

Workshop on Audit Risk Assessment

Day 2

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THE INSTITUTE OF
**CHARTERED
ACCOUNTANTS**
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Overall outline

- fraud risk
- business/operational processes and controls
- audit materiality
- interactive audit materiality calculations
- interactive preliminary audit analytics
- financial statements level risks with examples
- assertions level risks with examples
- general it controls

None of it's just a recap!!

- Fraud
- Consequences
- Simulation
- Fraud triangle
- Materiality



THE GLOBAL COST OF FRAUD



1,921
CASES

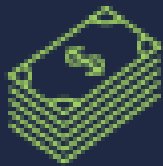
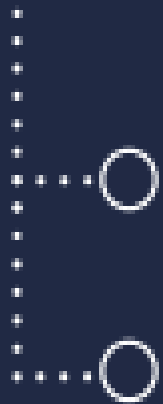
from



138
COUNTRIES and
TERRITORIES

Causing total
losses of more than

\$3.1 BILLION



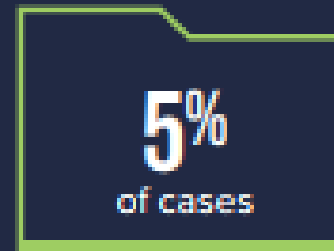
\$1,662,000

Average loss per case



22% of cases had losses of
\$1 million+

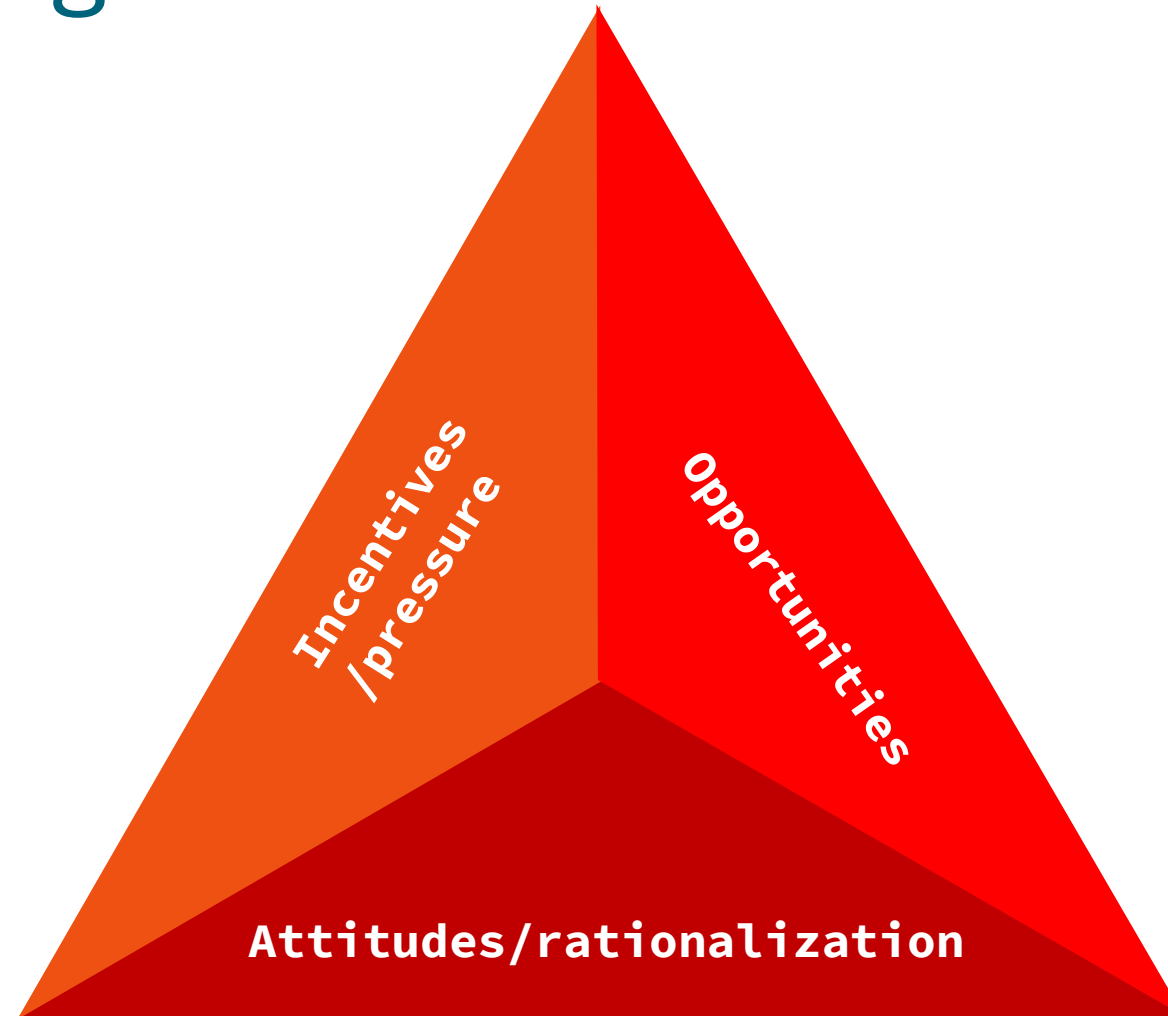
FINANCIAL STATEMENT FRAUDS
are the least common but most costly



