

Audit Planning [SA 300] & Risk Assessment in Audit [SA 315]

**The Chamber of Tax Consultants
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Coverage in today's Session

Background

Summary of QRB findings

Glimpse of SA 300 – Planning & SA 315 risk of material misstatement

Key points – Practice oriented

Background

Is the step of 'planning and risk assessment' exclusively for audit profession ?

When does audit planning begin and stop ?

Biggest blunder – 'same as last year'

Modular approach to audit of non-corporate entities which are level II / III entities & SMC entities

Special consideration for Joint audits, interim audits / reviews, CFS

How this SA help in Firm's / Engagement 'Composite audit quality index'

**Findings of QRB-
SA 300 & 315
[Relevance of
compliance with
these standards]**

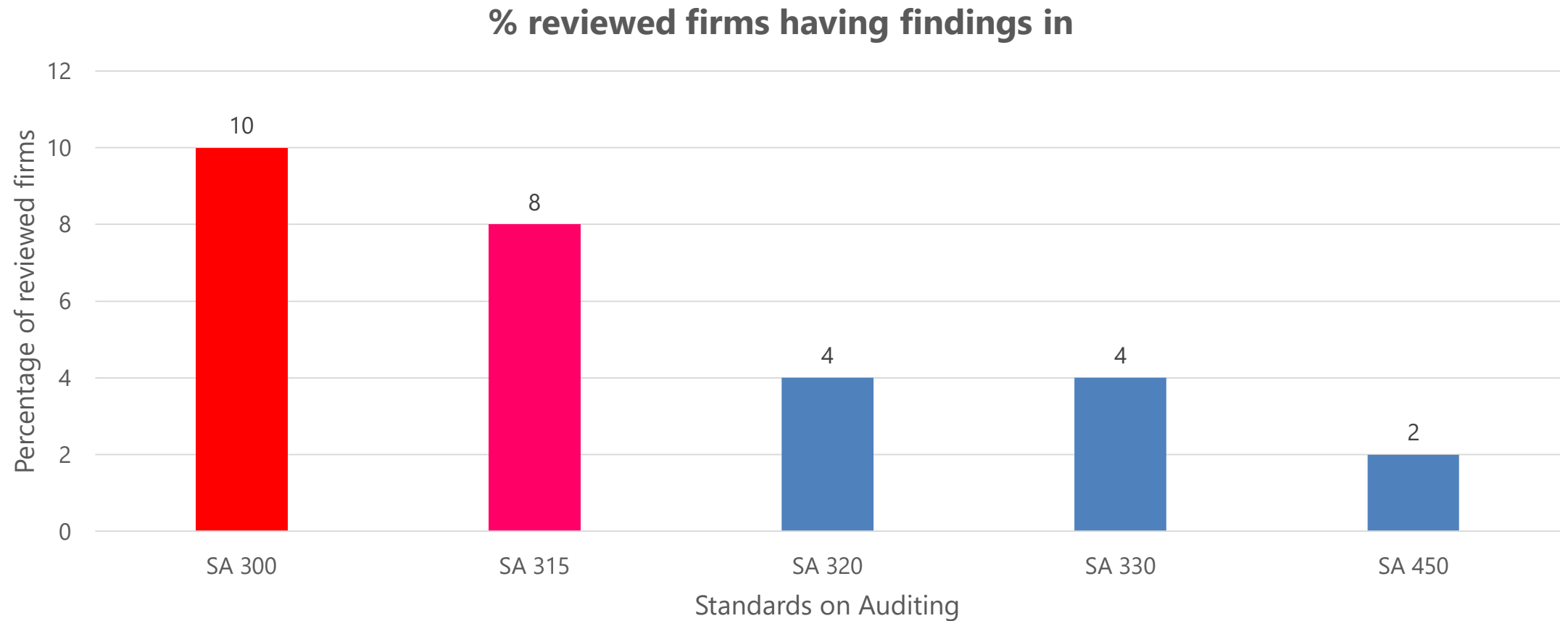
Focus Areas

Appropriate **identification** and assessment of material misstatements in the financial Statements as a whole and at the assertion level when developing an audit plan.

Entity specific - environment , risks and internal control, instead of merely completing templates provided by the audit firm.

Making appropriate **judgement**, when significant risks are identified and understanding internal control relevant to significant risks.

