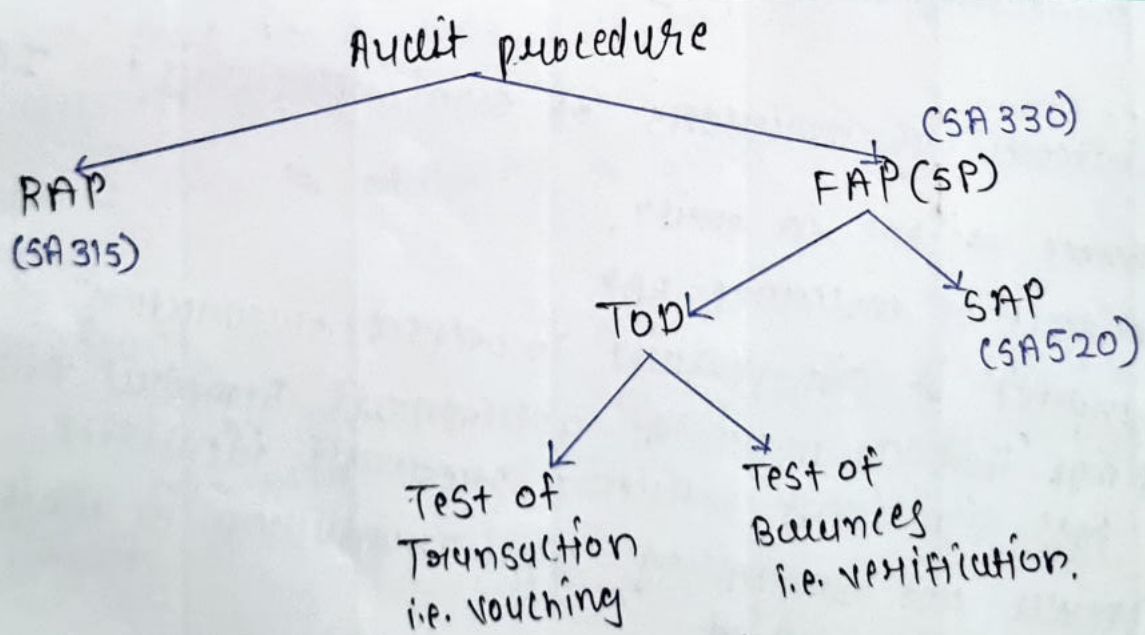


5.] Example of ^{multiple} factors that Auditor may considered before determining whether a deficiency or a combination is a significant deficiency
5Q
SAP/24/11/2
(54)
→ Refer Module-1 Pg. 2A.45

Chapter-10

Risk Assessment and

Internal Control



• what is included in RAP:-

It shall include the following,

Inquiries of management and others within the entity

Examples

- Interview audit personnel
- employee involved in unusual transaction
- in-house legal counsel
- marketing and sales personnel
- Risk mgt. function
- Info. system personnel.

Analytical procedure

A.P. performed AS RAP inc. Both F.I and INFI

Example

Relationship b/w sales and volume of goods sold,

it helps to identify unusual transaction or event

Observation and inspection,

Examples

- Entity's operation
- docs. (business plan and strategy) & I.C. manuals
- Report prep
 - By mgt
 - By TCW
- entity's premise & plant facility.

• understanding The Entity and its Environment:-

The Auditor shall obtain understanding of the following:-

R: Relevant industry, regulatory and other external factors inc. AFRF. Example of master auditor shall considered,

- Accounting principles, and industry specific practices.
- Regulatory framework or regulated industry
- legislation and regulation that affect entity.
- government policies directly affecting the conduct of entity.

O : entity's objective and strategies and those Related Business Risk that may result in ROMMS. for eg.

- industry development.
- new product or services
- expansion of business.

M : The measurement and review of Entity's financial performance. following may be used by Auditor,

- key performance indicator, key ratios, trends, operating statistics.
- period-on-period financial results analysis.
- credit rating agency Report.
- Budget, forecast or other level performance Report.

A : The Entity's selection and application of Accounting policies incl. changes thereto.

N : The Nature of Entity including,

- it's operations
- it's ownership and governance.
- Types of investment that Entity is making or plan to make.
- How Entity is financed and way of structure.

