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SAS 145

November 18, 2024

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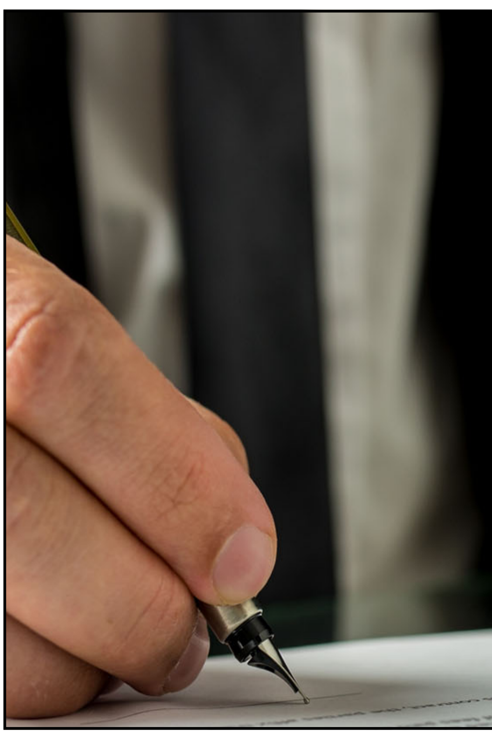

General Disclaimer

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Application of accounting and auditing principles is the responsibility of an organization's management and their independent public accountant.

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Learning Objectives

1. Describe impact of change on audit engagements
2. Recall changes to significant risk identification, inherent risk assessments and controls

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Common Deficiency

- Deficiencies in the auditor's risk assessment procedures is a common issue identified by practice monitoring programs in the United States and worldwide
  - In 2020 U.S. peer reviews, AU-C section 315 was the leading source of matters for further consideration (MFCs), constituting 25% of MFCs

Goal

- The ASB's project to enhance the auditing standards relating to the auditor's risk assessment was intended to enable auditors to appropriately address the following:
  - Understanding the entity's system of internal control, in particular, relating to the auditor's work effort to obtain the necessary understanding
  - Modernizing the standard in relation to IT considerations, including addressing risks arising from an entity's use of IT
  - Determining risks of material misstatement, including significant risks

Convergence

- The ASB has a strategic objective to converge with the International Standards on Auditing (ISAs)
  - ISA 315, Identifying and Assessing the Risks of Material Misstatement (Revised 2019) was used as the base

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Background

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Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

- Issued: October 2021

- Background:
  - Common Deficiency
  - Convergence

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Objective

- The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement

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Definition

Relevant Assertions

- An assertion about a class of transactions, account balance, or disclosure is relevant when it has an identified risk of material misstatement
  - The determination of whether an assertion is a relevant assertion is made before consideration of any related controls(i.e. based on inherent risk)

Levels of Risks

- Risks at the financial statement level relate pervasively to the financial statements as a whole and potentially affect many assertions

Levels of Risks Cont'd

- RMM is assessed at the assertion level in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence

RMM

- Risks of material misstatement at the assertion level consist of two components:

Inherent Risk

Control Risk

IR & CR

- A separate assessment of inherent risk and control risk is required

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RMM Cont'd

- A risk of material misstatement exists when
  - There is a reasonable possibility of a misstatement occurring (likelihood), and
  - If it were to occur, there is a reasonable possibility of the misstatement being material (magnitude)

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Spectrum of Risk

- Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others
  - The degree to which the level of inherent risk varies is referred to as the spectrum of inherent risk

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Definition

Significant Class of Transactions, Account Balance, or Disclosure

- A class of transactions, account balance, or disclosure for which there is one or more relevant assertions

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Cause of Risk

- Risks of material misstatement identified and assessed by the auditor include both those due to error and those due to fraud

Scalability

- Requirements are intended for audits of all entities, regardless of size or complexity
  - Application material incorporates considerations specific to both less and more complex entities, where appropriate
- Although the size of an entity may be an indicator of its complexity, some smaller entities may be complex, and some larger entities may be less complex

RAP

- The auditor's risk identification and assessment process is iterative and dynamic
- Initial expectations of risks may be developed, which may be further refined as the auditor progresses through the risk identification and assessment process