Risk Assessment & response to Assessed Risks



Non compliance of SA 300 – Audit Planning

Not specifying in audit programme, audit criteria or test programme necessary to satisfy audit objectives

- Sampling method and % not specified
- External direct confirmations from top parties and main bank accounts

Audit programme & procedures not updated in the light of experience gained during the course of the audit

- Adjustment entry not recorded for duty payment adjusted against license
- Input credit not availed as observed in transaction audit of purchases / expense

Not comprehensive - commensurate with the size and nature of the auditee

- Income tax & deferred tax not covered
- Audit of foreign branch excluded from audit programme

Non compliance of SA 300 – Audit Planning

Not making proper plan for limited review, treasury operations

- Impact of change in product mix on gross margins
- Expense variance analysis, update on management estimates, litigations

Not documenting the overall audit strategy and the audit plan

- Estimated time cost, interim review dates & final review timelines not covered

Not establishing client specific audit strategy

- System driven controls in ERP – change in audit approach & timeline

Non compliance of SA 315 – Identifying & Assessing the Risks of Material Misstatement

Not testing the effectiveness of the IT controls of the company

- Redundant access control rights as login credentials are available with everyone

Not performing risk assessment procedures in respect of transactions with related parties.

- Analysis of significant price variation in sales to related party and others

Not documenting assessed risks of material misstatement and consideration of fraud risk factors at the planning stage.

- Diversion of borrowed funds or variable pay based on turnover targets to KMP

Non compliance of SA 315 – Identifying and Assessing the Risks of Material Misstatement

Not documenting the risk assessment procedures.

- Enquiry and outcome of discussion with management for changes in estimates

Failure to document nature, timing and extent of test of control procedure to address the risk arising from control environment.

- Decentralised salary processing but in-built control with HO for changes in masters

“Give me six hours
to chop down a
tree and I will
spend the first
four ***sharpening
the axe.***”

- Abraham Lincoln

Glimpse of SA 300

S_{trategy}

- Understanding the characteristic of Audit
- Reporting objective
- Nature, time & extent of resources
- Results of preliminary activity

P_{lanning}

- Size and complexity of Auditee
- Past experience
- Change in circumstances
- RA & substantive procedures, extent of test of controls

D_{ocumentation}

- Overall audit strategy
- Overall audit plan
- Significant changes in audit strategy and audit plan and reasons thereof.