Understanding an Entity is continuous process:-

→ such understanding establish a frame of references within which auditor plans and perform the audit and exercise P.J for Example when RAMDAS.

(R) : AROMM of f.s.

(A) : consider APP.NESS of selection and application of A.P

- ①: determine materiality (SA 320)
- ②: developing expectation when use A.P. (SA 520)
- ③: Evaluate whether A.E obtained SAAE
- ④: identify areas where significant consideration required.

Audit Risk

• Introduction To Audit Risk:-

- meaning :- it means that auditor provide inappr. audit opinion when the F.S. materially misstated,
- it means that Auditor provide unmodified opinion when F.S. are materially misstated.

- Audit Risk (AR) is function of $\left[\begin{array}{l} IR \\ DR \end{array} \right]$

- what is NOT included in A.R

• Auditor's Business Risk such as

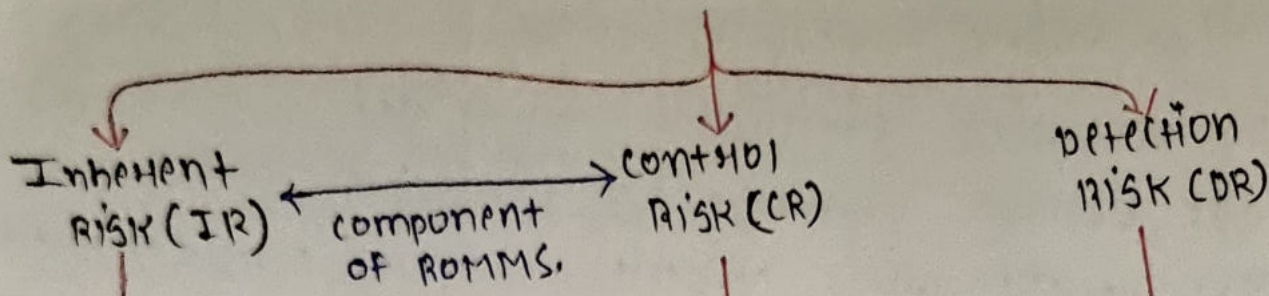
loss from litigation

adverse publicity

other event arising in connection with Audit of F.S.

• A.R. Not include the risk that auditor provide modified opinion when in fact F.S. NOT materially misstated.

$$A.R = IR \times CR \times DR$$



• IR is an susceptibility of an assertion about a CABD to MS that is material \rightarrow $\left[\begin{matrix} I \\ Aggt. \end{matrix} \right]$

before consideration of any related controls as described in SA 200.

• IR factors are considered in determining or designing



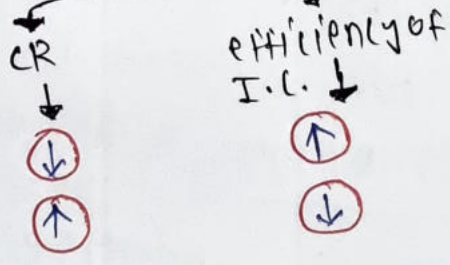
• only client can influence

• CR is the risk that M.S. that could occur in an assertion about CABD

- that M.S. is material \rightarrow $\left[\begin{matrix} I \\ Aggt. \end{matrix} \right]$

- will not PDC fraud or error on timely basis by Entity's I.C.

- Inverse relationship B/W



• only client can influence

eg. collusion among employees.

Detection Risk (DR)

• SA 200
• DR is the risk that procedure performed by auditor

- To \downarrow risk to an acceptably low level.

- will not detect a MS that exist & that could be material \rightarrow $\left[\begin{matrix} I \\ A \end{matrix} \right]$ with other MS.

• DR consists of
Sampling Risk Non-sampling Risk

- Auditor can influence DR

- it can be reduced by increasing Area of checking, Testing larger samples and includes more expert in ET

SA-330

Auditor's Responses To Assessed

Risks

Test of Control (TOC)

Nature

To design & perform TOC auditor shall

perform O.A.P (+) inquiry

determine controls tested depend on any other indirect control

if YES

obtain A.E support of effectiveness of that indirect control.

• Inq. (+) Insp. / Repres. fo.
> Inq. (+) observ.

Extent

• more permissive A.E needed



⊕ Extent of testing.

- matter considered. ↓
 - freq. of performance of control by entity.
 - EROD from control.
 - Avl. of R&R AE
 - extent to which AE obtained from test of other control related to assertion.

