

SA 315 Identifying and Assessing ROMM Through Understanding the Entity and its Environment

Objective

to **identify and assess ROMM**, whether due to fraud or error, at FS and assertion levels, **through understanding** the entity and its environment, including the entity's IC, thereby providing a basis for designing and implementing responses to the assessed ROMM.

Definitions

Assertions - Representations by **Mgt.**, explicit or otherwise, **that are embodied in the FS**, as used by auditor to consider the different types of potential misstatements that may occur.

Risk Assessment Procedures and Related Activities

Auditor shall perform **RAP** to provide a basis for the identification and assessment of ROMM at FS and assertion levels.

RAP shall include:

- Inquiries** of Mgt., of appropriate individuals and of others within the entity who may have information that is likely to assist in identifying ROMM.
- Analytical procedures.**
- Observation & inspection.**

Understanding of the Entity and its Environment, Including the Entity's IC (Knowledge of business)

Auditor shall obtain an understanding:

- Relevant industry, regulatory, and other external factors** including applicable **FRF**.
- Nature of the entity**, including:
 - its operations;**
 - its ownership and governance structures;**
 - the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and**
 - the way that the entity is structured and how it is financed;**

to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in FS.
- Entity's selection and application of accounting policies**, including the reasons for changes thereto.
- Entity's objectives and strategies**, and those **related business risks** that may result in ROMM.
- Measurement and review** of entity's financial performance.

Auditor shall obtain an understanding of whether the entity has a process for:

- Identifying **business risks** relevant to financial reporting objectives;
- Estimating **significance of risks**;
- Assessing **likelihood** of their occurrence; and
- Deciding about **actions to address those risks**

IS, including the related business processes

Auditor shall obtain an understanding of information system, including the related business processes, relevant to financial reporting, including the following areas:

- Classes of transactions** in entity's operations that are significant to the FS;
- Procedures**, within both information technology (**IT**) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to general ledger and reported in FS;
- Related accounting records**, supporting info. and specific accounts in the FS that are used to initiate, record, process and report transactions; this includes the correction of incorrect info. and how info. is **trfd** to the general ledger.
- How information system captures events and conditions**, other than transactions, that are **significant** to the FS;
- Financial reporting process** used to prepare the entity's FS, including significant accounting estimates and disclosures;

Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

Significant Risks

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

- Whether **risk is a risk of fraud**;
- Whether **risk is related to recent significant economic, accounting, or other developments** like changes in regulatory environment, etc., and, therefore, requires specific attention;
- Complexity of transactions**;
- Whether risk involves **significant transactions with related parties**;
- Degree of subjectivity** in measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- Whether risk involves **significant transactions** that are **outside the normal course of business**, or that otherwise appear to be unusual.

Process of Assessing Risk of MM

- Identify risks** throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering classes of transactions, account balances, and disclosures in FS;
- Assess** the **identified risks**, and **evaluate whether they relate more pervasively to the FS** as a whole and potentially affect many assertions;
- Relate** the identified risks to what can go wrong at assertion level, taking account of relevant controls that the auditor intends to test; and
- Consider likelihood of misstatement**, including the possibility of multiple misstatements, and whether potential misstatement is of a magnitude that could result in a MM.

IT benefits an IC by enabling an entity to:

- Enhance** timeliness, availability, and accuracy of info.
- Enhance** ability to monitor the performance of the entity's activities and its policies and procedures;
- Facilitate additional analysis of info.**
- Reduce risk that controls will be circumvented**

IT specific risks to an entity's IC, including, for ex-

- Possibility of **IT personnel gaining access privileges beyond** those necessary to perform their assigned duties thereby breaking down SOD.
- Unauthorised changes to data in **master files**.
- Unauthorised changes to systems or programs.
- Failure to make necessary changes** to systems or programs.
- Inappropriate manual intervention.**
- Potential loss of data** or **inability to access data** as required.

Sources of obtaining client info:

- Clients **annual report** to shareholders;
- Minutes** of shareholders/board of directors;
- Internal financial Mgt. reports** of current & previous year;
- Previous year **audit working papers**;
- Discussion with client**;