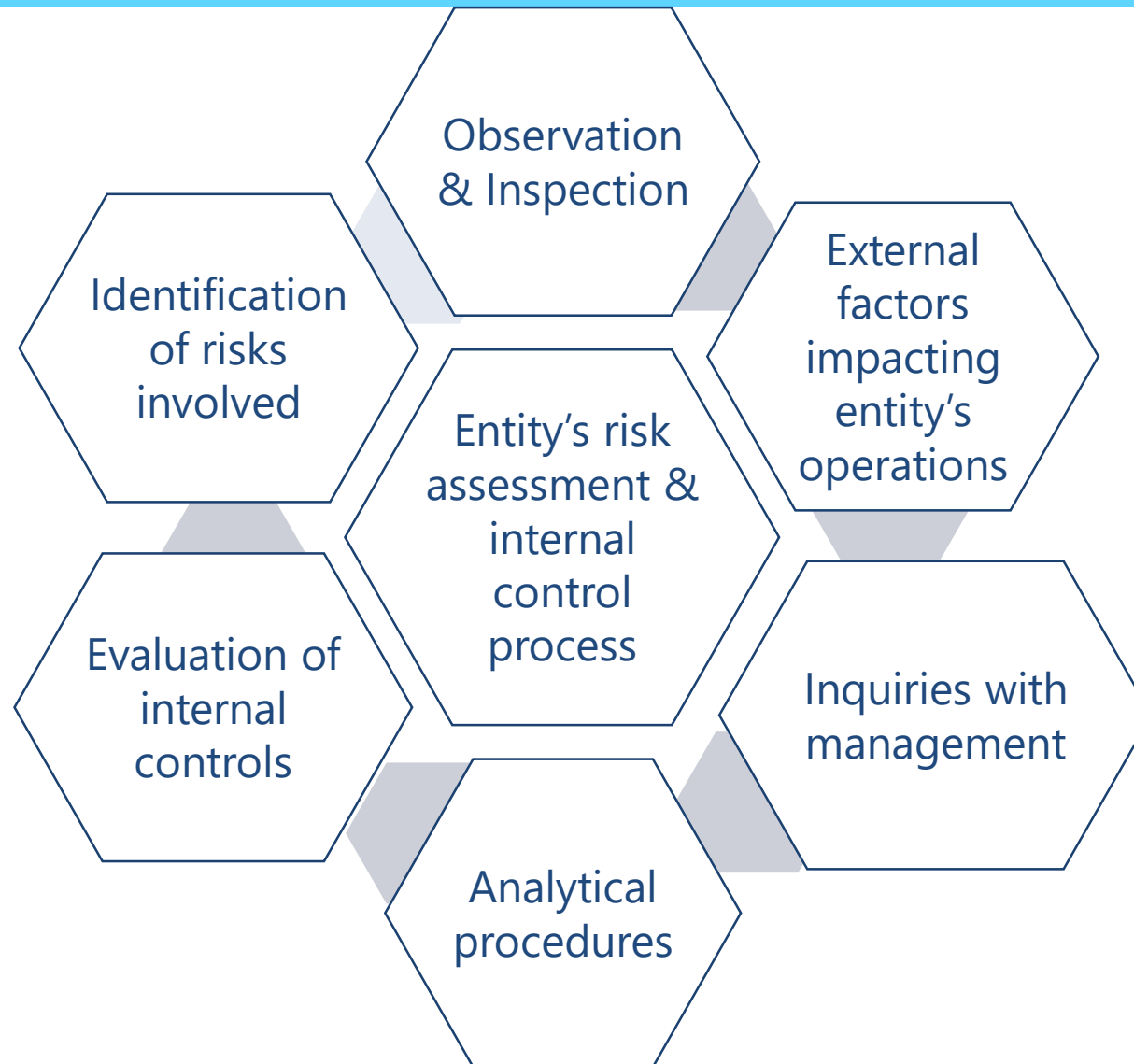
- Preliminary engagement activities
- Update on c/f points
- Analytical procedures
- General understanding
- Determine materiality
- Involvement of experts
- Other RA procedures

Risk Assessment is a matter of professional judgement

“Risk comes from not knowing what you are doing”

-Warren Buffet

Glimpse of SA 315



Key Points – Audit planning & risk assessment

Inquiry on recent updates relevant to auditee

New income
tax regime

Amnesty
schemes

Impact of
COVID-19

Changes in
labour laws

Adoption of
new Ind AS
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Impairment
of assets
(IL&FS, DHFL
& PMC bank)

What's Material?
Depends on How You
Define It

Concept of Materiality [SA 320]

Any information that affects the economic decision of the users.

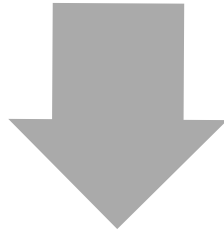
Based on Professional Judgement

Depends on size and nature of item – **Does standard give benchmark %**

Auditor to consider the cumulative effect of relatively small amounts

OVERALL MATERIALITY

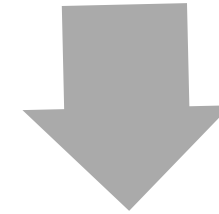
Used to determine if the financial statements as a whole are fairly stated.



This is to reduce the possibility that aggregate uncorrected and undetected misstatements in financial statements exceed materiality at financial statement level