Timing

• some controls checked only at a specific point of time such as P.V. performed by mgt

• for other controls there are no time constraints.

SP

{ AP designed To detect MMS @ }
AL

TOD

Test of Transaction
i.e. Vouching

Test of Balances
i.e. Verification,

SAP → Ref: SA 520.

- meaning of SAP
- To provide A.E. Ratio used
- Applicable to large volume of Transaction that tends to be predictable over time.

Nature and Extent of S.P.:-

Nature

depending on circumstances Auditor determine that

only (+) TOD (+) combination of SAP Both.

Extent

To design TOD, Extent of Testing is Based on sample size.

Objectives (SA 330)

obtain SAAE about AROMM through designing & implem.
Appt. Response To those Risk

SA 330 states that,

The auditor shall design and implement overall response to the assessed ROMM @ FS level.

the auditor shall design and perform FAP whose NTE are based on and are responsive to AROMM @ A.L.

* The auditor shall, consider the reason for assessment @ A.L. for each CABD inc.

↑ the Assessment of Risk
↑ persuasive A.E. required.

likelihood of MMS due to particular characteristic of CABD

whether RAP takes into account relevant control that require auditor to obtain AE about operating effectiveness of relevant control.

When Auditor shall design and perform TOC:-

- When auditor's assessment of ROMM @ AL inc. an expectation that control are operating effectively.
- SP alone cannot provide SAAE @ AL.
- Where reliance on control, Auditor obtain more persuasive AE
- in TOC, required highest level of assurance about operating effectiveness of control.

NOTE → some misc. point recd from book (M₂ pg. 1B.42)

SA-320

Materiality In Planning & Performing Audit

Materiality :- Misstatement that inc. omission considered to be material if they if aggt. could reasonably be expected to influence economic decision of users based on (i.e. taken on) F.S.

→ materiality is not always a matter of relative size.
eg. नाना Amt. नो fraud थल MMS indicate स? छ.

• Materiality in planning and performing audit is Auditor's responsibility and matter of APJ :-

→ concept of materiality applies on

```
graph TD; A[concept of materiality applies on] --> B[forming opinion]; A --> C[planning]; A --> D[performing]; A --> E[evaluation];
```

SA320 deals with it

→ The Auditor's make judgement about size of M.S. that will considered material. it provide basis for,

- ① NTE of
 - RAP (i)
 - FAP (ii)

② Identifying ROMM and Assessing it.

→ concept of materiality.

Exploined in AFRF

NOT EXPLICIT

Refer SA 320.

they generally explain that,

- meaning (SA 320)
- nature/size/both affect the judgement of materiality.
- common financial needs of users to be considered about judgement on materiality.
- possible effect of M.S. on specific individual users is not considered.

→ the auditor should consider

Statutory Requirement

Division I, SCH. III of Co. Act, 2013

Any Item of P&L

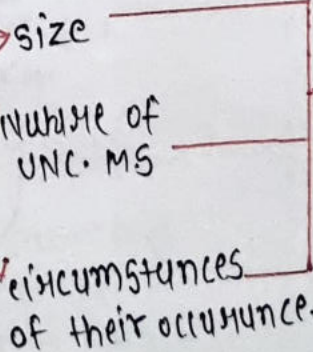
> 1% of RFD or 100,000

whichever is **HIGHER**

disclosed separately

S.H. Holding > 5% of total.

disclosed in notes to account as no. of shares



To evaluate effect of M.S. on F.S.

• Determination of materiality by Auditor based on Assumptions

Uses of F.S.

① Have reasonable knowledge of business, economic activities, and accounting.

② understand that FS prepared, presented and audited to level of materiality

③ ~~Take~~ Recognise uncertainties inherent in the measurement of amount based on APF.

④ make study of F.S. with reasonable diligence.

⑤ make reasonable economic decision on the basis of F.I.

P.M = Performance Materiality

meaning :-

Amt. or Amts. set by Auditor at less than materiality for

F.S. as a whole

OR

particular CABD

To reduce to an appt. low level the probability that Aggt. of

undetected

and

unconnected

misstatement

Exceeds the materiality for the F.S. as whole.