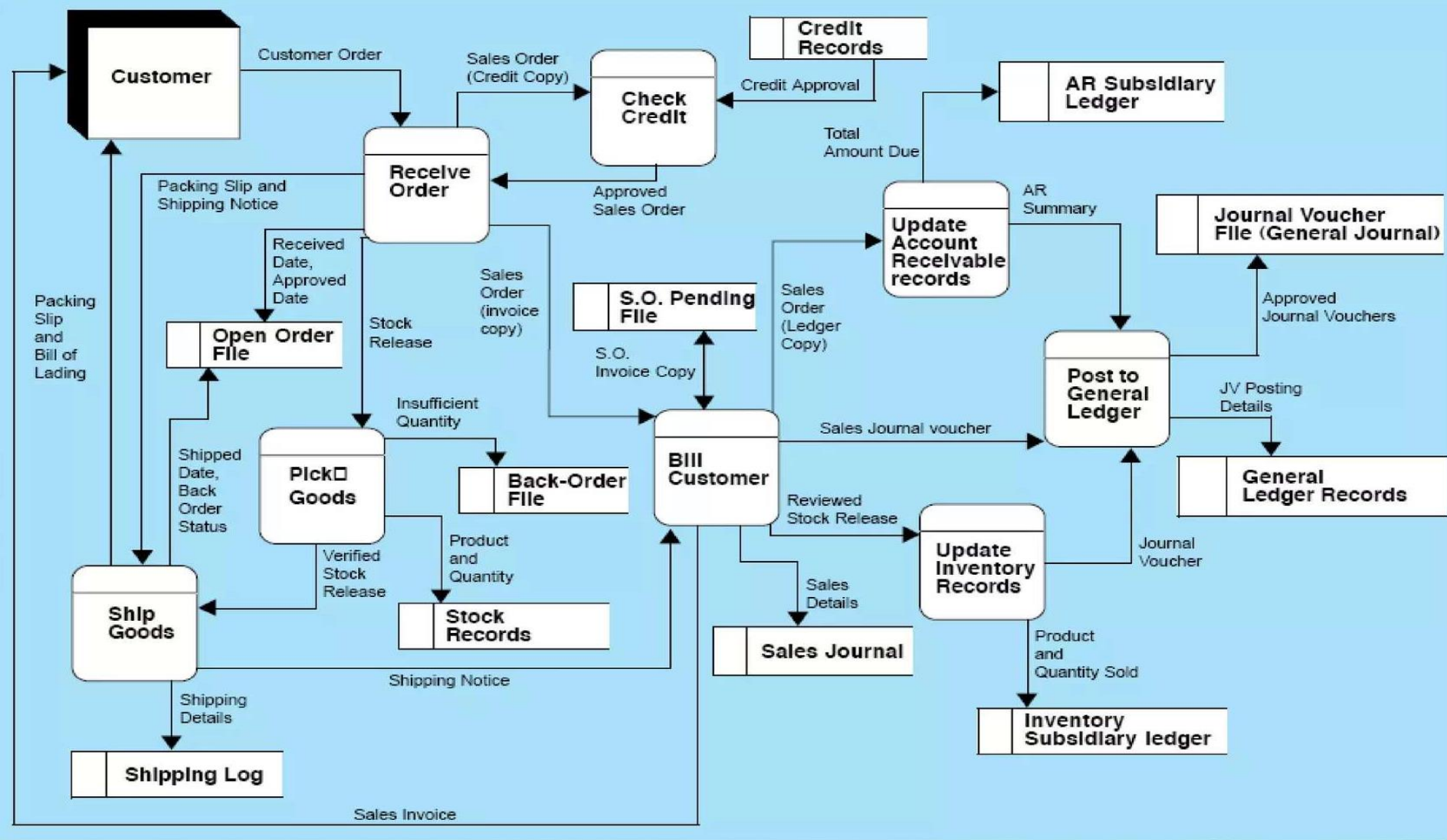
5%
of cases

\$766,000
median loss

Fraud Triangle



DFD of sales order process



“

Information is MATERIAL if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

”

The changes are effective from 1 January 2020



Get, set, go...



Follow the white dot



Materiality

“

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Key audit terms

- RMM
- Significant Risk
- Audit Assertions
- SCOT
- Audit Risk

Key financial information

Financial Data

Metric	2022	2021	2020
Revenue	BDT 250M	BDT 180M	BDT 150M
Net Income	BDT 30M	BDT 20M	BDT 15M
Total Assets	BDT 200M	BDT 160M	BDT 137M
Total Liabilities	BDT 90M	BDT 75M	BDT 60M
Total Equity	BDT 110M	BDT 85M	BDT 77M

Determining Materiality

- Applying a reasonable measurement percentage to an appropriate benchmark
- Determining the materiality amount and evaluating the appropriateness of the amount considering the firm's parameters related to appropriate benchmarks and reasonable measurement percentages.

Professional judgement

Selecting an appropriate benchmark and determining a reasonable measurement percentage is a matter of **PROFESSIONAL JUDGEMENT.**

Determined Amount

- Determined Amount 1,000,000
- Evaluate against appropriate benchmarks

Benchmark	Percentage	Amount
Revenue	3%	300,000
Net Income	10%	1,000,000

Documentation

More extensive audit

DOCUMENTATION may also be included when determining the materiality amount and evaluating the appropriateness of the amount.



Benchmarks and measurement percentages

The following factors may affect the selection of the appropriate benchmark or measurement percentage:

- The financial statement elements and items that financial statement users focus on
- The nature of the entity, where the entity is in its life cycle, and its industry, economic, and regulatory environment
- The entity's ownership structure and the way it is financed
