

*CNK & Associates LLP*

**Chartered Accountants**



**Virtual CPE Meeting on  
Standards on Auditing**

**WIRC of ICAI**

**Harshvardhan Dossa**

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# Today's Agenda



- SA 300 - Planning An Audit Of Financial Statements
- SA 315 - Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment
- SA 330 - The Auditor's Responses to Assessed Risks

# SA 300 - Planning An Audit Of Financial Statements



- Scope:
  - Deals with the auditor's responsibility to plan an audit of FS.
  - Framed in the context of recurring audits
- Effective Date:
  - Audits of financial statements for periods beginning on or after 1st April 2008.
- Objective
  - The objective of the auditor is to plan the audit so that it will be performed in an effective manner

# SA 300 - Planning An Audit Of Financial Statements



- Planning involves:
  - Establish overall audit strategy.
  - Developing audit plan
- Benefits of planning the audit of financial statements:
  - Devote appropriate attention to important areas.
  - Identify and resolve potential problems on timely basis.
  - Properly organize and manage the audit.
  - Assists Selection of engagement team members with requisite capabilities and competence.
  - Co-ordination of the work done by auditors of components and experts.
  - Facilitating direction and supervision of engagement team

# SA 300 - Planning An Audit Of Financial Statements



- The nature and extent of planning activities vary according to:
  - Size and complexity of the entity.
  - Key engagement team members' previous experience.
  - Changes in circumstances.
- Planning is a continuous and iterative process.
- Timings of certain activities needs to be completed prior to the performance of further audit procedures.
- Auditor may discuss elements of planning with management, but planning remains responsibility of the auditor

# SA 300 - Planning An Audit Of Financial Statements



- Involvement of Key Engagement Team Members
  - Participate in discussion with audit team.
  - Benefit of their experience & insight.
  - Increases effectiveness & efficiency of planning
- SA 315 and SA 240 also contain a requirement for discussion with the audit team as to the susceptibility of the financial statements of the entity to material misstatements and to material misstatement due to fraud respectively
- NFRA Observation:

*and there is no gross negligence as alleged.”* The **Audit Firm** has however failed to address NFRA’s observations made in its **DAQRR** Report that, “The firm has not complied with the requirement of Para 4 of SA 300 which requires the EP and Other Key Members to be part of the planning discussion”. The **Audit Firm** has failed to show any Audit Evidence regarding participation of EP and other key members in the planning discussion. The **Audit**

# SA 300 - Planning An Audit Of Financial Statements



- Preliminary Engagement Activities
  - Perform procedures required under SA 220
    - Client continuation, etc.
  - Evaluate compliance with ethical requirements including independence.
  - Establish understanding of terms of engagement as per SA 210.





## Additional Considerations in Initial Audit Engagements:

- Before starting initial audit engagement:
  - Perform procedures required under SA 220 – client acceptance, etc.
  - Communicating with predecessor auditor.
- Additional matters to consider in Audit Strategy and Audit Plan:
  - Any major issues discussed with management.
  - Audit procedures necessary regarding opening balances.
  - Other procedures required by firm's QC system.



- The Overall Audit Strategy assists the auditor in determining:
  - What/ When/ Amount of resources deployed for specific audit areas
  - How such resources are managed, directed and supervised (briefing, debriefing, reviews)
- Establishment of the overall audit strategy and the detailed audit plan are not necessarily **discrete or sequential** processes, but are **closely inter-related**.
- Considerations Specific to Smaller Entities
  - Co-ordination and communication between team members are easier.
  - Establishing the overall audit strategy for the audit of a small entity need not be a complex or time-consuming exercise

# SA 300 - Planning An Audit Of Financial Statements



- Contents of Audit Plan:
  - NTE of Risk Assessment Procedures
  - NTE of planned further audit procedures at assertion level.
  - Other procedures required to comply with SAs.
- Update & change the overall audit strategy & audit plan as necessary.
- Plan NTE of direction, supervision & review of engagement team members.



## Documentation:

- Overall audit strategy:
  - Necessary for proper planning & communicating significant matters to engagement team.
- Audit plan:
  - Record of proper planning & review of audit procedures for approval before use.
- Significant changes to overall audit strategy/ audit plan and reasons for changes:
  - Reflects appropriate response to these changes.



## Appendix 3:

### **Illustrative Format of Audit Plan Identification and Assessment of Key Risks of Material Misstatement**

**(to be completed for all material classes of transactions,  
account balances and disclosures)**

Area	
Amount as per Trial Balance	
Components of the amount	
Understanding of the processes based on inquiry with: <ul style="list-style-type: none"><li>• Management</li><li>• Those Charged with Governance</li><li>• Internal auditor</li><li>• Business process owners</li><li>• In-house legal counsel</li><li>• Any other source</li></ul>	



Results of preliminary analytical procedures – any unusual or unexpected relationships	
Results of design effectiveness of internal controls <ul style="list-style-type: none"><li>• Control environment</li></ul>	
<ul style="list-style-type: none"><li>• Risk assessment</li><li>• Information system and business process</li><li>• Control activities</li><li>• Monitoring of controls</li></ul>	
Results of observation and inspection of : <ul style="list-style-type: none"><li>• Entity's operations</li><li>• Documents and records</li><li>• Reports</li><li>• Premises</li></ul>	



**Other information available**

- past audits
- other engagements of the entity
- continuance assessment
- results of limited reviews at interim periods
- discussions within engagement team
- any other source

Identified risks	Risk description	Inherent / Control	Assertion
Key risks			
Non –key risks			
Impact on any other area			

## Illustrative Format of Audit Planning Schedule



Tasks/ Timing	Week 1	Week 2	Week 3	Week 4	Week 5	Budgeted hours	Actual hours
<b>Meetings</b>							
Meetings with management to understand entity's operations and significant developments, update progress	√	√	√	√	√	X	
Deployment of engagement team and team meetings	√	√	√	√	√	X	
Meetings with Those Charged with Governance – sharing audit strategy and conclusions	√	√			√	X	