• Factors Affecting identification of Benchmark (B.M):

Focus: Item on which the Attention of user's Tends To **Focused**

on :-

V : Relative **Volatility** of B.M.

I : **Industry** & Economic Environment in which Entity operates

O : **Ownership** Structure and way entity financed.

L : Where entity stand in its **Life cycle**.

E : **Element** of FS i.e. A, L, I, E.

N : **Nature** of Entity.

→ percentage Applied on chosen B.M. is matter of APJ.

• Factors Affecting Materiality for Particular CABD :-

LE/R/ARF Affect user's expectation

↓
Regarding measurement and disclosure

↓
eg. RPT, Remn of mgt/TCW etc.

Key disclosure Related to industry in which entity operates.

↓
eg. REID cost for Phumy. Co.

Aspect that separately disclosed in F.S.

↓
eg. Newly Acq. Co.

• Revision In Materiality :-

→ AS a result of

↓
Δ in circumstances

↓
Δ in understanding & operation of entity as a result of FAP

↓
Acquired New Information.

Further if,

• Actual F.R. different than anticipated F.R.

• lower materiality require than initially determined determine whether it result into revision in PM and check that NTE of FAP Appt.

• materiality and Audit Risk are considered throughout the audit in particular when,

• I&A
ROMM

• determine
NTE OF FAP

• Evaluating the
effect of UNC. M.S
on F.S. and form
opinion in A.R.

AUTOMATED ENVIRONMENT

• Key Features of ATME:-

- Enable faster business operation
- Ability to process large volume of transaction.
- Better security and control.
- less prone to human error
- provide latest information.

• meaning:-

- ATME refers to business environment where the processing, operation, accounting and even the decision making are carried out by computer system.

- also known as (IS, IT)

Following are the points that Auditor should keep in mind to understand ATME:-

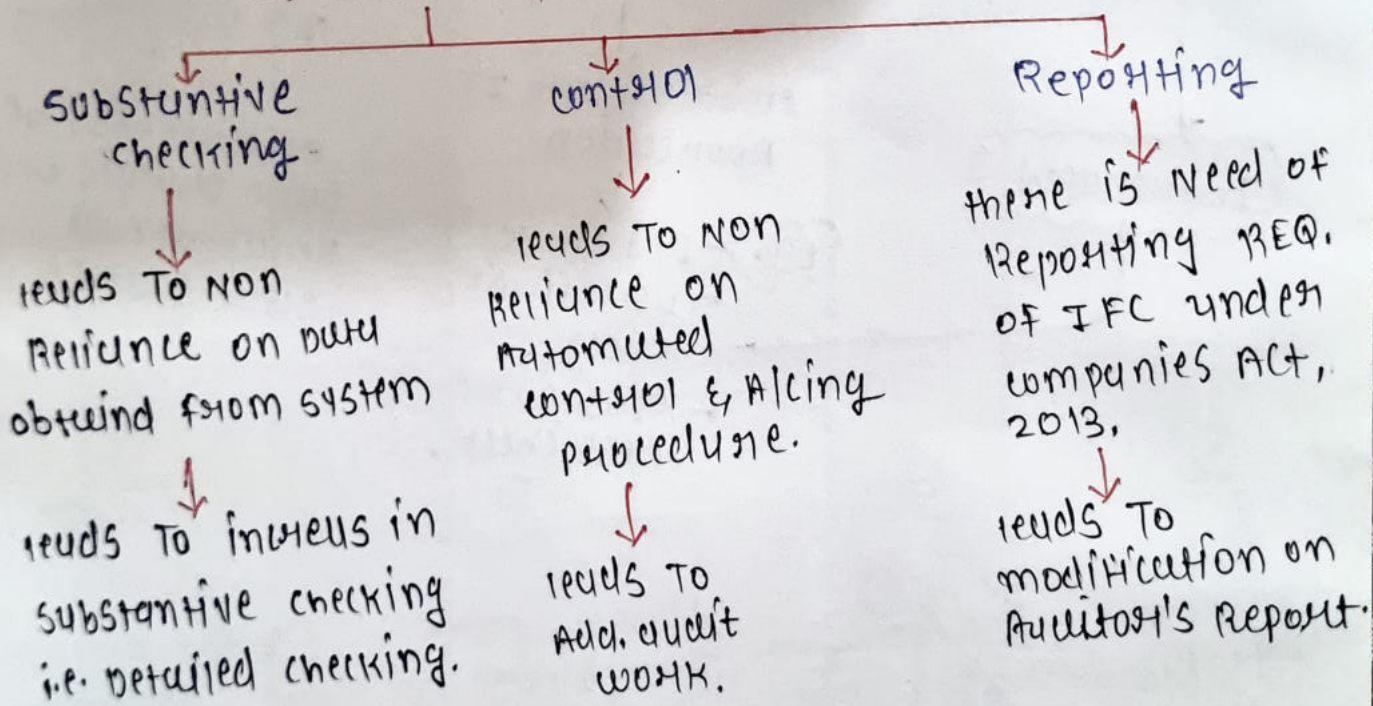
- Info. system being used
- Their purpose.
- Inhouse vs packaged
- location of IT system (local vs global)