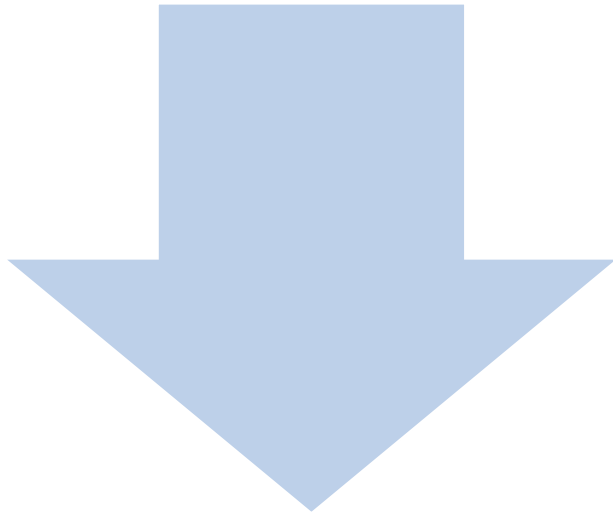
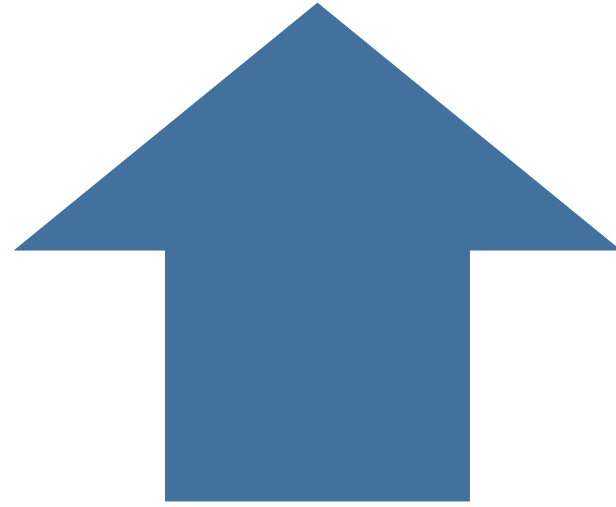
PERFORMANCE MATERIALITY

Used to design audit procedures at the Financial statements line items or class of transaction level or for disclosures.



This is to allow for the possibility that uncorrected and undetected misstatements of individual financial statement line items could in aggregate exceed to overall materiality threshold.

Higher
Materiality



Lower
Audit Risk

Determine Materiality

- Identify Audit risk- (High/ Medium/ Low)
- Identify benchmark- (PBT/ Revenue/ Total assets etc.)
- Compute overall materiality- (___ % of benchmark)
- Compute performance materiality- (___ % of overall materiality)
- Compute de minimis level- (___ % of overall materiality)

PLANNING STAGE

- Perform Audit procedures- (Substantive/Analytical)

EXECUTION STAGE

- Revise materiality, if required
- Opine whether financial statements are materially misstated

COMPLETION STAGE

Materiality – Practical Approach



Common Risks of material misstatements

- Cut off procedures not followed
- Incorrect depreciation/ Estimated useful life
- Provisions – double booking
- Accounting policies not followed
(Realignment not done)

Common Audit Adjustments

Provisions

Opening provisions not reversed

Inventory

NRV test for stock in hand

Income & Expenses

Cut-off procedures not followed

Significant Risks of Material Misstatements

- Fraud- Double payment
- Going Concern – Negative net worth
- Significant volume of transactions with related parties
- Claims not acknowledged as debts
- Integration with new ERP

Documentation of Risk assessment

- Preliminary discussion of past history for risks involved & new updates
- IT Control environment [e.g. authorization matrix, rights, decentralized]
- Reliable sources [approved results, minutes of board meeting]
- Going concern / Negative net worth
- Significant fluctuation in gross margins
- Limitation / exclusions in internal audit reports

Common Audit Disclosures

Prior period items & Subsequent events

- Disclosure in notes
- Impact on taxation
- Events before date of board meeting (adjusting & non-adjusting events)