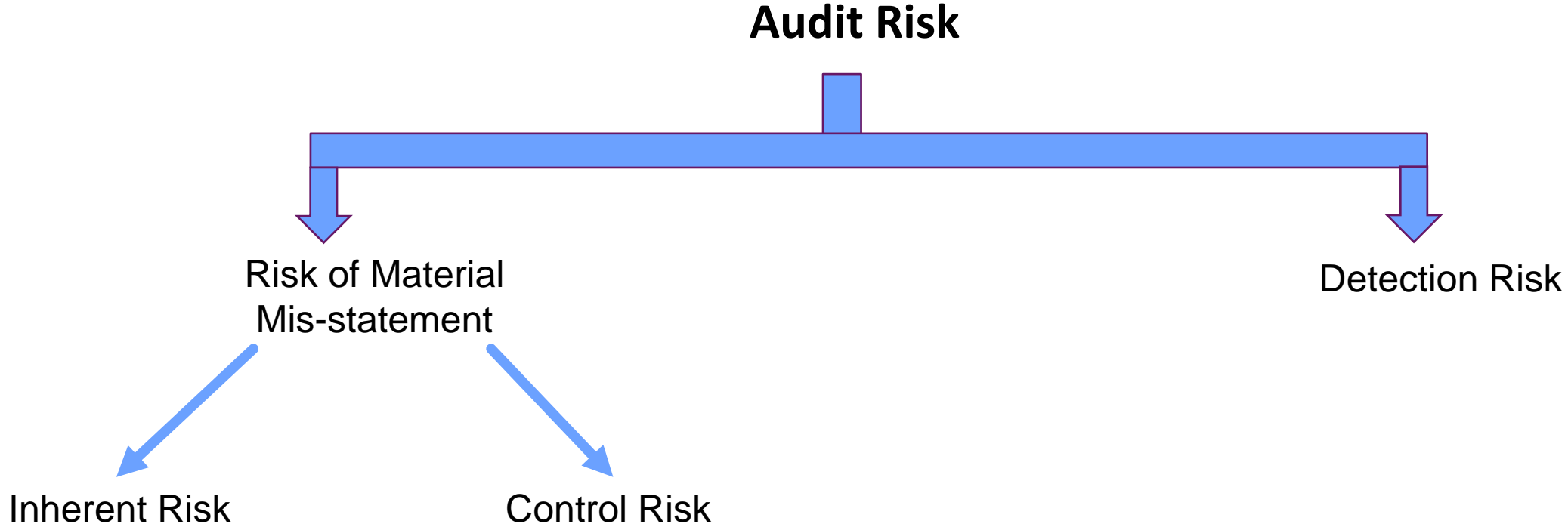
<b>Conclusions</b>						
Perform final analytics and other closing procedures					√	X
Review by Engagement Partner and conclude on evidences obtained					√	X
Consultations with Quality Review Partner					√	X
Share draft results and discuss with management					√	X
Finalise and Issue opinion, discuss with Those Charged with Governance					√	X

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

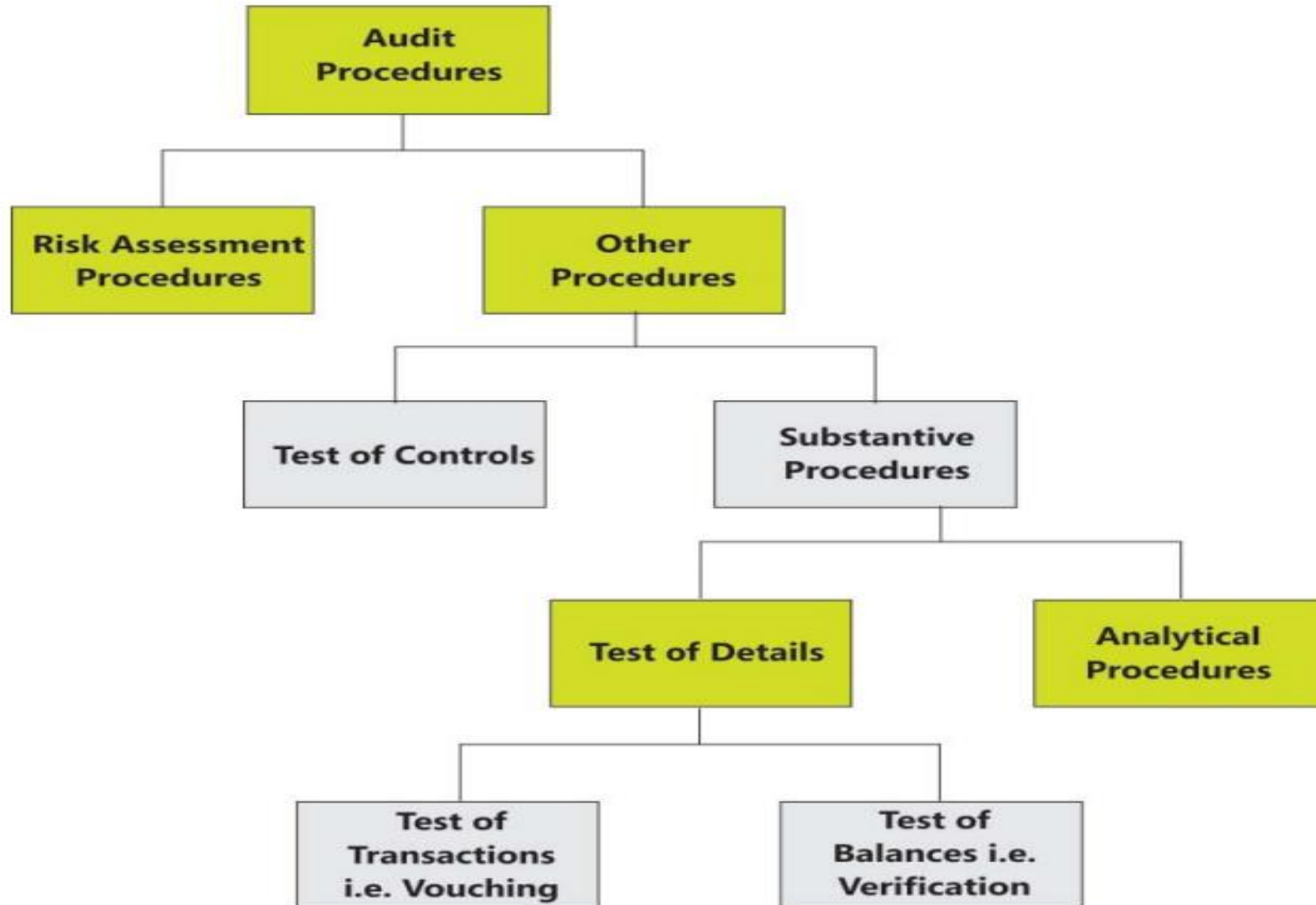


- Scope:
  - deals with the auditor's responsibility to identify and assess the ROMM in the financial statements,
  - through understanding:
    - the entity
    - its environment,
    - entity's internal control.
- Effective Date
  - Audits of financial statements for periods beginning on or after April 1, 2008.

