

# Item 5: Example financial statements risk analysis

Conducting a risk analysis for each financial statements item and its accompanying notes can assist management to prioritise the resources allocated to the preparation of the financial statements (including the extent of quality assurance required) and to determine whether there is scope to improve controls.

The degree of formality and rigour of the risk assessment will depend on a number of factors, including the overall complexity of the entity’s financial statements, the maturity of its financial statements process and the level of financial reporting risk the entity is prepared to accept.

Entities may find it useful to present the summary table at Steps 3 and 4 to the Audit Committee for review of progress.

Reference: Section 3.2.3 (page 42).

## Conduct of risk analysis

The following provides four practical steps in conducting a risk analysis:

### Step 1: Conduct inherent risk assessment

- (a) Assess the financial statements item against key inherent reporting risk factors.

Each entity should decide on the inherent risk factors most appropriate to its own operations and circumstances and the weightings to be applied to each factor. Examples of factors that can impact inherent risk are materiality, the level of judgment involved, disparity of data sources and results of previous audits by internal audit and the ANAO.

- (b) Based on the results of Step (a), determine an overall inherent risk of High, Medium or Low. An explanation of each risk level is set out below.

High	Medium	Low
Poses a significant financial reporting risk.	Poses a moderate financial reporting risk.	Poses a minimal financial reporting risk.
likely to require ongoing and sustained resource commitment.	likely to require moderate level of resource commitment.	likely to require low level of resource commitment.
likely to involve complex control and accounting issues or balances that require estimation or judgment.	likely to involve less complex control and accounting issues.	likely to involve routine control and accounting issues.

### Step 2: Conduct residual risk assessment

The effectiveness of existing controls is then assessed and an overall residual reporting risk rating of High, Medium or Low is assigned for each financial statements item. The risk rating is the same as the ones used in Step 1.

A High risk rating would mean that there is a reasonable possibility of significant financial reporting misstatements. The item would therefore require ongoing and sustained resource commitment. Conversely, a Low risk rating would mean that there is a minimal financial reporting risk which can be managed by routine control procedures and is unlikely to need the specific application of resources.

**Step 3: Summarise all risk ratings**

Collate all individual risk ratings for each financial statements item to give an overall picture of the reporting risk for all financial statements items.

**Step 4: Determine actions required**

The final step involves determining the action required for the entity taking into account the risk rating for each financial statements item. This may include assigning a risk owner.

**Example risk analysis**

An example risk analysis for the item Property, Plant and Equipment (PPE) is below. The example serves as an illustration only, and does not cover all financial statements items.

**Step 1: Conduct inherent risk assessment**

Risk Factor (See Note 1)	Key Questions to Consider	Rating (See Note 1)	Reason/Analysis
<b>Materiality</b>	<p>How significant is the item as a percentage of total income, expenses, assets or liabilities?</p> <p>How significant is the item to the key users of the financial statements?</p> <p>How material are individual transactions?</p>	<b>H</b>	<p>The item represents 12 per cent of total assets.</p> <p>The item is topical because of a recent Parliamentary interest.</p> <p>About 40 per cent of transactions have high dollar values.</p>
<b>Reporting requirements</b>	<p>Are there any complex or new accounting requirements?</p> <p>Are there any significant compliance issues?</p>	<b>L</b>	None identified.
<b>Level of judgment</b>	<p>Does the item require considerable judgment to record the account balances and transactions correctly?</p> <p>Does it require estimates, management judgment or specific knowledge and skills of the item and related accounting standards?</p>	<b>H</b>	<p>Judgment is required for capitalisation threshold, useful lives and revaluations.</p> <p>Judgment is required in determining whether the asset belongs to other related entities.</p>

Risk Factor (See Note 1)	Key Questions to Consider	Rating (See Note 1)	Reason/Analysis
<b>Extent of reliance</b>	<p>Is the accuracy of data dependent on areas, systems, experts or related entities outside the control of Finance Team?</p> <p>Does experience suggest that such data are provided in a timely and accurate manner?</p>	<b>H</b>	<p>Significant reliance on Business Areas to provide information. Data provided in prior year had significant errors.</p> <p>Reliance on external experts with respect to valuation.</p> <p>Reliance on related entities to manage and correctly record assets in regional offices.</p>
<b>Transaction numbers</b>	<p>Is there a significant number of transactions in the population?</p>	<b>M</b>	<p>A significant number of individual transactions are processed each year.</p>
<b>Level of manual intervention</b>	<p>Is the level of manual intervention used to initiate, record, process or report transactions significant?</p> <p>Is manual intervention appropriate?</p>	<b>M</b>	<p>Manual adjustments are generally required to reflect revaluations and impairments of PPE.</p> <p>The level of manual intervention is appropriate because judgment is required to initiate and record the adjustments.</p>
<b>Disparity of data sources</b>	<p>Can data be easily and reliably retrieved?</p>	<b>M</b>	<p>Three different registers are used to manage and control assets.</p>
<b>Audit issues identified</b>	<p>How significant are previous audit findings in respect of this item?</p> <p>Have these findings been adequately addressed?</p>	<b>M</b>	<p>Previous internal audit and ANAO audit findings remain outstanding. Corrective action is in progress.</p>
<b>Inherent Risk Summary</b>			
<b>Inherent risk</b>	<p>Based on the assessment above:</p> <p>Have key inherent reporting risk been identified?</p> <p>What are the key contributing inherent risk factors for the item?</p> <p>What is the overall inherent risk rating?</p>	<b>H</b>	<p>Key contributing factors:</p> <p>Materiality of the balance.</p> <p>Level of judgment required in determining correct asset classification and valuation.</p> <p>High level of reliance on Business Areas to correctly identify assets for capitalisation.</p> <p>Reliance on other related entities to manage some key assets.</p>

Note 1: Different weightings should be given to each risk factor. The materiality of the financial statements item would be expected to have the greatest weighting.

