

↳ Auditor gives an → INAPPROPRIATE OPINION
 ↓
 when the F.S. ARE MM

* Auditor expresses → unmodified Opinion
 ↓
 when the F.S. ARE MM

Reputation Damage Regulatory Action Legal Action

* Auditor $\begin{matrix} \nearrow \text{Plan} \\ \searrow \text{Perform} \end{matrix} > \text{Audit} \rightarrow \text{AUDIT RISK is}$
 ↓

REDUCED TO AN ACCEPTABLY LOW LEVEL

* Audit Risk = $f(\text{ROMM} \times \text{Detection Risk})$
 ↓
 Inherent Risk Control Risk

1.1 Risk of Material Misstatement

→ FS are MM → PRIOR TO AUDIT

↓
Probability of $\left\{ \begin{matrix} F \\ E \end{matrix} \right\}$ in FS ↔ Before Audit

* Misstatement = Amount Classification Presentation Disclosure

$\left[\begin{matrix} \text{Recorded F.S.} & - & \text{As per App. F.R.F.} \end{matrix} \right]$

F E

* RoMM @

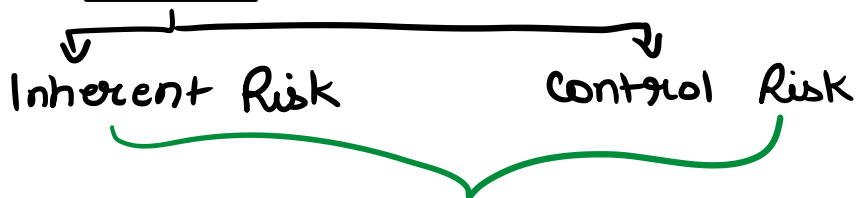
→ Overall F.S. level → Relate Pervasively to F.S. as a whole + potentially affect many assertions

→ Assertion level → Assessed to determine

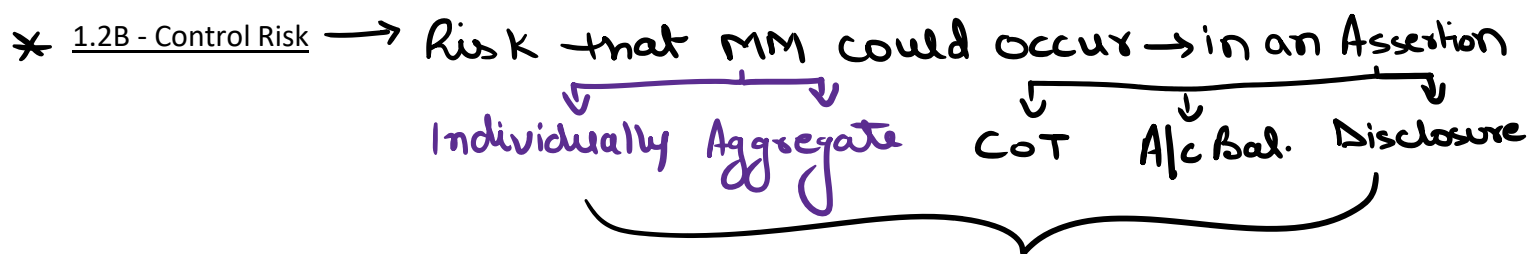
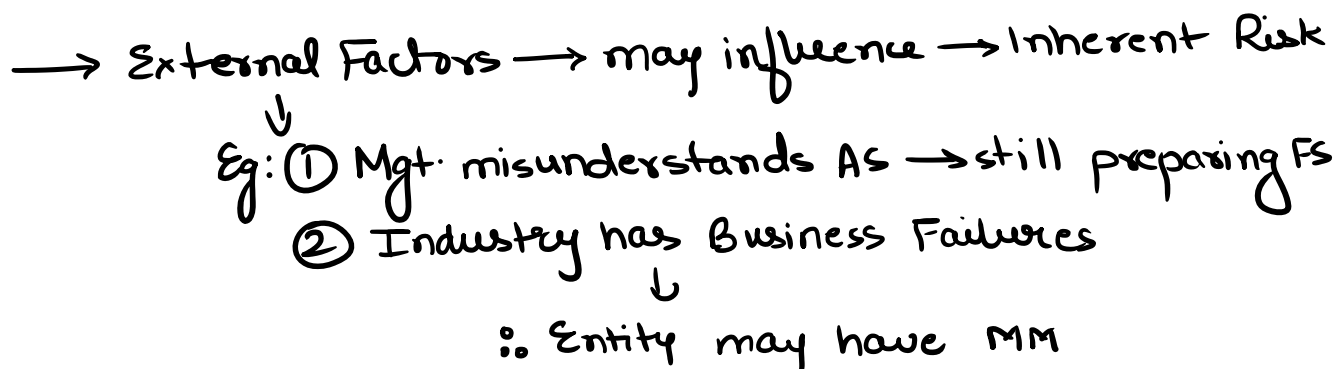
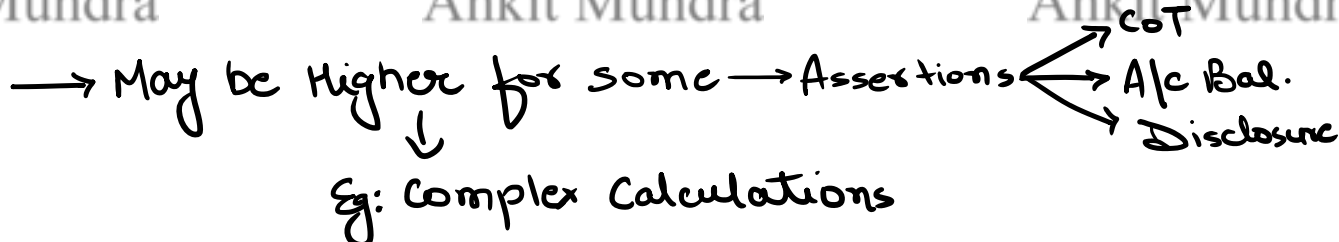
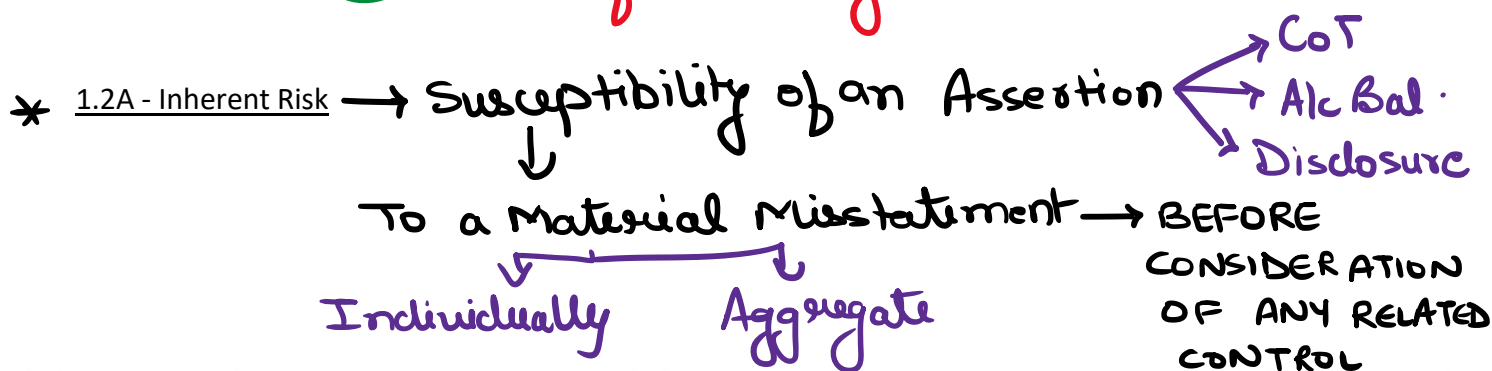
CoT A/c Bal. Disclosures

