WT 2 (Ch. 3 – Audit Strategy, Planning and Execution & Ch. 4 – Risk Assessment and IC)

Instructions: Part A comprises of MCQ.

Part B comprises of descriptive questions.

Part – A (Multiple Choice Questions)

Q.1	(b)	**(2 Marks)**
Q.2	(a)	**(2 Mark)**
Q.3	(c)	**(1 Mark)**
Q.4	(c)	**(1 Mark)**
Q.5	(a)	**(1 Mark)**

Part B (Descriptive Questions)

Q. No. 1 is Compulsory. Attempt Any two from the rest.

Q.1(a): Designing and performing substantive procedures:

- SA 330 states that irrespective of the assessed risk of material misstatement, **the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure**. In the given situation, the auditor has assessed the risk of material misstatement to be low. However, despite such assessment, substantive procedures have to be performed. **(1 Mark)**
- **SA 330 further states that the auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures.** External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. **(1 Mark)**
- Despite the low assessed risk of material misstatement, substantive procedures have to be performed due to the **following reasons: -**

  (i) The auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement and

  (ii) there are inherent limitations to internal control, including management override. (1 Mark)
- It is also in accordance with the spirit of professional skepticism.

Conclusion: Approach of CA Y is in accordance with Standards on Auditing. **(1 Mark)**

Q.1(b): Agreement with Auditor's Expert:

- As per SA 620 "Using work of Auditor's Expert" the nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances, as may the respective roles and responsibilities of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore required that these matters are agreed between the auditor and the auditor's expert. **(1 Mark)**
- In certain situations, the need for a detailed agreement in writing is required like -
  - (i) The auditor's expert will have access to sensitive or confidential entity information.
  - (ii) The matter to which the auditor's expert's work relates is highly complex.
  - (iii) The auditor has not previously used work performed by that expert.
  - (iv) The greater the extent of the auditor's expert's work, and its significance in the context of the audit. **(2 Marks)**

Conclusion: Considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/engagement letter with the auditor's expert in respect of the work assigned to him. **(1 Mark)**

Q.2: Dealing with Risks arises to Fair Value Estimations:

As per SA 540 "Auditing Accounting Estimates, including Fair Value Accounting Estimates" auditor shall obtain an understanding of the following in order to identify and assess the risks of material misstatement for accounting estimates:

(a) The **requirements of the applicable FRF** relevant to accounting estimates. **(1 Mark)**

(b) **How management identifies** those transactions, events and conditions that may give rise to the need for accounting estimates.

In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing accounting estimates.

(1 Mark)

(c) The **estimation making process** adopted by the management including:

- (i) The method, including where applicable the model used in making the accounting estimates.
- (ii) Relevant controls.
- (iii) Whether management has used an expert.
- (iv) Assumptions underlying the accounting estimates.
- (v) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so why.
- (vi) Whether and if so, how the management has assessed the effect of estimation uncertainty.

(2 Marks)

(d) Auditor shall **review the outcome of accounting estimates** included in the prior period financial statements. **(1 Mark)**

Q.3(a): Determination of Audit Risk:

- Audit Risk is a function of two components: Risk of material Misstatement and Detection Risk, *i.e.* Audit Risk = Risk of material Misstatement × Detection Risk
- Risk of material Misstatement = Inherent risk × control risk
- Inherent Risk in this case is 40%.
- Control risk in the given case is 25% (100%-75%).
- Risk of material Misstatement = 40% × 25 % = 10% **(1 Mark)**
- Detection risk is the risk that the substantive procedures performed by the auditor fails to detect material misstatement. Detection Risk in the given case is 100-60 = 40%
- Overall Audit Risk = Risk of Material Misstatement × Detection Risk = 10 × 40% = 4%

(1 Mark)

Q.3(b): Components of Internal Control:

CA Z has gained an understanding of various IT controls operating in the company including General IT controls and application controls**. Such activities form part of "control activities", which is one of the components of internal control of an organization.**

Control activities are the policies and procedures that help ensure management directives are carried out. Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels. **(1 Mark)**

Examples of specific control activities include those relating to the following:

(a) Performance reviews

These control activities include reviews and analyses of actual performance versus budgets, forecasts, and prior period performance; relating different sets of data – operating or financial – to one another, together with analyses of the relationships and investigative and corrective actions; comparing internal data with external sources of information; and review of functional or activity performance. **(1 Mark)**

(b) Physical controls: Controls that encompass:

- The physical security of assets, including adequate safeguards such as secured facilities over access to assets and records.
- The periodic counting and comparison with amounts shown on control records (for example, comparing the results of cash, security and inventory counts with accounting records). **(1 Mark)**

Q.4: Standard Operating Procedures (SOPs) of assessment and evaluation of control:

(a) **Enterprise Risk Management**: Organization having robust processes to identify & mitigate risks across the entity & its periodical review will assist in early identification of weaknesses in internal control and taking effective control measures. In such entities, surprises of failures in controls is likely to be few. **(1 Mark)**

(b) **Segregation of Job Responsibilities**: Segregation of duties is an important element of control which ensures that no two commercial activities should be conducted by the same person. **(1 Mark)**

(c) **Job Rotation in Sensitive Areas**: In key commercial functions, job rotation is regularly followed to avoid degeneration of controls. **(1 Mark)**

(d) **Documents of delegation of Financial Powers**: Document on delegation of powers allows controls to be clearly operated without being dependent on individuals. **(1 Mark)**

(e) **IT based Controls**: In an IT Environment, it is much easier to embed controls through the system instead of being human dependent. The failure rate for IT embedded controls is likely to be low, is likely to have better audit trail & is thus easier to monitor. **(1 Mark)**