- The relative volatility of the benchmark. [ISA 320.A4]

Benchmarks and measurement percentages some examples

Indicative Benchmark	Indicative Measurement percentage
Profit before tax	Up to 10%
Equity/net assets (except employee benefit plans)	Up to 10%
Gross profit	Up to 4%
Earnings before interest, tax, depreciation, and amortization (EBITDA)	Up to 5%
Total revenues	Up to 3%
Total expenses	Up to 3%
Total assets	Up to 2%

The above benchmarks and respective percentages are for indicative purpose only. It is the responsibility of the firm to select and apply the benchmarks and percentages appropriately.



Selecting an appropriate benchmark

- Depends on the nature of the entity
- Depends on changing circumstances
- Not always static/ may change year to year

Selecting a reasonable measurement percentage

- Concentration of ownership or management
- Level of debt and debt arrangements
- Business environment
- the percentage will often decrease as the size and complexity of the entity increases.

Factors to consider

Factors to consider when selecting an appropriate benchmark or measurement percentage:

- financial statement elements and whether there are items on which financial statement users focus
- nature of the entity, where the entity is in its life cycle, and its industry and economic environment
- entity's ownership structure and the way it is financed
- relative volatility of the benchmark

Performance Materiality

- **LESS** than materiality
- **REDUCE PROBABILITY** of aggregate uncorrected and undetected misstatement
- a matter of **PROFESSIONAL JUDGMENT**
- should **Not Exceed 75%** of materiality

New developments

Cutting-Edge Wearable Ring Development - NovaRing

Description: NovaRing is a revolutionary wearable ring designed to monitor health data, including heart rate, blood oxygen levels, sleep patterns, and stress levels. It uses advanced AI algorithms to provide personalized health insights.