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



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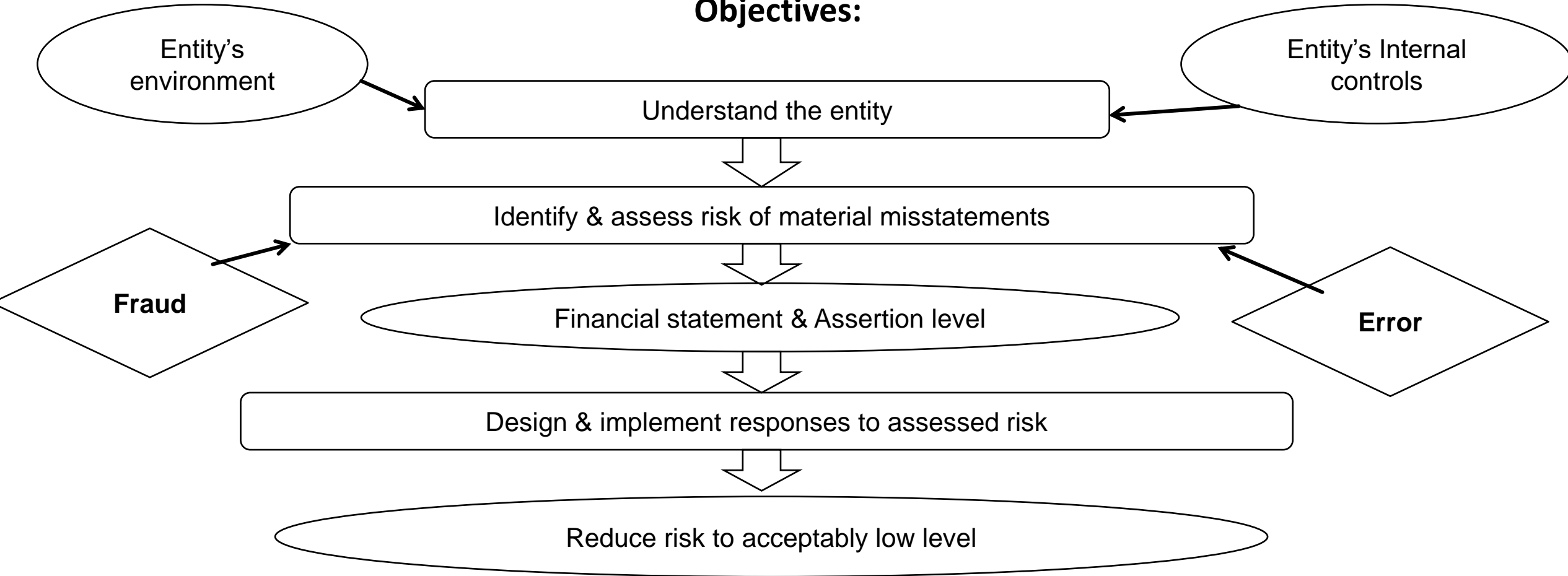


- Assertions:
  - Representations by management.
  - Embodied in financial statements.
  - Used to assess potential misstatements.
- Internal control (IC):
  - Designed, implemented & maintained by TCWG.
  - Provides only reasonable assurance.
  - Process to ensure:
    - Reliability of financial reporting.
    - Effectiveness & efficiency of operations.
    - Safeguarding of assets.
    - Compliance with applicable laws & regulations.
  - Control – Any aspects of one or more of the component of IC.

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



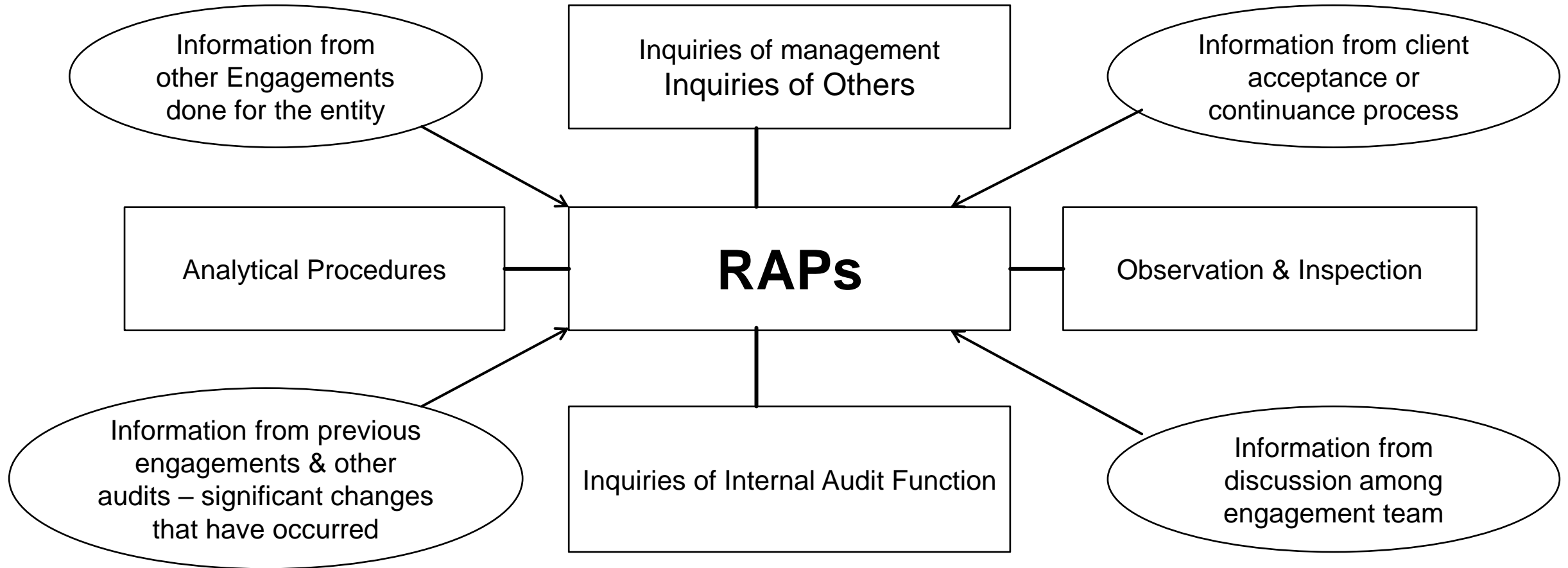
## Objectives:



# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



## Types of Risk Assessment Procedures:



# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



## Risk Assessment Procedures – Inquiry of Management

Source	Information obtained
Those Charged with governance	Understand environment in which financial statements are prepared
Employees	Appropriateness of selection, application of certain accounting policies
Marketing personnel	Changes in marketing strategies, sales trends, contracts etc
In-house legal counsel	Litigation, compliance with laws, Knowledge of frauds, etc.



# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



- Risk Assessment Procedures – Analytical Procedures
  - May identify aspects of entity of which auditor was unaware.
  - May assist in assessing the ROMM to provide basis for designing & implementing responses to assessed risks.
  - Identify unusual transactions/ relationships, etc. (possibility of fraud).
  - APs on data aggregated at high level gives only broad initial indication of material misstatement.
- Risk Assessment Procedures – Observation & Inspection
  - May support inquiries of management and others.
  - Provide information about entity/ its environment
  - Examples: Entity's operations, Documents, Management/TCWG reports, Premises & plant facilities

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



- Risk Assessment Procedures – Inquiry of Internal Audit Function
  - useful to auditor in obtaining an understanding of the entity and its environment, and in identifying and assessing ROMM at the FS and assertion levels.
  - In accordance with SA 240, if IA function provides information to auditor regarding any actual, suspected or alleged fraud, auditor takes this into account in auditor's identification of risk of material misstatement due to fraud.

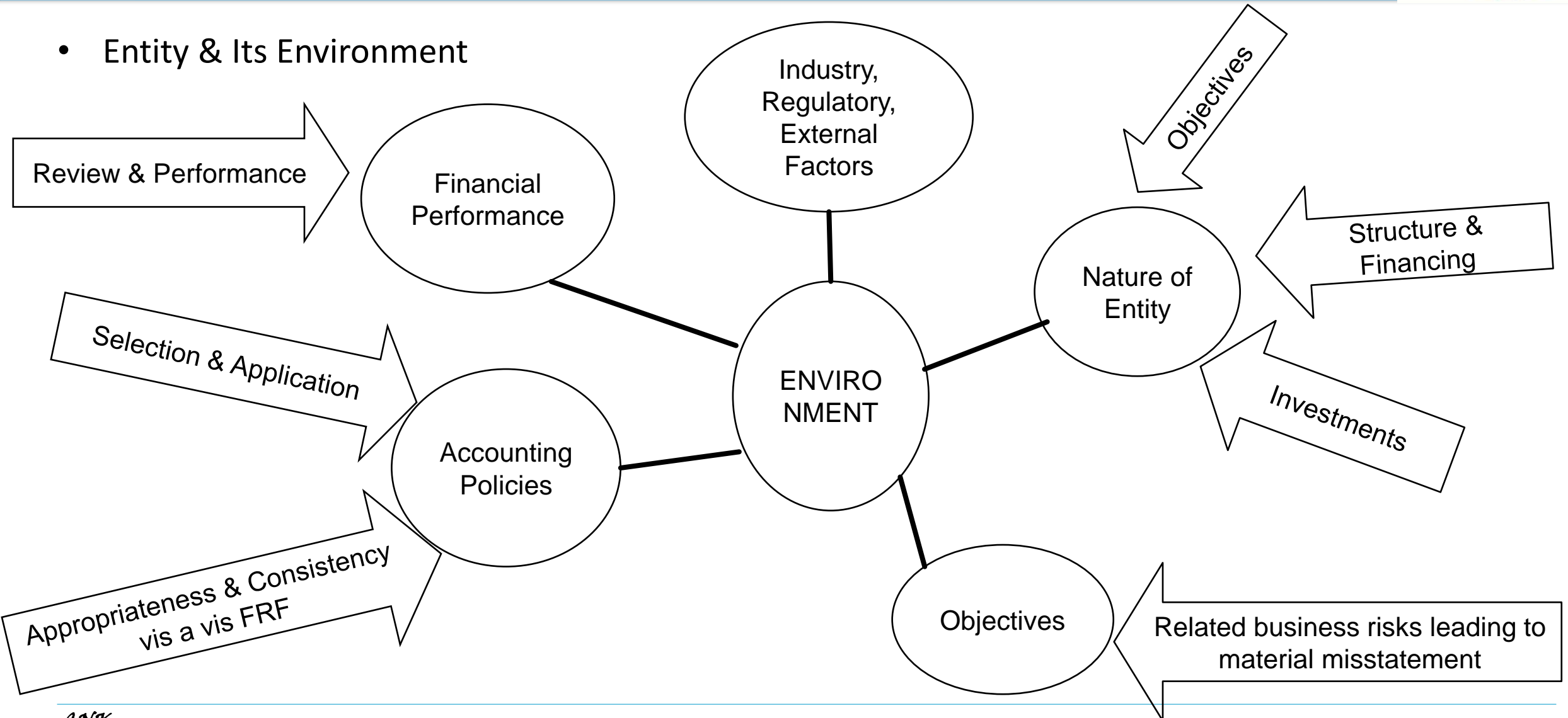
## NFRA Observation:

- i) The **Audit Firm** has performed no Analytical Procedures as risk assessment procedure and have failed to comply with Para A13 to Para A15 of SA 315.

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



- Entity & Its Environment



# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



- Now let us understand Internal Control in 4 different sections:
  1. General Nature and Characteristics of Internal Control.
  2. Controls Relevant to the Audit.
  3. Nature and Extent of the Understanding of Relevant Controls.
  4. Components of Internal Control.

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



## 1. Internal Control:

- Obtain an Understanding:
  - Not all controls are relevant to Financial Reporting.
  - Use Professional judgement.
- Purpose:
  - Reliable financial reporting.
  - Efficiency/ effectiveness of operations.
  - Compliance with laws & regulations.
  - Safeguarding of assets.
- Design, implementation & maintenance varies with size & complexity of entity.
  - Smaller Entity Consideration:
  - Internal controls – less structures & simple.

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



- Limitations:
  - Faulty human judgment.
  - Collusion among employees and/ or management.
  - Management override of controls.
  - Costs vs benefits.
  - Judgments as to nature & extent of risk assumed vis a vis controls.
- Small Entity Considerations
  - Fewer employees therefore less segregation of duties but closer owner oversight.
  - More chances of owner override of controls.