- Outsourced Activities
- Key person (CIO, CISO, Administrator)

• Risk Arise from use of IT system:-

- unauthorised Access To data,
- change in data (direct)
- Excessive Access To data (super user)
- inappropriate seq. of duties.
- loss of data.

Above risk should be mitigated, if not
it has impact on,



Types of Control

General IT Control

Related To P&P

Relate To many Application

support the effective. of function

Interrelated.

Application Control

Include

Auto. control

manual control

operate at a business process lvl.

embedded into IT Application

- Eg.
- Edit check
 - user limit check
 - Reasonableness check.

I.T. Dependent Control.

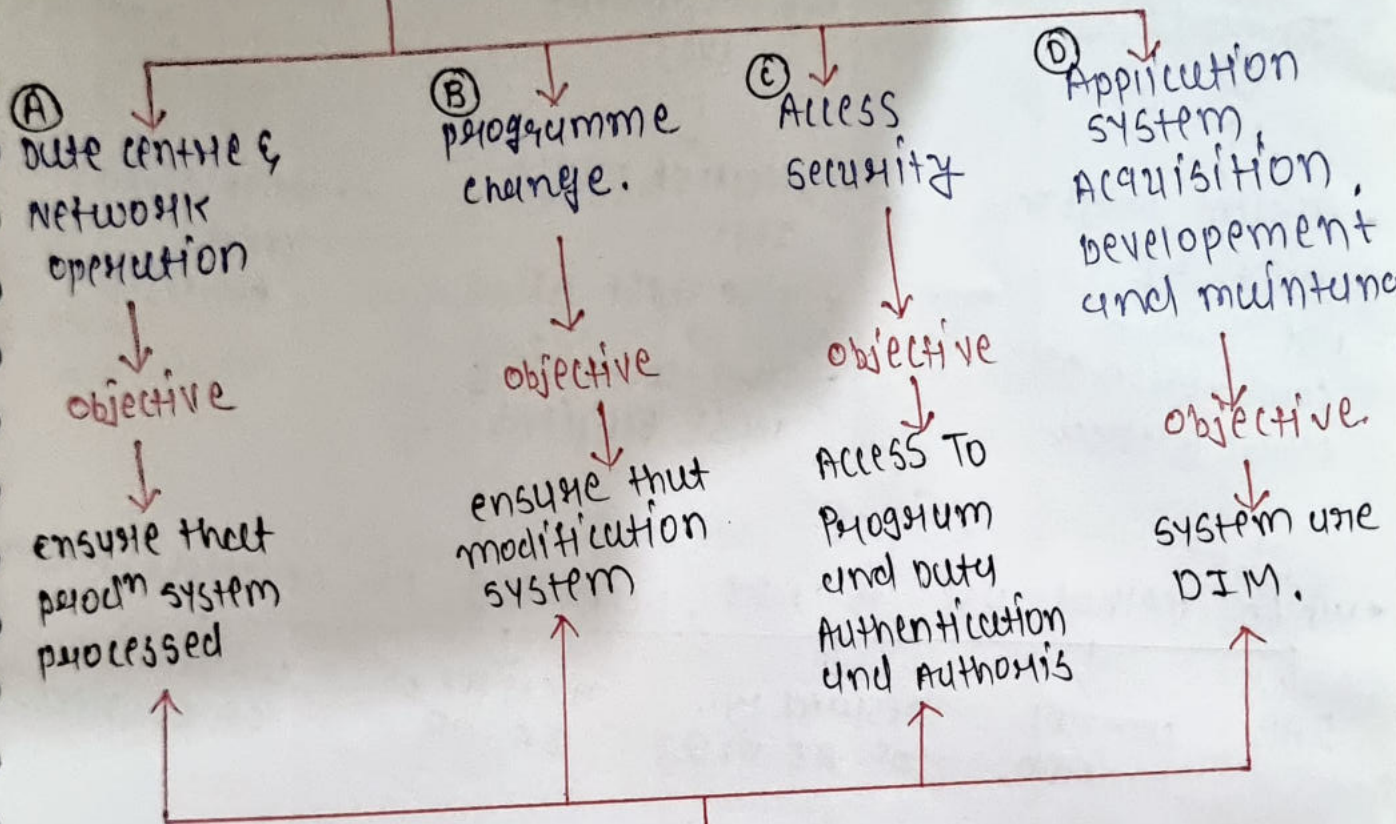
Basically manual control

use some form of Data, Info, Report

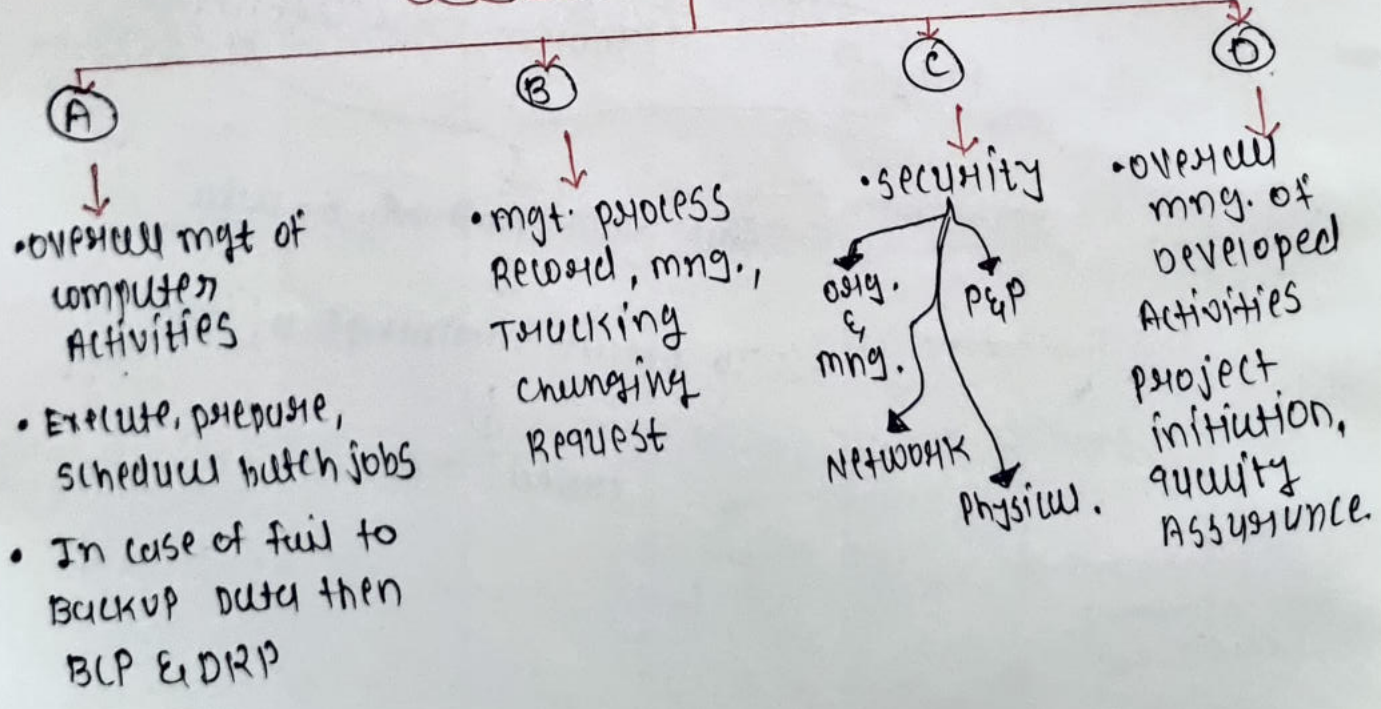
produced from I.T. system

effectiveness of Data depends on Reliability of Data source.