## Step 2: Conduct residual risk assessment

### Analysis of Existing Key Controls

Existing key controls in place are:

Monthly reconciliation of PPE movement schedules showing opening balances, additions, disposals, transfers, depreciation, impairments and closing balances are performed to ensure completeness of all asset movements in the asset registers and FMIS.

Year-end review is undertaken to ensure assets are categorised by class and appropriately disclosed in the financial statements, including movement tables.

Asset stocktakes are conducted in accordance with the *Policy on Assets* and stocktake reports are reconciled to the asset registers and FMIS. Stocktake reports are endorsed by management.

Year-end reviews of valuation reports are conducted.

Annual review for impairment in accordance with Accounting Standard AASB 136 *Impairment of Assets* is carried out to ensure PPE value is not overstated.

Service agreements with related entities are reviewed annually to ensure that their management controls are adequate to minimise material misstatements in recording and ownership.

### Residual Risk Summary

### Rating

#### Residual risk

Based on the analysis of existing controls above:

Have all existing key controls been identified?

What are the key contributing risks remaining after existing controls have been exercised?

What is the overall residual risk rating?

**M**

Key contributing factors:

Controls in place are relatively mature and are subject to periodic review.

However the item is material and improvements are still required by Business Areas to provide more timely and accurate information.

**Steps 3 and 4: Summarise risk ratings and determine actions required**

Note	Item	20XX-XX Budget (\$'000)	20YY-YY Actual (\$'000)	Inherent Risk Rating	Residual Risk Rating	Key Actions Taken/ Required
<b>3A</b>	Revenues from Government	260,700		<b>L</b>	<b>L</b>	See Note 1
<b>3B</b>	Sale of goods and rendering of services	497,900		<b>H</b>	<b>H</b>	Additional resources will be committed to reconcile work in progress and revenue by 31 October. Information collection pack will be reviewed to ensure accurate revenue information is provided by Business Areas. Prior year audit findings are being followed up.
<b>3C</b>	Other revenue	1,200		<b>L</b>	<b>L</b>	See Note 1
<b>3E</b>	Other gains	77,200		<b>H</b>	<b>M</b>	Additional resources will be used to review 'resources received free of charge' and 'write-down of inventories' which have not been reviewed comprehensively for the past three years.
<b>4A</b>	Employee benefits	136,500		<b>M</b>	<b>L</b>	See Note 1
<b>4B</b>	Suppliers	130,200		<b>M</b>	<b>L</b>	See Note 1
<b>4C</b>	Depreciation and amortisation	18,800		<b>M</b>	<b>L</b>	See Note 1
<b>4D</b>	Finance cost	17,800		<b>L</b>	<b>L</b>	See Note 1
<b>5A</b>	Cash and cash equivalents	7,500		<b>M</b>	<b>L</b>	See Note 1
<b>5B</b>	Trade and other receivables	312,300		<b>H</b>	<b>H</b>	Additional resources will be used to reconcile accounts receivable with cash received. Review for indicators of impairment will be carried out. An examination of control procedures in debt collection has been completed and recommended corrective actions are planned for completion by 31 January.

Note	Item	20XX-XX Budget (\$'000)	20YY-YY Actual (\$'000)	Inherent Risk Rating	Residual Risk Rating	Key Actions Taken/ Required
6A	Land and buildings	398,100		H	M	Documents on ownership of properties will be reviewed to ensure that they are signed by the correct delegates. A comprehensive review of amounts capitalised for leases will be undertaken.
6B	Property, plant and equipment	104,100		H	M	Information collection pack and stocktakes procedures for PPE are to be updated. Additional training will be provided to Business Areas to ensure that they provide more timely and accurate information.
6C	Intangibles	23,100		M	M	A comprehensive review of material invoices will be carried out to verify the capitalised amount.
6D	Other non-financial assets	2,100		L	L	See Note 1
7A	Suppliers	26,900		M	L	See Note 1
8A	Employee provisions	37,700		M	L	See Note 1
8B	Other provisions	3,100		L	L	See Note 1
9	Restructuring					
	—Departmental	21,200		H	M	Transfer of assets and liabilities from the ABC Entity underway. Due diligence review of ABC Entity's data and supporting documentation. Contracts and lease commitments to be examined at hard close.  Additional tasks incorporated in the financial statements work plan.
	—Administered	121,200				

Note	Item	20XX-XX Budget (\$'000)	20YY-YY Actual (\$'000)	Inherent Risk Rating	Residual Risk Rating	Key Actions Taken/ Required
15F	Royalties	65,700		H	M	An internal audit review will be conducted on administered revenue. Control and substantive testing on material revenue items and preparation of business process and control mapping.
16D	Grants	1,587,600		M	M	Material balance. No prior year issues except for the section 83 (of the <i>Constitution</i> ) matter raised by the ANAO. Assess where the grant programs are supported by a head of Commonwealth legislative power (e.g. section 51 of the <i>Constitution</i> ). Review to include reconciliation of grant database to FMIS, cut-off testing and review of commitments information.
23	Special Accounts	318,200		H	M	Assessment of section 83 (of the <i>Constitution</i> ) matter currently being conducted.  Restructuring—additional seven special accounts to be transferred. Due diligence review currently being conducted.

Note 1: To be managed by existing control procedures. No additional resource commitment required.