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



- Internal Controls – Benefits and Risks of Automated Controls

Benefits of automated controls	Risks of automated controls
Consistency in application	Inaccuracy in design
Enhanced timelines, availability & accuracy of information	Unauthorised access
Additional analysis possible	Unauthorised changes to master files
Better monitoring	Unauthorised changes to systems or programs
Reduced risk of circumvention of controls	Failure to make necessary changes to programs/systems.
Better segregation of duties	Inappropriate manual intervention
	Inability to access data

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



- Suitability of manual controls:
  - Large/unusual/ non recurring transactions.
  - Where errors are difficult to design/ predict.
  - Changing circumstances not covered by automated controls.
  - Monitoring effectiveness of controls.
- Manual controls less reliable because can be easily bypassed, ignored, overridden & more prone to errors– consistency cannot be assumed.
- Not suitable for:
  - High volume/ recurring transactions.
  - Control activities where automation is possible.



# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



## 2. Understanding Controls Relevant to Audit:

### – Factors to consider:

- Materiality.
- Significance of related risk.
- Size of entity.
- Nature of entity's business.
- How a specific control prevent/ detects & corrects misstatements.
- Legal/ regulatory requirements, etc

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



- Nature & extent of understanding controls relevant to audit:
  - Evaluate the design of these controls.
  - Determine their implementation.
- Procedures:
  - Inquiry of entity personnel.
  - Observing application of specific controls.
  - Inspecting documents & reports.
  - Tracing transactions through information system relevant to financial reporting.
- Understanding ICs alone not sufficient to test operating effectiveness unless there is some automation to ensure consistency.

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



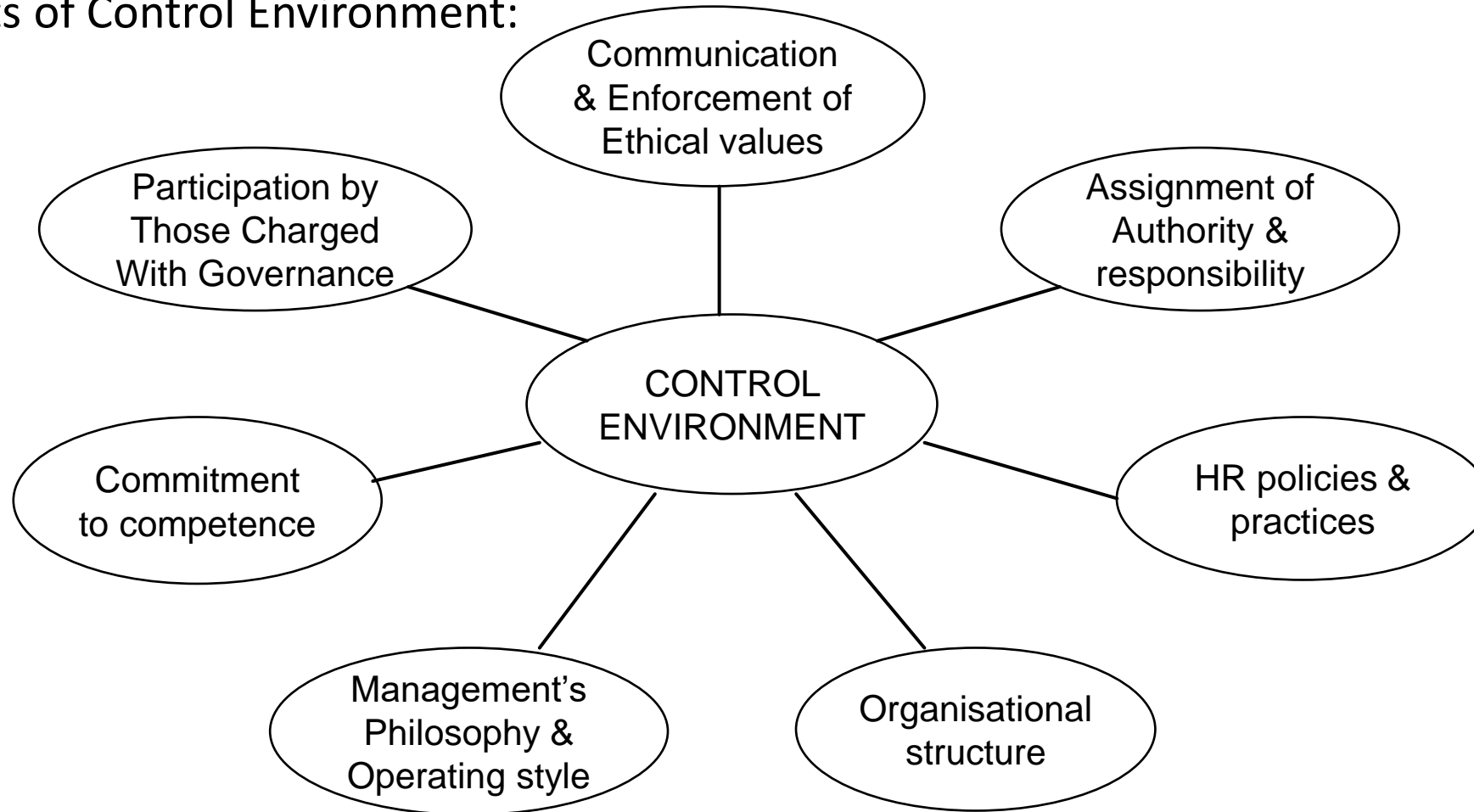
## 3. Components of Internal Control:

- Control Environment
- Control Activities
- Entity's Risk Assessment Procedures
- Information System
- Monitoring