Response

- AU-C section 330 requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level
- AU-C section 330 also requires the auditor to design and perform further audit procedures whose nature, timing, and extent are based on and are responsive to the assessed risks of material misstatement at the relevant assertion level

Requirements

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Risk Assessment

- The auditor should design and perform risk assessment procedures to obtain audit evidence that provides an appropriate basis for
  - The identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, and
  - The design of further audit procedures in accordance with AU-C section 330

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Risk Assessment Cont'd

- The auditor should design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory

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RAP

- The risk assessment procedures should include:
  - Inquiries of management and of other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists)
  - Analytical procedures
  - Observation and inspection

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Audit Evidence

- In obtaining audit evidence, the auditor should consider information from
  - The auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement, and
  - When applicable, other engagements performed by the engagement partner for the entity

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Prior Evidence

- When the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor should evaluate whether such information remains relevant and reliable as audit evidence for the current audit

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Engagement Team Discussion

- The engagement partner and other key engagement team members should discuss the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement

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Not Present

- When there are engagement team members not involved in the engagement team discussion, the engagement partner should determine which matters are to be communicated to those members

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Inherent Risk Factors

- Characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure, before consideration of controls. Such factors may be qualitative or quantitative and include complexity, subjectivity, change, uncertainty, or susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk.
- Depending on the degree to which the inherent risk factors affect the susceptibility of an assertion to misstatement, the level of inherent risk varies on a scale that is referred to as the spectrum of inherent risk.

Understanding the Entity

- The auditor should perform risk assessment procedures to obtain an understanding of
  - Aspects of the entity and its environment:
    - The entity's organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT
    - Industry, regulatory, and other external factors
    - The measures used, internally and externally, to assess the entity's financial performance
  - The applicable FRF and the entity's accounting policies and the reasons for any changes thereto
  - How inherent risk factors affect the susceptibility of assertions to misstatement and the degree to which they do so, in the preparation of the financial statements in accordance with the applicable FRF

Inherent Risk Factors

- Inherent risk factors may be qualitative or quantitative and affect the susceptibility of assertions to misstatement
  - Inherent risk factors are characteristics of events or conditions that affect susceptibility of an assertion about a class of transactions, account balance, or disclosure, to misstatement, whether due to fraud or error, and before consideration of controls

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Inherent Risk Factors Cont'd

- Qualitative inherent risk factors relating to the preparation of information required by the applicable FRF include:

Complexity | Subjectivity | Change

Uncertainty | Susceptibility*

*Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk

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Appendix B

Relevant inherent risk factor	Examples of events and conditions that may indicate the existence of risks of material misstatement at the assertion level
Complexity	Regulatory: • Operations that are subject to a high degree of complex regulation Business model: • The existence of complex alliances and joint ventures Applicable financial reporting framework: • Accounting measurements that involve complex processes Transactions: • Use of off-balance-sheet financing, variable interest entities, and other complex financing arrangements
Subjectivity	Applicable financial reporting framework: • A wide range of possible measurement criteria of an accounting estimate, for example, management's recognition of depreciation or construction income and expenses • Management's selection of a valuation technique or model for a noncurrent asset, such as investment properties

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Accounting Policies

- The auditor should evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework

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Definition

System of Internal Control

- The system designed, implemented, and maintained by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations

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Definition Cont'd

- For purposes of GAAS, consists of five interrelated components:
  1) Control environment
  2) The entity's risk assessment process
  3) The entity's process to monitor the system of internal control
  4) The information system and communication
  5) Control activities

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Control Environment

- The auditor should, through performing risk assessment procedures, obtain an understanding of the control environment relevant to the preparation of the FS by
  - Understanding the set of controls, processes, and structures that address
    - How management's oversight responsibilities are carried out, such as the entity's culture and management's commitment to integrity and ethical values;
    - When those charged with governance are separate from management, the independence of, and oversight over the entity's system of internal control by, those charged with governance;
    - The entity's assignment of authority and responsibility;
    - How the entity attracts, develops, and retains competent individuals;
    - How the entity holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control; and

