WT 4 (Ch. 3 – Risk Assessment and Internal Control)

Part – A (Multiple Choice Questions)

Q.1 (c) (2 Marks)

Q.2 (d) (2 Marks)

Q.3 (b) (1 Mark)

Q.4 (c) (1 Mark)

Q.5 (c) (1 Mark)

Part B (Descriptive Questions)

Q.1 (a) Statement is Incorrect:

Objective of Data Center and Network Operations is to ensure that production systems are processed to meet financial reporting objectives. Objective of Application system acquisition, development, and maintenance is to ensure that systems are developed, configured and implemented to meet financial reporting objectives. **(2 Marks)**

(b) Statement is incorrect.

The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement. **(2 Marks)**

Q.2 (i) (a) Inherent Risk **(1 Mark)**

(b) Control Risk **(1 Mark)**

(ii) **Risk of Material Misstatement:**

The risks of material misstatement may exist at two levels:

(a) **The overall financial statement level**: Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions. **(1 Mark)**

(b) **The assertion level for classes of transactions, account balances, and disclosures**: Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk. **(1 Mark)**

(iii) **Understanding of the Company's Automated Environment:**

As required by SA 315, auditor is required to obtain an understanding of the entity and its environment as a part of Risk Assessment procedure to identify and assess Risk of Material Misstatements.

While obtain an understanding of the company's automated environment, auditor should consider the following points:

- Information systems being used (one or more application systems and what they are)
- Their purpose (financial and non-financial)
- Location of IT systems - local vs global
- Architecture (desktop based, client-server, web application, cloud based)
- Version (functions and risks could vary in different versions of same application)
- Interfaces within systems (in case multiple systems exist)
- In-house vs Packaged
- Outsourced activities (IT maintenance and support)
- Key persons (CIO, CISO, Administrators)

(0.5 Mark for each Correct Point – Any six points)

Q.3 (a) Considerations w.r.t. understating of Information Systems:

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

(a) The classes of transactions in the entity's operations that are significant to the financial statements;

(b) The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;

(c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions;

(d) How the information system captures events and conditions that are significant to the financial statements;

(e) The financial reporting process used to prepare the entity's financial statements;

(f) Controls surrounding journal entries.

(1 Mark for each Correct Point – Any four points)

(b) Factors affecting identification of appropriate benchmark as per SA 320:

Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

(1) The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);

(2) Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);

(3) The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;

(4) The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and

(5) The relative volatility of the benchmark.

(1 Mark for each Correct Point – Any Three)

Q.4 (a) Application of Data Analytics:

In an automated environment, auditors can apply the concept of data analytics for several aspects of an audit including the following:

- Check completeness of data and population that is used in either test of controls or substantive audit tests.
- Selection of audit samples – random sampling, systematic sampling.
- Re-computation of balances – reconstruction of trial balance from transaction data.
- Reperformance of mathematical calculations – depreciation, bank interest calculation.
- Analysis of journal entries.
- Fraud investigation.
- Evaluating impact of control deficiencies.

(1 Mark for each Correct Point – Any Four)

(b) **Identification of Significant Risks**:

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

(1) Whether the risk is a risk of fraud;

(2) Whether the risk is related to recent significant economic, accounting, or other developments;

(3) The complexity of transactions;

(4) Whether the risk involves significant transactions with related parties;

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

(6) Whether the risk involves significant unusual transactions.

(1 Mark for each Correct Point – Any Three)