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



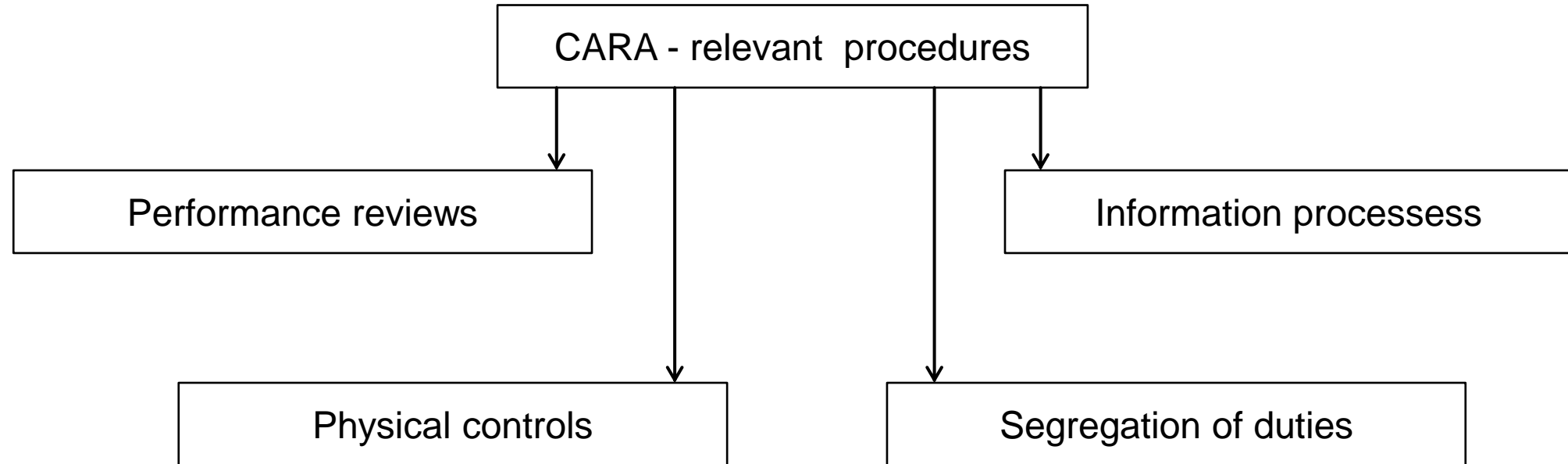
- Elements of Control Environment:



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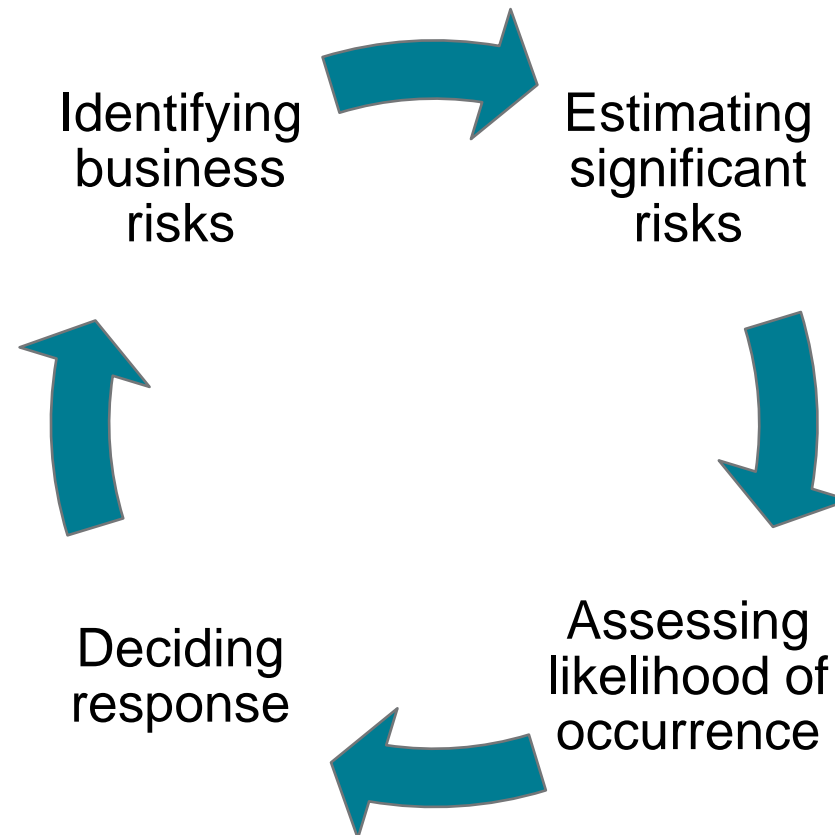