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Control Environment Cont'd

- Evaluating, based on the auditor's understanding obtained whether
  - Management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior;
  - The control environment provides an appropriate foundation for the other components of the entity's system of internal control considering the nature and complexity of the entity; and
  - Control deficiencies identified in the control environment undermine the other components of the entity's system of internal control

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Risk Assessment Cont'd

- The auditor should, through performing risk assessment procedures, obtain an understanding of the entity's risk assessment process relevant to the preparation of the financial statements by
  - Understanding the entity's process for
    - Identifying business risks, including the potential for fraud, relevant to financial reporting objectives;
    - Assessing the significance of those risks, including the likelihood of their occurrence;
    - Addressing those risks; and
  - Evaluating, based on the auditor's understanding obtained, whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and complexity of the entity

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Risk Assessment Cont'd

- If the auditor identifies RMM that management failed to identify, the auditor should
  - Determine whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process and, if so, obtain an understanding of why the entity's risk assessment process failed to identify such RMM; and
  - Consider the implications for the auditor's evaluation

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Monitoring

- The auditor should obtain an understanding of the entity's process for monitoring the system of internal control relevant to the preparation of the financial statements by
  - Understanding those aspects of the entity's process that address
    - Ongoing and separate evaluations for monitoring the effectiveness of controls and the identification and remediation of control deficiencies identified and
    - The entity's internal audit function, if any, incl its nature, responsibilities, & activities
  - Understanding the sources of the information used in the entity's process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose
  - Evaluating, based on the auditor's understanding, whether the entity's process for monitoring the system of internal control is appropriate to the entity's circumstances considering the nature and complexity of the entity

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Information & Communication

- The auditor should obtain an understanding of the entity's information system and communication relevant to the preparation of the financial statements by
  - Understanding the entity's information-processing activities, including its data and information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances, and disclosures
    - How information flows through the entity's information system, including how
      - Transactions are initiated, and how information about them is recorded, processed, corrected as necessary, incorporated in the general ledger, and reported in the financial statements and
      - Information about events and conditions, other than transactions, is captured, processed, and disclosed in the financial statements,
    - The accounting records, specific accounts in the financial statements, and other supporting records relating to the flows of information in the information system,
    - The financial reporting process used to prepare the entity's financial statements, including disclosures, and
    - The entity's resources, including the IT environment

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Information & Communication Cont'd

- Understanding how the entity communicates significant matters that support the preparation of the financial statements and related reporting responsibilities in the information system and other components of the system of internal control
  - Between people within the entity, including how financial reporting roles and responsibilities are communicated,
  - Between management and those charged with governance,
  - With external parties, such as those with regulatory authorities
- Evaluating, based on the auditor's understanding obtained, whether the entity's information system and communication appropriately support the preparation of the entity's financial statements in accordance with the applicable financial reporting framework considering the nature and complexity of the entity

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Control Activities

- The auditor should identify the following controls that address RMM at the assertion level:
  - Controls that address a risk that is determined to be a significant risk
  - Controls over JEs & other adjustments required by AU-C 240
  - Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures, which should include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence
  - Other controls that, based on the auditor's professional judgment, the auditor considers are appropriate

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Definition

General Information Technology (IT) Controls

- Controls over the entity's IT processes that support the continued proper operation of the IT environment, including the continued effective functioning of information-processing controls and the integrity of information in the entity's information system

IT Environment

- The IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies. For the purposes of this definition
  - An IT application is a program or a set of programs that is used in the initiation, processing, recording, and reporting of transactions or information. IT applications include data warehouses and report writers.
  - The IT infrastructure comprises the network, operating systems, and databases and their related hardware and software
  - The IT processes are the entity's processes to manage access to the IT environment, manage program changes or changes to the IT environment, and manage IT operations

Definition

Information-Processing Controls

- Controls relating to the processing of information in IT applications or manual information processes in the entity's information system that directly address risks to the integrity of information

IT Controls

- The auditor should identify the IT applications and the other aspects of the entity's IT environment that are subject to risks arising from the use of IT
  - Identify the following:

The related risks arising from the use of IT	The entity's general IT controls that address such risks