GENERAL I.T. CONTROL HAVE CONTROL OVER following



To Meet F.R. objective.
Activities Included in



• Testing method of ATME:-

Inquiry
①

- efficient audit test
- least AE
- use within combination of other method.

Reperformance
②

- effective audit test
- give best AE
- time consuming least efficient

Inquiry + inspection
③

- most effective and efficient

• Which method use is APT, depending on several factors

RAP

control environ.

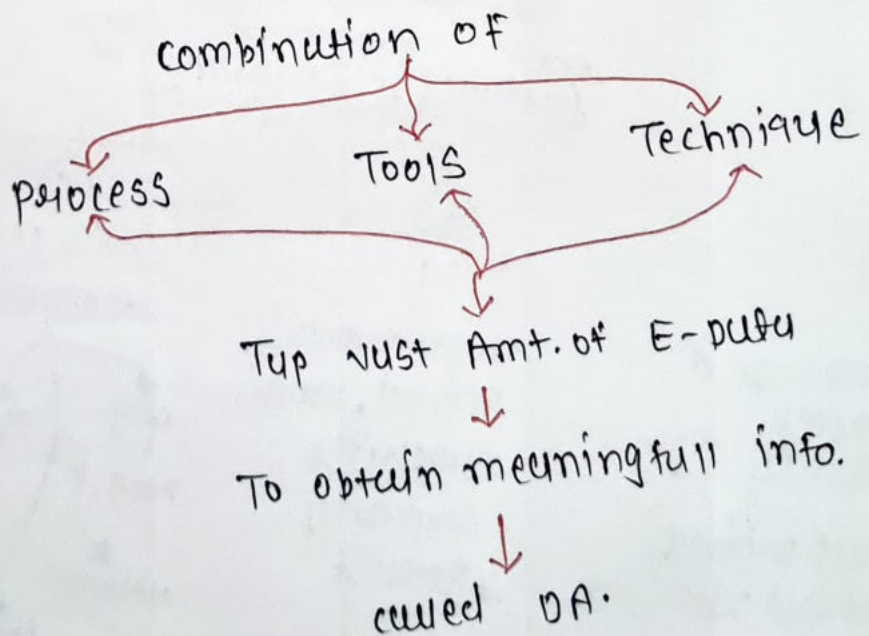
Desired lvl. of AE REQ.

History of ERROR

complexity of business.

• Data Analytics (DA) for audit:-

meaning :-



DA used in

Testing of E-Records

Testing of data residing in IT system using Audit Tools

To perform, following

Fraud investigation

Evaluating impact of control deficiency

selection of audit sample

Recompu. of Balances

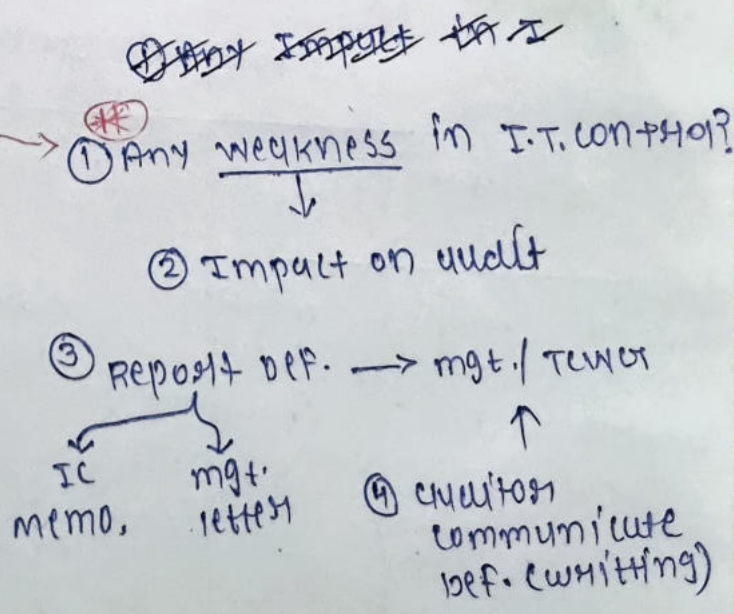
check completeness of data & Popuⁿ. used TOC/SAP