- Control Activities relevant to Audit– *relevant procedures*





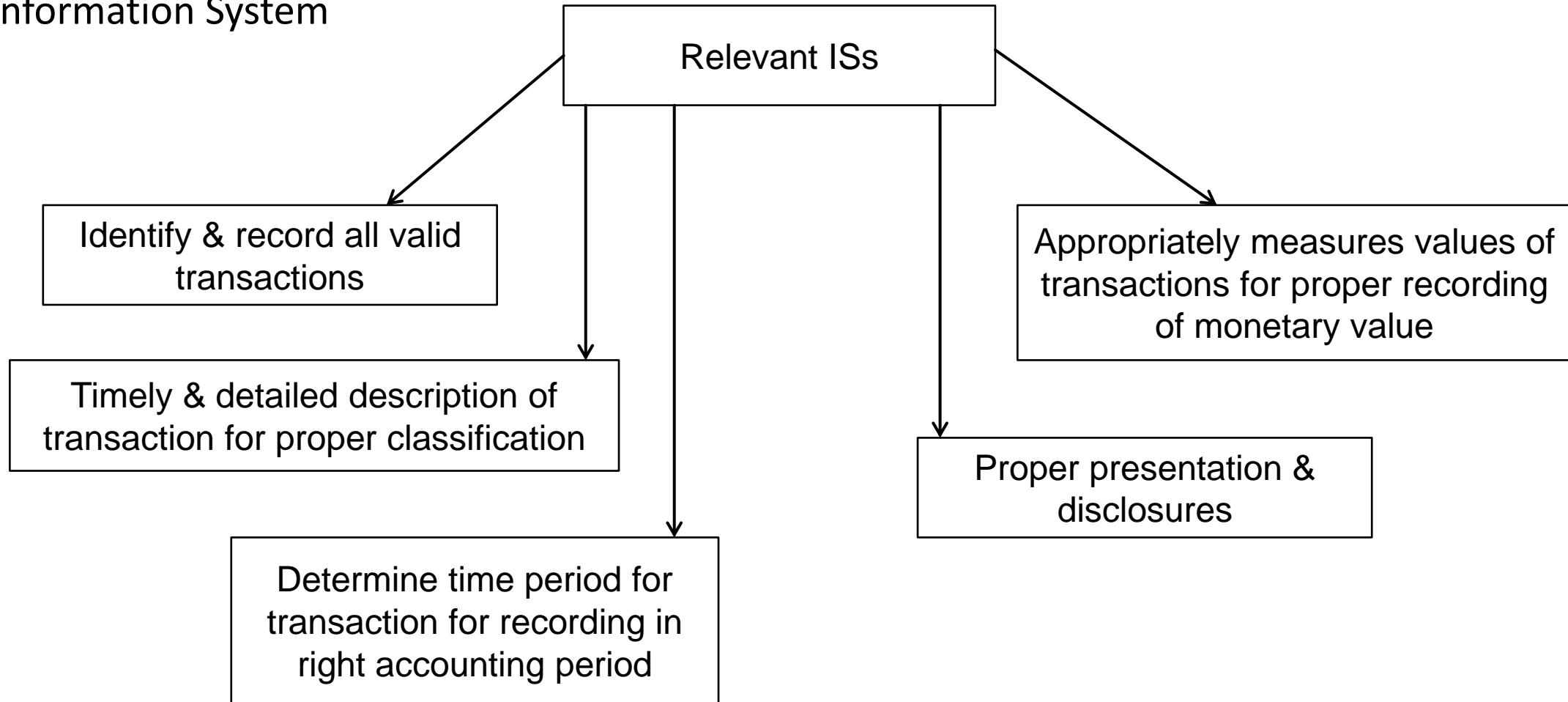
## Entity's Risk Assessment Procedures



# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



- Information System



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Information System – important Audit considerations

- Smaller Entity Considerations:
  - Info systems less sophisticated but role equally significant – understanding them is therefore important.
  - Active management --> less description of accounting procedures/ sophisticated accounting records/ written policies.
  - More of inquiry than review of documentation.
  - Less structured communication



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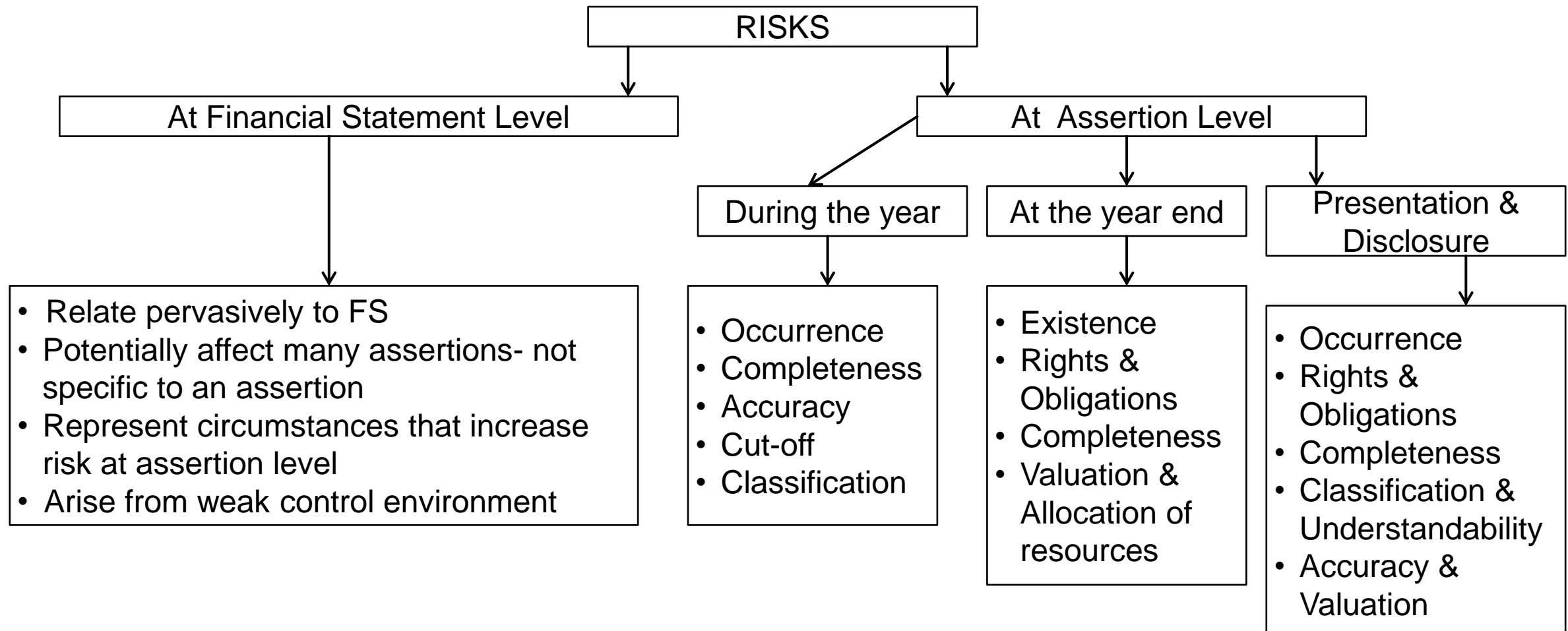


- Monitoring Controls
  - Process to assess effectiveness of IC performance over time.
  - Involves assessing effectiveness of controls on a timely basis & taking necessary remedial actions.
  - Done by separate evaluations or ongoing activities or combination of the two. Eg. Communication from external parties (eg. regulators).
- Understand:
  - Major monitoring activities.
  - Entity's Remedial Actions to deficiencies in controls.
  - Internal audit function, if existing in entity. Its responsibility, its organizational status and activities performed or to be performed.
  - Sources of information used in monitoring activities.
  - Basis upon which management assesses reliability of information.

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



- Identifying and Assessing ROMM



# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



- Conditions and Events that May Indicate Risks of Material Misstatement
  - Operations in regions that are economically unstable, for example, countries with significant currency devaluation or highly inflationary economies.
  - Operations exposed to volatile markets, for example, futures trading.
  - Operations that are subject to a high degree of complex regulation.
  - Going concern and liquidity issues including loss of significant customers.
  - Constraints on the availability of capital and credit.
  - Changes in the industry in which the entity operates.
  - Changes in the supply chain.
  - Developing or offering new products or services, or moving into new lines of business.
  - Expanding into new locations, etc

# SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment



## Documentation

- Discussion with engagement team and significant decisions reached.
- Key elements of understanding of entity, its environment & ICs.
- Identified & assessed risks of material misstatements at financial statement & assertion level.
- Risks that require special audit consideration.
- Risks for which substantive procedures alone do not suffice.
- Form & extent of documentation depends upon:
  - Nature, size & complexity of entity & ICs.
  - Availability of information from entity.
  - Audit methodology.
  - Technology used in audit

# SA 330: The Auditor's Responses to Assessed Risks



- Scope:
  - Auditor's responsibility to:
  - Design & implement responses to risk of material misstatements identified & assessed in accordance with SA 315.
- Objective:
  - Obtain sufficient appropriate audit evidence about the assessed risk of material misstatement:
    - Through designing & implementing appropriate responses to those risks
- Effective Date
  - Audits of financial statements for periods beginning on or after April 1, 2008.