Stage of Development: The product is in the late stages of R&D but has not yet reached full maturity. Key challenges remain in miniaturizing the technology and ensuring regulatory compliance.

Market Expectations: Analysts predict that NovaRing could capture a 10% market share in the wearable health tech industry within two years of launch.

The global wearable health tech market is projected to grow to USD7.5 billion by 2025, making NovaRing a potential game-changer for TechNova.

New developments

Financial Implications

R&D Costs: TechNova has invested BDT 5 million in NovaRing over the past three years including BDT 1 million during 2022, with an additional BDT 2 million budgeted for 2023.

Revenue Projections: If successful, NovaRing could generate BDT 20 million in annual revenue by 2025.

Investor Pressure: Shareholders and venture capital partners are eager to see a return on their investment, creating significant pressure on management to deliver results.

Specific materiality!

The materiality level or levels for one or more particular classes of transactions, account balances, or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of the users taken on the basis of the financial statements.

Materiality for particular classes of transactions, account balances, or disclosures

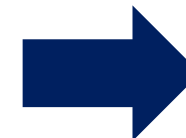
IF...

Transactions, account balances, or disclosures for which misstatements could reasonably be expected to influence the economic decisions of the financial statement users



Then...

The engagement team determines the materiality level or levels to be applied to those classes of transactions, account balances, or disclosures



This is referred to as materiality for a particular class of transactions, account balances, or disclosures

Lower Performance Materiality

- To address **RISK** within a particular class of transactions, account balance or disclosure.
- Risk material misstatement due to **FRAUD**

Recap

- **LOWER MATERIALITY** for particular classes of transactions, account balances, or disclosures
- If lower materiality is determined, it's required to calculate lower performance materiality
- **LOWER PERFORMANCE MATERIALITY** to address specific risk

Quick quiz!

In which scenario is it likely that a misstatement less than materiality in each of the classes of transactions, account balances, or disclosures would influence the economic decisions of a user? Assuming that materiality is 500,000.

- The entity has an asset retirement obligation for 300,000 and if it is not fully satisfied within the terms of the executed contract, the entity could be subjected to penalties up to 2,000,000
- Management has just completed the acquisition of an entity for an amount less than 500,000, but this transaction will need to be disclosed separately in the financial statements
- The entity entered into an arrangement with a sister entity for 400,000 worth of management services

Audit Observation

The calculated depreciation charge for fixed assets during the year is Tk. 1,294,569, whereas the draft accounts show a depreciation value of Tk. 1,298,116. This results in a discrepancy of Tk. 3,547;

What would we do?

Trivial amount

- clearly inconsequential, whether taken individually or in aggregate

Check! Check!! Check again!!!

- Revision as the audit progresses
- Reassessment prior to evaluating uncorrected misstatements

Application of Materiality

- Planning and performing the audit
- Evaluating the effect of any identified misstatements (corrected and uncorrected) on the audit
- Evaluating the effect of any uncorrected misstatements on the financial statements
- Forming an opinion on the financial statements as a whole. [ISA 320.5, ISA 320.8, ISA 320.A1]

Get your facts straight!

- Can we determine separate materiality amounts for different statements (for example, the statement of financial position and statement of comprehensive income)?
- Is there a threshold whereby actual financial results differ from the anticipated results resulting in a need to revise materiality?
- Why is it important to reassess materiality prior to evaluating the effect of uncorrected misstatements?
- When we have a lower materiality amount for a particular class of transactions, account balance, or disclosure, do we need a lower trivial amount?
- Can materiality for a particular class of transactions, account balance, or disclosure be higher than materiality for the financial statements as a whole?



Let's play

Jeopardy!!

It's just a game

Just for a little relaxation during the long session



**Practice makes
perfect**

Shall we practice?

Let's identify the materiality based on the displayed financial statements.



Thank you