

SA 315 – IDENTIFYING AND ASSESSING THE RISK OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT

CLARIFICATIONS AND AUDIT PROCEDURES

- SA 315 and SA 330 has replaced with AAS 6, 20 and 29.
- As assessment of audit risk for both manual as well as CIS environment.
- Here audit risk means that the expression of opinion given by auditor is incorrect. E.g. he has issued clean opinion instead of qualified opinion.
- Here risk on the part of auditor that he may focus cases of negligence of his duties.

PARTS & REASONS OF AUDIT RISK

- Audit risk arises because of 3 types of risk
 1. **Inherent risk:-**
 - Risk that the fraud or error will arise e.g. as employees are unskilled.
 - For making assessment of inherent risk auditor shall acquire good knowledge of client's organization (AAS-20) e.g. interaction with clients as well as employees of client.
 2. **Control risk:-**
 - Risk that the internal control system set by the management is not good enough to control every kind of fraud and errors.
 - Auditor shall make assessment of such risk by checking establishment, implementation and continuity of such internal control system established by management.
 3. **Detection risk:-**
 - Risk that the fraud and error which has arisen not controlled and not detected during the course of audit.
 - Such fraud and error shall become part of this financial statement.
 - If on such false financial statement if any expression is given then it may be false known as audit risk.
 - Detection risk was originally part of AAS 6 but removed out of SA 315 and has made it a part of SA 330.
 - Moreover, there is inverse relationship of detection risk and combined level of inherent risk and control risk.
 - If inherent and control risk is high then detection risk shall be lower and vice versa.
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SA 330 – THE AUDITOR'S RESPONSES TO ASSESSED RISKS

RESPONSE OF AUDITOR TO ASSESSED RISK

- As a part of this response to this assessed risk at SA 315; auditor performs following two procedures
 1. Compliance procedure
 2. Substantive procedure
- 1) **Compliance procedure:-**
 - As a part of such compliance procedure auditor study and satisfy himself with the internal control system set by management.
 - Such assessment assists him to decide nature, timing, and extent of substantive procedure.
 - If such detailed evaluation of internal control system is done in previous year then auditor shall check the changes only.
 - But it is mentioned within this SA that auditor needs to evaluate internal control system in detail at least once in three years.
 - 2) **Substantive procedure:-**
 - Here auditor shall carry the work of pure audit detailed vouching, verification, confirmation etc.
 - If audit staff has evaluated records in the interim period then auditor shall check the rest part only.
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SA 450 – EVALUATION OF MISSTATEMENT IDENTIFIED DURING THE AUDIT

TYPES OF MISSTATEMENT AND ITS DISPOSITIONS

1. Factual misstatement
2. Judgment misstatement
3. Projected misstatement

1.) **Factual misstatement:-**

- It is based on facts e.g. error in accounting of electricity bill.
- Here, auditor should ask accountant to rectify and otherwise auditor should issue a qualified report.

2.) **Judgment misstatement:-**

- It is a mistake on the part of accountant in making any judgment e.g. bad debts provision, deciding useful life of assets.

- Here, auditor should give opportunity to the accountant to justify and if not able to justify his judgment then auditor should qualify his audit report.

3.) Projected misstatement:-

- Here, auditor shall decide expected level and tolerance level of errors in population.
- Now, auditor shall conduct the work of audit on samples and based on the errors in samples auditor shall make projection for total possible error in population.
- If such projection indicates more errors than tolerance level the auditor should issue a qualified report even if all errors found within samples are rectified.

SA 720 – THE AUDITORS RESPONSIBILITY IN RELATION TO OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENT.

EXTENSION IN SCOPE OF AUDIT

- With introduction of SA 720 auditor need to carry work of audit on the other parts of annual report as will which includes
 1. Director report
 2. Financial statement
 3. Planned capital expenditure
 4. Financial ratio
 5. Selected quarterly data
- Even after introduction of SA 720 following aspects are out side the preview of audit
 1. A press release
 2. A covering letter to annual report
 3. Information contained in analyst briefing
 4. Information contained in entity's website

AUDIT PROCEDURES AND CONCLUSIONS

- If auditor finds only contradictory statement in any part of the annual report then he should search whether audited financial statement is incorrect or other parts.
- If other part is incorrect e.g. financial summarizes then auditor should ask management to modify such other part and if management deny still auditor can't qualify but he simply convey such act in his audit report.
- But, if audited financial statement proves to be false then auditor should compelled management to rectify and in the absence, auditor should qualify his report.

SA 265 – COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT

PROCEDURE UNDER SA 265

- Internal control system (ICS) is set by management to prevent fraud and errors.
- ICS is evaluated by the auditor.
- Such evaluation is technically known as compliance procedure.
- If result of evaluation is weak then two outcomes.
 1. Carry more substantive procedure
 2. Communicate weakness in ICS

COMMUNICATION OF WEAKNESS OF ICS

- If such weakness is related with sales, inventory, and fixed assets and communicates within CARO (point 4)
- If weakness is related with any other area then communicates to management through a letter known as letter of weakness.
- Such communication of letter of weakness was optional earlier but with the introduction of SA 265 it has become compulsory.

CLARIFICATION

- This SA do not give responsibility to auditor to identify the weakness rather such identification is already done within SA 315 and Sa 330 under this SA auditor just communicate the weakness in ICS.
- In fact main intention to carry work of audit is related with the expression of opinion but discovering and communicating weakness in ICS is incidental to achieve main objectives.

MANAGEMENTS ACTION AND AUDIT RESPONSES

- If any significant weakness is communicated by auditor and if management after doing cost benefit analysis do not rectify the weakness still auditor should not qualify his report but he should communicate such weakness every year unless rectified by the management.
- But if weakness is not significant then it can be communicated orally and it needs to be communicated only for once.