

## Summary of Material Misstatements

Adjustment	Profit or Loss Dr/(Cr)	Assets Dr/(Cr)	Liabilities Dr/(Cr)	Equity Dr/(Cr)
1. Maintenance expense	(150,000)		150,000	
2. Payroll	80,000		(80,000)	
3. Revenue	700,000	(700,000)		
Xx				
Total	630,000	(700,000)	70,000	

Overall Materiality = \$650,000.

In aggregate: xxx < xxx

Individually: xxx and xxx individually immaterial

The most appropriate audit opinion is “unmodified opinion”. This is because the misstatements are material in xxx account OR not material individually and in aggregate. Also sufficient appropriate evidence has been obtained.

OR

The uncorrected misstatements are material in aggregate. Hence a modified opinion is required. The misstatements are limited to a small number of accounts and do not represent a significant portion of the financial statements, and are therefore **material but not pervasive**. A qualified opinion is therefore appropriate. A Basis for Qualification paragraph provides a description and quantification of the financial effects of the misstatement.

KAM (KAM is likely to describe the issue and audit response to xxx as a significant risk)/OI required?  
Listed entity?

Exam type question 1 **ROMM identification** – common explanation:

High risk area

- (1) Significant judgement is required in determining appropriate **revenue recognition** as
  - First time implementation of xxx standard given it is a significant change in accounting policy
  - Xxx entity 's customers have unique, non-standard rebate agreement
- (2) The **valuation technique** in xxx account under xxx standard is complex and requires significant specialist knowledge
- (3) Accounting **for FX differences** can be complex and increases the risk that the financial statements are misstated.

- (4) The **acquisition** in the current year is a significant transaction outside the ordinary course of business and significant judgement and expertise is required to correctly account for the transaction or determine the fair value of acquired assets and liabilities.
- (5) **Related parties transactions** – The sensitive nature and susceptibility of transactions not being at arm's length may result in risk around related parties being significant. There is also a risk that not all related party relationships and transactions would not be identified.
- (6) **Accounting estimate** – A high level subjectivity requires a high level of professional scepticism by the auditor. Accounting estimates are often significant risks because of the high level of judgement involved.
- (7) **Risk of going concern** – The auditor would need to consider financial, operational, or other indicators that may indicate that the going concern basis of accounting is at risk
- Decline in revenue and margins in the past few years. Company was previously consistently profitable, current year loss (the trend of declining revenue and margins is industry wide and likely to be permanent due to xxx, placing a risk on the company's ability to continue trading in the future)
  - Large inventories write off (the increase inventory balance combined with the lower demand indicates a risk that xx may not be able to generate sufficient future revenue or cash flows through the sale of inventory)
  - The cash balance is decreasing (correlate to a negative operating cash flow due to xx inability to generate sufficient revenue or cash flows through the sale of inventory/ collection of accounts receivable, which places a risk on the company's ability to continue trading in the future)
  - The financial result of xx entity has been deteriorating and bank borrowing are required to be paid. The ongoing principal and interest payments continue to diminish cash reserves, which is a key mitigating factor in addressing of going concern.
- (8) **Fraud** – Management's intentional manipulation of results arose from an incentive to improve results
- Ongoing litigation disputes. The provision for legal fees is an accounting estimate which may include management assumptions and application of professional judgement. Management may understate the provision for legal fees in order to improve the financial results
- (9) **Listed company** – Increase regulatory and disclosure requirements imposed on listed companies increase the risk of material misstatement
- Shareholder expectations** – expectations of shareholders and other external stakeholders may put pressure on management to manipulate the financial statements
- (10) A new xxx introduced this year **with no comparable market available** – With no comparable market for the new xxx, it may be difficult to obtain sufficient appropriate audit evidence as to whether or not the assumption made are appropriate or respective provision for xxx is accurate and complete.
- (11) The **lack of supervision over** xxx may result in xxx's work not being reviewed, which will create an opportunity to commit fraud.
- (12) XXX change xxx **in violation to the company policy** – xxx's ability to deviate from company policy may indicate the opportunity for fraud
- (13) Due to the nature of **intangibles**, there is a need to prepare support for the value of the intangible reported in the balance sheet