LUNAWAT & CO.

CHARTERED ACCOUNATNTS

SA-315

Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment

16th January, 2015

Why Auditing Standards are Important??

Auditing Standards are mandatory to be by followed by practitioners under the direction issued by the council of ICAI

If not complied with Auditing Standards in performing Assurance Engagement →

CA shall be held guilty of Professional misconduct under Schedule-II of CA-Act, 1949

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As per the Section 143(9) of Companies Act-2013, New

Every auditor shall comply with the auditing standards

Brief Historical Background of Auditing Standards

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1955	Research Committee constituted by ICAI for developing Accounting & Auditing Practice
1964	Research Committee of ICAI issued "Statements on Auditing Practice" (SAP)
1977	IAPC constituted by IFAC & issued "International Auditing Guidelines" (IAG) later known as ISA*
1982	"Auditing Practice Committee" (APC) constituted by ICAI to spearhead the Framework of SAPs & GNs
2002	APC renamed as AASB (Auditing & Assurance Standards Board) SAP renamed as AAS (Auditing & Assurance Standards)
2008	Nomenclature of AASs known as Engagement & Quality Control Standards (SAs/SREs/SAEs/SRSs/SQC)

*ISA-International Auditing Standards

SA - 315

Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment

Contents of SAs

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- Requirements
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Introduction

- **Scope of this SA**
  - **Deals with Auditor’s Responsibility**
  - **to identify and assess RMM in Financial Statements**
  - **through Understanding the Entity and its Environment**
  - **including Internal Control**

- **Effective Date**
  - **On or after April 1, 2008.**
  - **New (SA 315)+(SA 330) = Old (AAS 6) + (AAS 20) + (AAS29)**

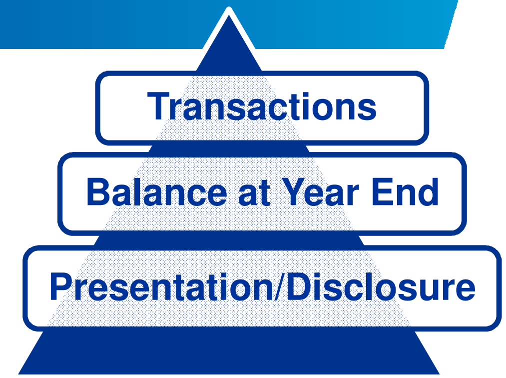
Objective of SA - 315

- To identify and assess the risks of material misstatement (RMM)
- whether due to fraud or error,
- at the financial statement and assertion levels
- through understanding the entity and its environment
- including the entity’s internal control,

- thereby providing basis for designing and implementing
- response to assessed RMM (SA-330)

- help to reduce the RMM to an acceptably low level

Definitions



- **Assertions**
  - Representation by mgmt. in recording txns. in books &
  - Preparation of Financial Statements
- **Business Risk**
- **Internal Control**
- **Risk assessment procedures**
  - Audit procedures performed to obtain
  - understanding of the entity and its environment, including I.C.
  - to identify and assess the RMM, whether due to fraud or error
- **Significant risk**
  - An identified and assessed risk of material misstatement
  - that requires special audit consideration.

Requirements

I. Risk Assessment Procedures and Related Activities
II. The Required Understanding of the Entity and Its Environment, Including the Entity's Internal Control
III. Identifying and Assessing the Risks of Material Misstatement
IV. Documentation

Requirements - RAP

- **Risk Assessment Procedures (RAP)**
  - **Inquiries of management, and of others within the entity**
  - **Analytical procedures**
  - **Observation and inspection**

- **For RAP, Auditor shall also consider information obtained from :**
  - **auditor's client acceptance or continuance process**
  - **auditor's previous experience with the entity**
  - **audit procedures performed in previous audits**
  - **discussion with engagement team about susceptibility of F.S.**

Requirements - Understanding of the Entity and Its Environment

- **Auditor shall obtain understanding of the following :**

  a) Relevant industry, regulatory, & other external factors, including Applicable F.R.F.

  b) Nature of the Entity :

     i. Operations,

     ii. Ownership, Governance Structure;

     iii. Types of Investments that the entity is making and plans to make

     iv. the way that the entity is structured and how it is financed

  c) Entity's selection and application of accounting policies

  d) Entity's objectives and strategies

  e) Measurement and review of the entity's financial performance

Requirements - Understanding of the Entity's Internal Control

- **The auditor shall obtain an understanding of internal control relevant to the audit**

- **Component of Internal Control (on which understanding is reqd.)**
  - I. Control environment
  - II. The entity's risk assessment process
  - III. The information system, including the related business processes relevant to financial reporting, and communication.
  - IV. Control activities relevant to the audit
  - V. Monitoring of controls