• Internal Financial Control [IFC] :-

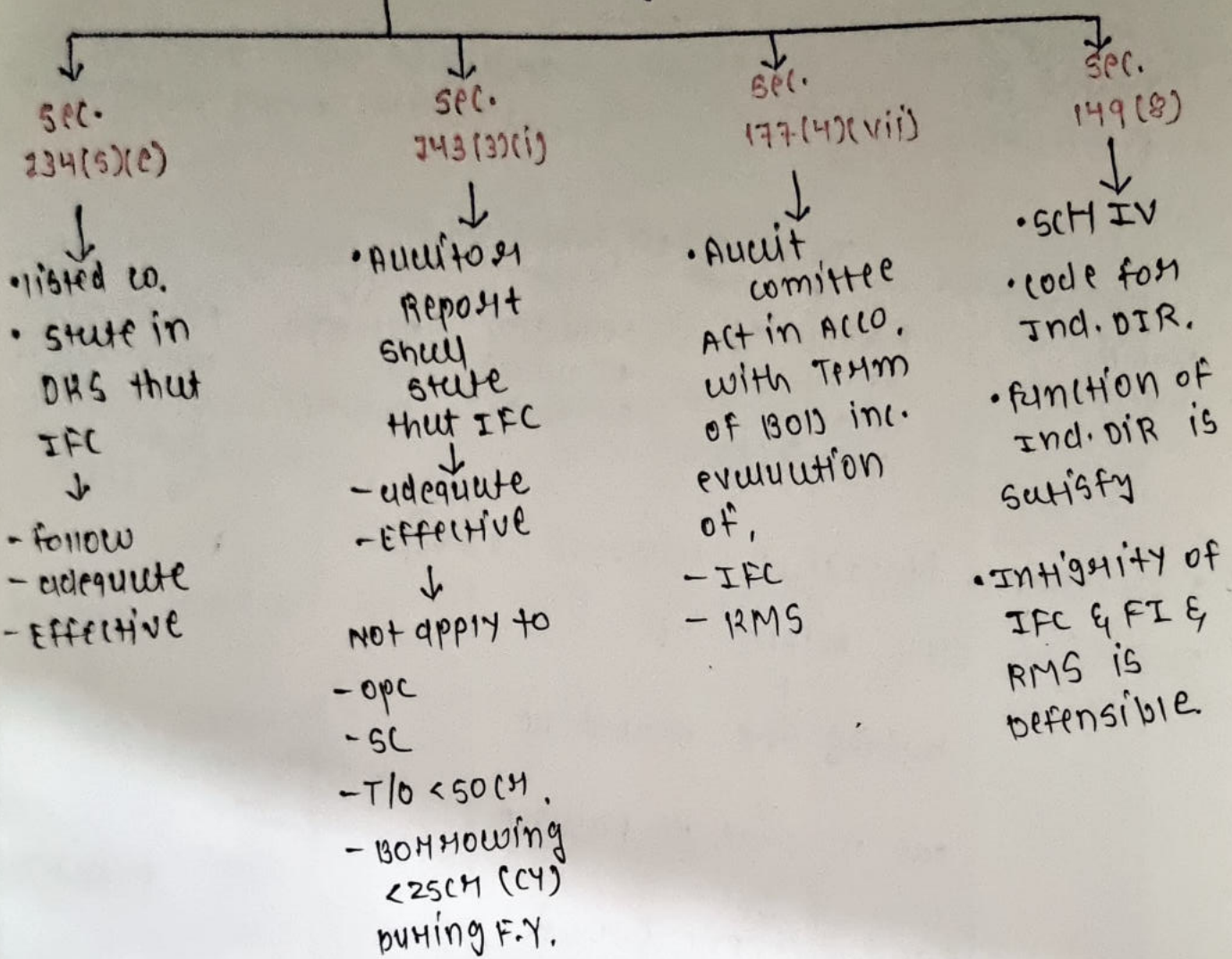
meaning :- IFC refers to policies and procedure put in place to ensure, C.A.R.E (+) PDC fraud.

• Assess and Report Audit finding :-

At conclusion of audit certain finding / matter need to assess & report to SH / mgt / TCWU



Responsibilities Regarding IFC Under Co. Act, 2013:



SA 330 :- Using AE obtained in previous audit:-

Auditor shall consider

