more suitable where judgment is required such as</p> <ul style="list-style-type: none"> • Large, unusual or non-recurring transactions • In changing circumstances that require control response outside scope of existing automated control • In monitoring effectiveness of automated controls • Circumstances where errors are difficult to predict
<p>Assertions</p> <p>Representations by Mgt, explicit or otherwise, that are embodied in FS, as used by auditor to consider diff types of potential misstatements that may occur</p> <p>Assertions are of 3 categories</p> <ul style="list-style-type: none"> • Assertions about classes of transactions & events for audit period - Occurrence, Completeness, Accuracy, Cut-off & Classification • Assertions about A/c balances at period end - Existence, Rights & obligations, Completeness & Valuation & allocation • Assertions about presentation & disclosure - Occurrence & rights & obligations, Completeness, Classification & understandability & Accuracy & valuation 	<p>Risks that Require Special Audit Consideration</p> <p>In exercising judgment as to which risks are significant risks, auditor shall consider following -</p> <ul style="list-style-type: none"> • Whether risk is risk of fraud • Complexity of transactions • Degree of subjectivity in measurement of financial Info related to risk • Whether risk involves significant transactions with RP • Whether risk involves significant transactions that are outside normal course of business or unusual • Whether risk is related to recent significant economic, A/cing, or other developments

Misstatements are considered to be **material** if they, individually or in aggregate, could reasonably be expected to **influence economic decisions of users** taken on the basis of FS

Performance Materiality means **amount** set by auditor **at less than materiality** for FS as a whole to **reduce** to an appropriately low level, **probability** that aggregate of uncorrected and undetected **misstatements exceeds materiality** for FS as a whole. It also refers to amount set by auditor at less than materiality level for particular classes of transactions, A/c balances or disclosures

Use of Benchmarks in Determining Materiality for FS as a Whole

Determining materiality involves exercise of **professional judgment**. A **percentage** is often **applied** to a **chosen benchmark** as starting point in determining materiality. **Factors** that may **affect identification** of appropriate **benchmark** include

- **Nature of entity**, where entity is at in its life cycle, and industry & economic environment in which entity operates;
- Entity's **ownership structure** & way it is financed
- Elements of **FS**
- Whether there are items on which **attention of users** of particular entity's FS tends to be **focused**
- Relative **volatility of benchmark**

Eg of Benchmarks

- **PBT** from continuing operations for **profit-oriented** entities
- If **PBT is volatile** then gross **profit** or total **revenues**
- For **Public Utility Programs/Projects** – **Total Cost or Net Cost** (Expenses less revenues)
- If Entity has **custody of assets - Assets**

Revision as Audit Progresses

Materiality may need to be revised as a result of -

- **New info**
- **Change in circumstances** that occurred during audit
- **Change in auditor's understanding** of entity as a result of FAP

If auditor concludes that a **lower materiality** than that initially determined is **appropriate**, auditor shall determine whether it is necessary to **revise performance materiality**, and whether **NTE of FAP** remain appropriate

In designing FAP to be performed, auditor shall

- Consider **reasons for assessment** given to **ROMM** at assertion level for each class of transactions, account balance, and disclosure, including Inherent Risk and Control Risk
- Obtain **more persuasive** audit evidence, the **higher** the auditor's **assessment of risk**

FAP comprises of **TOC & Substantive Procedures**

Tests of Controls

Audit Procedure designed to evaluate **operating effectiveness** of controls in **preventing, detecting & correcting MM** at assertion level

Auditor shall design and perform TOC to obtain SAAE as to operating effectiveness of relevant controls when

- Auditor's assessment of ROMM at assertion level includes an **expectation** that **controls are operating effectively** (i.e., auditor **intends to rely on operating effectiveness** of controls in determining NTE of substantive procedures)
- **Substantive procedures** alone **cannot** provide **SAAE** at assertion level

In designing and performing TOC, auditor shall **obtain more persuasive** audit **evidence**, the **greater** the **reliance** auditor places **on effectiveness of a control**

Substantive Procedures

Audit Procedures designed to **detect MM** at assertion level

Irrespective of assessed **ROMM**, auditor shall design and **perform substantive procedures** for each material class of transactions, account balance, and disclosure