Requirements - Identifying and Assessing the RMM

- The auditor shall identify and assess the at:
  - the financial statement level
  - the assertion level
- to provide a basis for designing and performing further audit procedures

- For this purpose, the auditor shall:

I. Identify risks,

II. Assess and evaluate the identified risks,

III. Effect at the assertion level.

IV. Consider the likelihood of misstatement

Requirements - Identifying and Assessing the RMM

- **Risks that Require Special Audit Consideration**

  a) Whether the risk is a risk of fraud;

  b) Whether the risk is related to recent significant economic, accounting, or other changes;

  c) The complexity of transactions

  d) Whether the risk involves significant trxns. with related parties;

  e) The degree of subjectivity in the measurement of the financial information; and

  f) Whether the risk involves significant unusual transactions.

Requirements - Identifying and Assessing the RMM

- **Risks for which substantive procedures alone do not provide sufficient appropriate audit evidence:**
  - **Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions**
  - **Auditor shall obtain an understanding the entity's controls over such risks that are relevant to the audit**

- **Revision of risk assessment**
  - **The auditor shall revise the assessment and modify the further planned audit procedures as additional audit evidence is obtained during the course of the audit.**

Requirements - Identifying and Assessing the RMM

Material weakness in internal control

- The auditor shall evaluate whether he identified a material weakness in design, implementation or maintenance of internal control.
- The auditor shall communicate material weakness in internal control to management as required by SA 260

Requirements - Documentation

- **The auditor shall document:**
  a) The discussion among the engagement team & the significant decisions reached
  b) Key elements of the understanding obtained regarding the entity and its environment including the I.C. components, Source & RAP performed
  c) The identified and assessed RMM at
     - the financial statement level
     - the assertion level
  d) The risks identified, and related controls about which the auditor has obtained an understanding

How an audit should take place

- **Preliminary Engagement Activities**

  (Client continuance, Ethical requirement, Terms of Engagement etc.)

  (SA-220) (SA-200 & SA-220) (SA-210)

- **Planning Activities** (Audit Strategy → Scope, Timing & Direction)

  (Audit Plan → N.T.E. of audit procedures)

SA - 300

- **Risk Assessment Procedures (RAP)**

  (Understanding of Entity, its Environment & Internal Control)

SA - 315

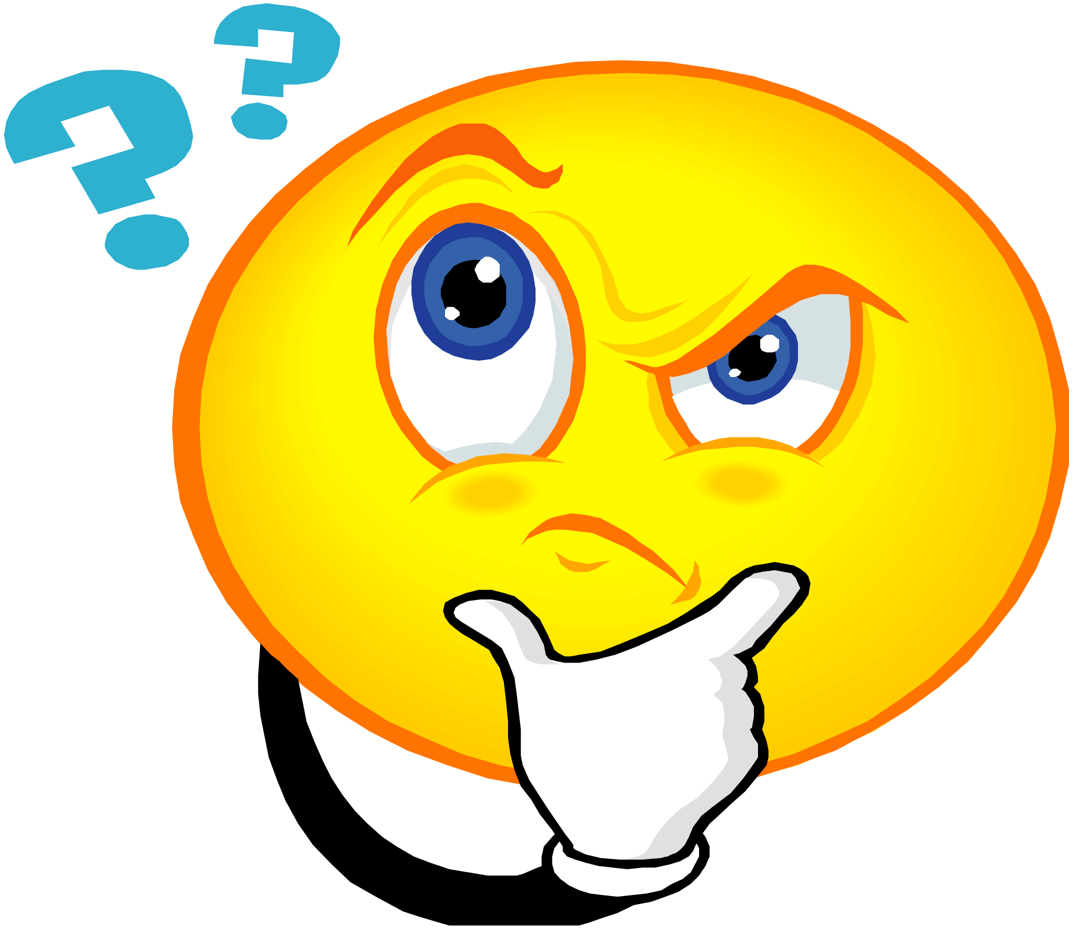
- **Performing Test of controls** (for Existence, Effectiveness & Continuity)
- **Performing Test of details (Substantive Procedures)**