Cash flow statement

- Write back of provisions
- Exchange fluctuation

Related party

- New party / new transaction not disclosed
- Date not specified

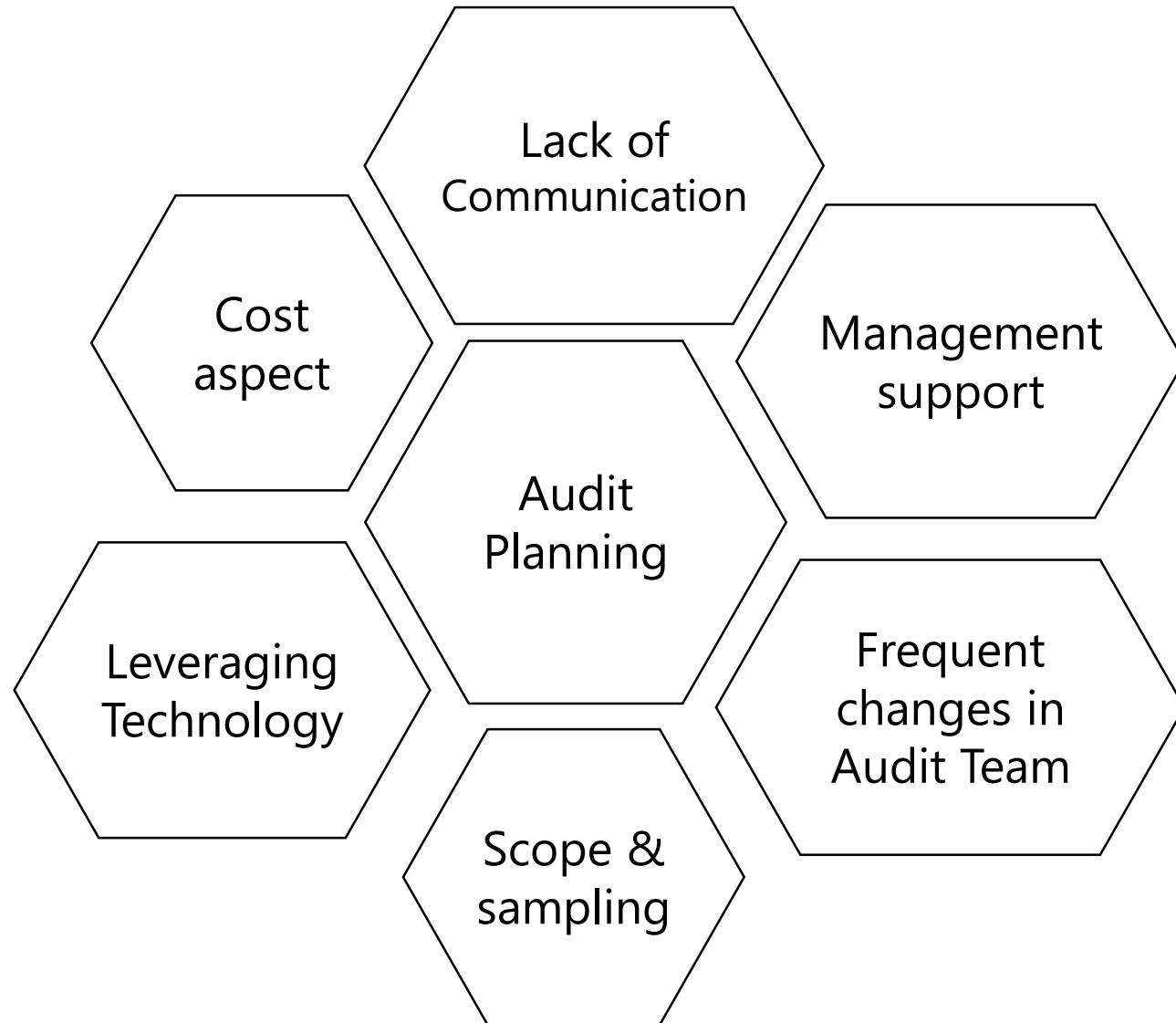
Consideration specific to SMEs

Promoter driven controls

Limitation in segregation of duties

Less sophisticated Information System

Practical difficulties-Audit Planning



Practical difficulties-Risk Assessment



Complexity in client's business (project revenue)

ERP controls (vulnerability test)

Related party transactions (referral fees & cost sharing)

Management estimates (variable staff incentive)

Failure to use appropriate risk metrics (IFC for disclosures in FS)

Assertions

- **Class of transactions & events**
 - occurrence, completeness, accuracy, cut-off, classification
 - Eg. Export benefit income
- **Account balances**
 - Existence, completeness, rights & obligations, valuation
 - Eg. Provision for product warranty claims
- **Presentation and disclosure**
 - Occurrence, completeness, classification, understandability, accuracy and valuation
 - Eg. Disclosure of research and development expenditure

Follow best audit practices

- Use of checklist – standard and customized to the extent relevant for client engagement. Also for Ind AS entities, checklist will have to be updated accordingly.
- Training to audit team members
- Use of technology to the extent relevant and ease
- Ensure no communication gap internally within audit team & client –be flexible and dynamic
- Formally document the steps followed
- Lastly, Do not water tight – build some contingency in planning and debriefing exercise



By failing to prepare, you are preparing to fail.

Benjamin Franklin



Thank You

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