## Definitions

- Substantive Procedures:
  - Audit Procedures designed to detect material misstatements at assertion level:
    - Tests of details – classes of transactions/ account balances/ disclosures.
    - Substantive analytical procedures.
  - Tests of Controls:
    - Audit Procedure for evaluating operating effectiveness of controls in preventing/ detecting & correcting material misstatement at assertion level

# SA 330: The Auditor's Responses to Assessed Risks



- Overall responses to be designed & implemented to address risk of material misstatement at Financial Statement level.
- May include:
  - Emphasizing on professional skepticism.
  - Assigning more experienced/ skilled staff or experts.
  - More supervision.
  - Incorporate unpredictability in audit procedures.
  - General changes to nature, timing & extent of audit procedures
- Overall responses affected by auditor's understanding of control environment:
  - Weakness in IC:
    - Conduct more audit procedures at period end.
    - Obtain more extensive audit evidence from substantive procedures.
    - Increase the number of locations to be audited.



- Audit Procedures Responsive to ROMM at Assertion Level
  - Design & perform further audit procedures to address identified ROMM at assertion level.
  - Nature, timing & extent of audit procedures should be based on this identified risk:
    - Only tests of controls would suffice ?
    - Only substantive procedures would suffice ?
    - Combined approach is needed?





## Further Audit Procedures-

- Designing further audit procedures:
  - Consider reason for assessment given to risk at assertion level.
    - Likelihood of material misstatement due to particular characteristic of that class of transactions/ account balance/ disclosure (Inherent Risk).
    - Whether risk assessment takes into account relevant controls (Control Risk) & consequently the operating effectiveness of controls.
  - Obtain more persuasive audit evidence the higher the auditor's assessment of risk.
  - Auditor may increase:
    - Quantity of the evidence, and
    - Obtain more reliable evidence.



- Smaller Entity Considerations
  - Not many control activities exist.
  - Extent of documentation of controls is limited.
  - Use substantive procedures.
  - In some cases – absence of control activities or a component of IC, obtaining appropriate audit evidence difficult.



## Tests of Controls

- Design and perform tests of controls (ToC) at assertion level when:
  - Auditor's expects controls are operating effectively.
  - Auditor intends to rely on operating effectiveness of controls to determine nature, timing & extent of substantive procedures.
  - Substantive procedures alone cannot provide SAAE
- ToC different from understanding & evaluating design & implementation of controls:
  - But same type of audit procedures used, so ToC can be done while obtaining understanding of IC.
- In designing & performing ToC, obtain more persuasive audit evidence to be able to place greater reliance on effectiveness of controls:
  - Especially where substantive procedures alone do not suffice.



- Extent of ToC – factors to consider:
  - Frequency of performance of control by entity during the period.
  - Length of time during the audit period of reliance on control effectiveness.
  - Expected rate of deviation from control.
  - Relevance & reliability of audit evidence at assertion level.
  - Extent to which audit evidence is obtained from tests of other controls related to the assertion
- Timing of TOC:
  - Reliance at a point of time – test controls at point of time. Eg. Controls over physical inventory counting.
  - Reliance over a period of time – test should be able to provide evidence that controls were effective over the period of time.



## Using Audit Evidence Obtained in Previous Audits:

- Before using evidence from previous audit:
  - Establish continuous relevance of that evidence.
  - Understand whether there is any change in relevant controls affecting the relevance of audit evidence by performing: Inquiry + Observation + Inspection.
  - If change in control – test controls in current audit.
  - If no change:
    - Test controls at least once in every third audit.
    - Test some controls each audit – provides corroborating evidence about continuing effectiveness.
  - Use professional judgment
- Greater reliance on controls/ higher ROMM → shorter time span between re-testing:



- Evaluating Operating Effectiveness of Controls:
  - Evaluate whether material misstatements detected by substantive procedures indicate controls are not working effectively:
    - Non detection of misstatements is not an evidence that relevant controls are effective.
  - Deviation from controls – inevitable but make specific inquiries to understand the matter & potential consequences & determine if:
    - ToC performed provide appropriate basis for reliance on controls.
    - Additional ToC are necessary.
    - Potential risk of misstatement to be addressed using substantive procedures.
    - Compare detected rate of deviation vis-a-vis expected rate of deviation.



- Substantive Procedures:
  - Irrespective of assessed risk of material misstatement, design & perform substantive procedures for each material class of transactions, account balance & disclosures
  - Consider whether external confirmation procedures are to be performed as substantive procedures.
  - Substantive APs used more in case of large volumes of data that tend to be predictable over time
  - Extent of substantive procedures increased if results of ToC are not satisfactory
  - Related to financial statement closing process
    - Agreeing/ reconciling financial statements with underlying accounting records.
    - Examining material journal entries & other adjustments
  - Responsive to Significant Risks
    - Substantive procedures should be specifically responsive to that significant risk.
    - Substantive procedures include ToD.



- Evaluating the Sufficiency & Appropriateness of Audit Evidence:
  - Before conclusion of audit, evaluate whether assessment of risk of material misstatement at assertion level remain appropriate.
  - Auditor cannot assume that an instance of fraud/ error is an isolated occurrence.
  - Sufficiency & appropriateness – consider all relevant audit evidence, regardless of whether it appears to corroborate or to contradict assertions in FS.
- Unable to obtain sufficient appropriate audit evidence:
  - Qualified/ disclaimer opinion.





- Documentation:
  - Overall responses to address assessed risks of material misstatement at FS level & NTE of further audit procedures.
  - Linkage of those procedures to assessed risks at assertion level.
  - Results of audit procedures & conclusions (where not clear).
  - Conclusions regarding operating effectiveness of controls tested in previous audit.
  - Demonstration that FS agree with underlying accounting records.
- Form and Extent of Documentation is matter of professional judgment

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**Thank You!!!**

[harshvardhandossa@cnkinidia.com](mailto:harshvardhandossa@cnkinidia.com)