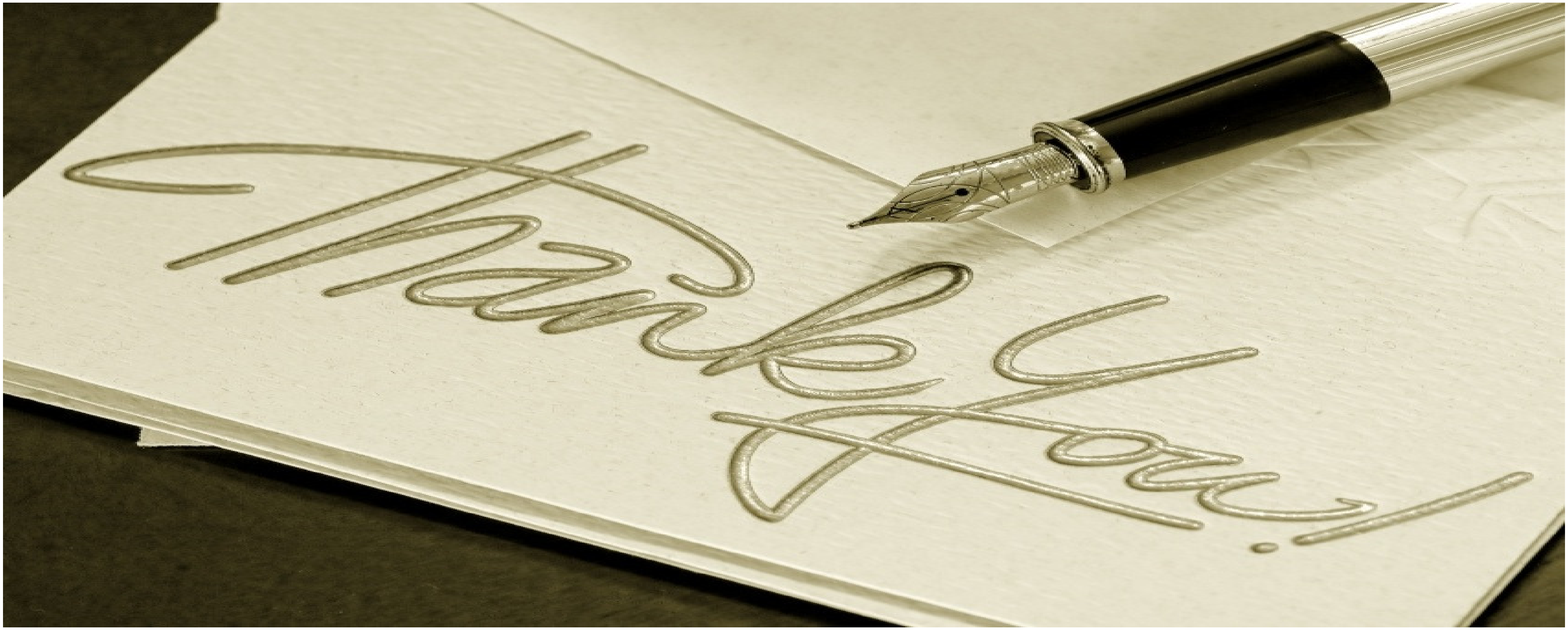
  (Completeness, Validity, Accuracy, Measurement, Valuation)

SA - 330

- **Evaluation of Misstatement, if identified** SA - 450
- **Forming an opinion based on audit evidence obtained** SA - 700

Questions???





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