Definition

Controls

- Policies or procedures that an entity establishes to achieve the control objectives of management or those charged with governance
- In this context
  - Policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions
  - Procedures are actions to implement policies

Controls

- For each control identified
  - Evaluate whether the control is designed effectively to address the RMM at the assertion level or effectively designed to support the operation of other controls
  - Determine whether the control has been implemented by performing procedures in addition to inquiry of the entity's personnel

Direct vs. Indirect

- Direct controls are controls that are precise enough to address RMM at the assertion level
- Indirect controls are controls that support direct controls. Although indirect controls are not sufficiently precise to prevent, or detect and correct, misstatements at the assertion level, they are foundational and may have an indirect effect on the likelihood that a misstatement will be prevented or detected on a timely basis.

Common Deficiencies in ICFR

- Based on the auditor's understanding and evaluation of the components of the entity's system of internal control, the auditor should determine whether one or more control deficiencies have been identified

Identifying Risks

- The auditor should identify the risks of material misstatement and determine if they exist at
  - The financial statement level
  - The assertion level for classes of transactions, account balances, and disclosures
- The auditor should determine the relevant assertions and the related significant classes of transactions, account balances, and disclosures

Assessing Risk at Financial Statement Level

- For identified risks of material misstatement at the financial statement level, the auditor should assess the risks and
  - Determine whether such risks affect the assessment of risks at the assertion level, and
  - Evaluate the nature and extent of their pervasive effect on the financial statements

Assessing Inherent Risk at Assertion Level

- For identified RMM at the assertion level, the auditor should assess inherent risk by assessing the likelihood and magnitude of misstatement
- Take into account how and the degree to which
  - Inherent risk factors affect the susceptibility of relevant assertions to misstatement, and
  - The RMM at the financial statement level affect the assessment of inherent risk for RMM at the assertion level

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Assessing Risk

- The auditor should determine whether any of the assessed RMM are significant risks
- The auditor should determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the RMM at the assertion level

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Definition

Significant Risk

- An identified risk of material misstatement
  - For which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur, or
  - That is to be treated as a significant risk in accordance with the requirements of other AU-C sections

Assessing Control Risk

- For identified RMM at the assertion level, the auditor should assess control risk based on the auditor's understanding of controls and the auditor's plan to test the operating effectiveness of controls
  - If the auditor does not plan to test the operating effectiveness of controls, the auditor should assess control risk at the maximum level such that the assessment of the **RMM is the same as the assessment of inherent risk**

Evaluating Audit Evidence

- The auditor should evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the RMM
  - If not, the auditor should perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis
- In identifying and assessing the RMM, the auditor should take into account all audit evidence obtained from the risk assessment procedures, whether **corroborative or contradictory** to assertions made by management

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Not Significant but Material

- For material classes of transactions, account balances, or disclosures that have not been determined to be significant classes of transactions, account balances, or disclosures, the auditor should evaluate whether the auditor's determination remains appropriate

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Iterative Process

- If the auditor obtains new information that is inconsistent with the audit evidence on which the auditor originally based the identification or assessments of the RMM, the auditor should revise the identification or assessment

Audit Documentation

- The auditor should include in the audit documentation
  - The discussion among the engagement team and the significant decisions reached;
  - Key elements of the auditor's understanding of risk; the sources of information from which the auditor's understanding was obtained; and the risk assessment procedures performed;
  - The evaluation of the design of identified controls, and determination whether such controls have been implemented
  - The identified and assessed RMM at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made

Effective Date

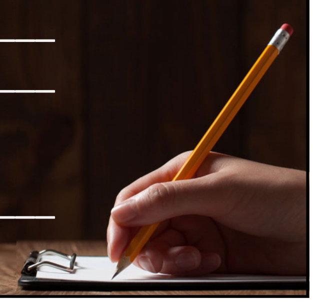
- For audits of financial statements for periods ending on or after December 15, 2023

3, 2, 1 Method of Applying New Knowledge

3 things I learned
____
____
____

2 actions to apply what I learned
____
____

1 way I will share my learning
____



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What Questions Do You Have?

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