Document type: Audit Risk Assessment Policy of Rahman Anis & Co., Chartered Accountants for Clients

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Introduction:

Creating a comprehensive risk assessment policy for a client undergoing an audit involves several key components. This policy should address the identification, evaluation, and management of risks that could impact the financial statements and overall business operations. The risk assessment policy for a client which will be followed by Rahman Anis & Co. (RAC) is given hereunder:

Step 1—Obtain an Understanding of Our Client and Its Environment

The first step in the process is to obtain and document an understanding of our client and its environment, including the industry in which that client operates, the regulatory environment, and other external factors.

As the auditor, we want to understand how our client makes money. What are the products it sells, who are its customers, what gives our client a strategic advantage? Does our client obtain a new customer because it is a low-cost provider or does our client have a unique product or strategy that allows it higher than average profit margins?

We also want to obtain and document our understanding of the industry in which our client operates. This would include not only the type of industry, but whether that industry is very competitive, easy to enter, what unique revenue characteristics might it have, how quickly do the products change, and other circumstances?

Step 2—Obtain an Understanding of Internal Control

The risk assessment standards require by RAC to obtain an understanding and document key aspects of the client's internal control over financial reporting. Some of us may immediately be thinking that our client has no controls so what's the purpose—that assumption is FALSE. All entities have controls even though they may not be documented.

Working from the COSO framework, think first about the control environment—does the owner want to do the right thing? How does the owner communicate his or her intentions to the employees? Although we might not realize it, how the owner acts and how the owner communicates expectations to employees are controls and these are controls that we want to document and determine that they have been placed in operation. A client, who is not willing to do the right thing, is a client we should run away from.

Also, as we think about controls, think about how the bookkeepers or accountants make decisions relative to account coding and classification? How does the bookkeeper determine that there are proper cutoffs with the recording of assets or liabilities? These are examples of essential basic controls that need to be understood and documented.

And as a reminder, if we're going to rely on the controls over account coding and classification, we'll need to test controls to make sure that those controls we think are effective, really are designed, implemented, and operating effectively.

We also might want to think about how the business owner monitors the financial results. This too is a control. If an account would be materially misstated in an internal monthly financial report, would the business owner likely spot that misstatement?

These are all examples of controls that should be understood and documented even in the smallest of clients. Although these controls may seem basic and elementary in nature, these are often the key controls for many small business entities. Additionally, it is likely that we will rely on these controls and, therefore, they need to be tested if they are going to be relied upon.

If a control is a process designed to prevent or detect and correct misstatements, and our client has no controls, that would mean that our client has no processes or policies in place that would prevent or detect and correct a misstatement. If that's the case, one has to ask how would we ever finish an audit given that situation?

But let's remember, what are we looking for and why? We're looking for processes (that is, controls) over accounts and assertions where there may be control weaknesses that could lead to material misstatements that will not be detected and corrected by the client and that might not be sufficiently covered by the standardized audit plan. Identifying those areas will help we identify significant risks.

Make sure we accumulate those control deficiencies so we can assess whether they are significant deficiencies or material weaknesses—both of which we will need to communicate.

Step 3—Brainstorming Meeting

This step probably allows the best opportunity for the engagement team to identify significant risks as long as the engagement partner does not join the conversation. In conducting the brainstorming session, the engagement partner should allow for a free flow of ideas about how a material misstatement, whether caused by error or fraud, could occur.

Although the risk assessment and fraud standards do not require separate brainstorming sessions, we would encourage to set aside a separate amount of time to just focus on fraud risks and how an employee of the client, including the owner, could perpetrate a fraud that would be material to the financial statements. Keep in mind that for smaller clients, the risk of misappropriation of assets may be a higher risk than the risk of a financial statement fraud.

This session should be conducted taking into consideration the client's accounting processes and controls and taking into consideration the fraud triangle—incentive, opportunity, and rationalization.

Do not, for one second, assume that our client's employees would never perpetrate a fraud. Never assume that the owner, even though he or she may be a friend, will never be tempted. As an auditor, we should always maintain our professional skepticism and always be alert to those threats that could ruin our career and our firm's reputation.

At the sake of repeating ourselves, remember, the purpose of this exercise is to identify significant risks of misstatement, whether caused by error or fraud.

Step 4—Summarization of the Audit Risk Assessment

Now that our risk assessment process is almost complete, it is time to document our assessments and see what significant risks we've identified. These should be unique significant risks for this specific client, this specific year.

Depending on how our firm's core audit plans have been developed, they will likely cover the "normal" audit risks. When we've identified those risks that are significant risks, and we've determined the accounts and assertions that could be affected, we need to design or draft audit plan steps that will uniquely mitigate the significant risks identified. This step should be performed or closely supervised by the engagement partner or manager as it takes years of experience to understand the type of audit procedures that should be applied to these high or significant risks. As part of the audit documentation, we will remember to document the linkage between the significant risks identified and the audit plans designed to mitigate and respond to those significant risks.

Chances are these audit procedures will be unique to any client and during the particular year; therefore, asking a less experienced staff person with little or no experience to carry out these procedures is not a good idea. We'll want someone in the firm who has the competencies and the experience to make certain that these unique audit steps are designed and completed appropriately and that the audit evidence obtained is sufficient in the circumstances.

Appendix:

1. RACCOBR Client Risk Assessment Tool and KYC (V_1)RACCOBR Client Risk Assessment Tool and KYC (V_1).xlsx

Note:

Reference materials of practicing the risk assessment:

- **ICAB Audit Practice Manual 2017 ..\ICAB Audit Practice Manual 2017.pdf**

- Identifying and assessing the risks of material misstatement (ISA-315) IAASB-Introduction-to-ISA-315.pdf
- IFAC-ISA-315-Material-Misstatement-Implementation-Tool-Auditors.pdf
- ISA-315-Full-Standard-and-Conforming-Amendments-2019-.pdf