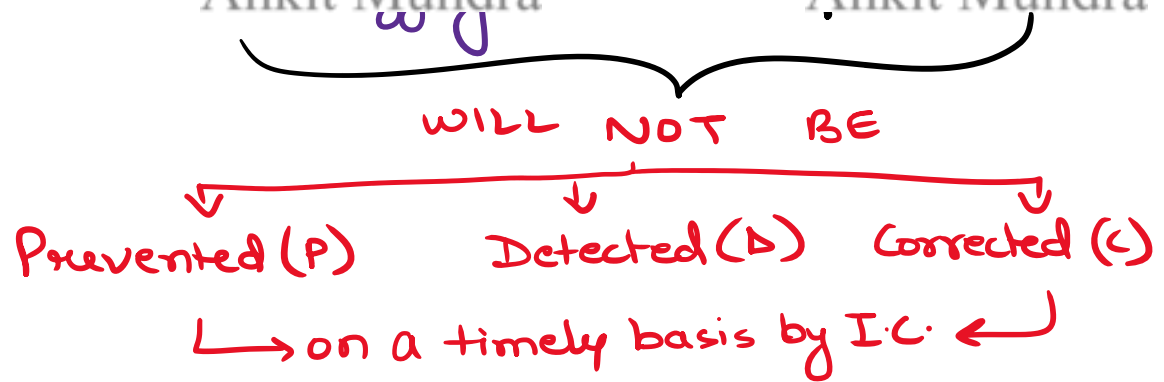
N E T
↳ of FAP

1.2 - Components of RoMM



- ① Are Entity's Risk
- ② Exist independently of → Audit of F.S.
- ③ Influenced by client
- ④ Not Influenced by Auditor

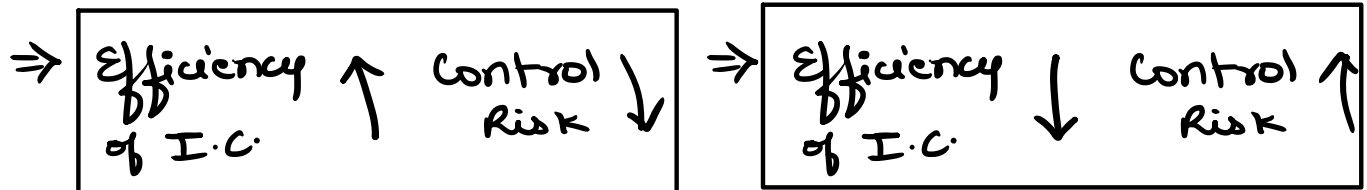




→ There exists an INVERSE Relationship b/w

↓ ↓

Control Risk I.C.



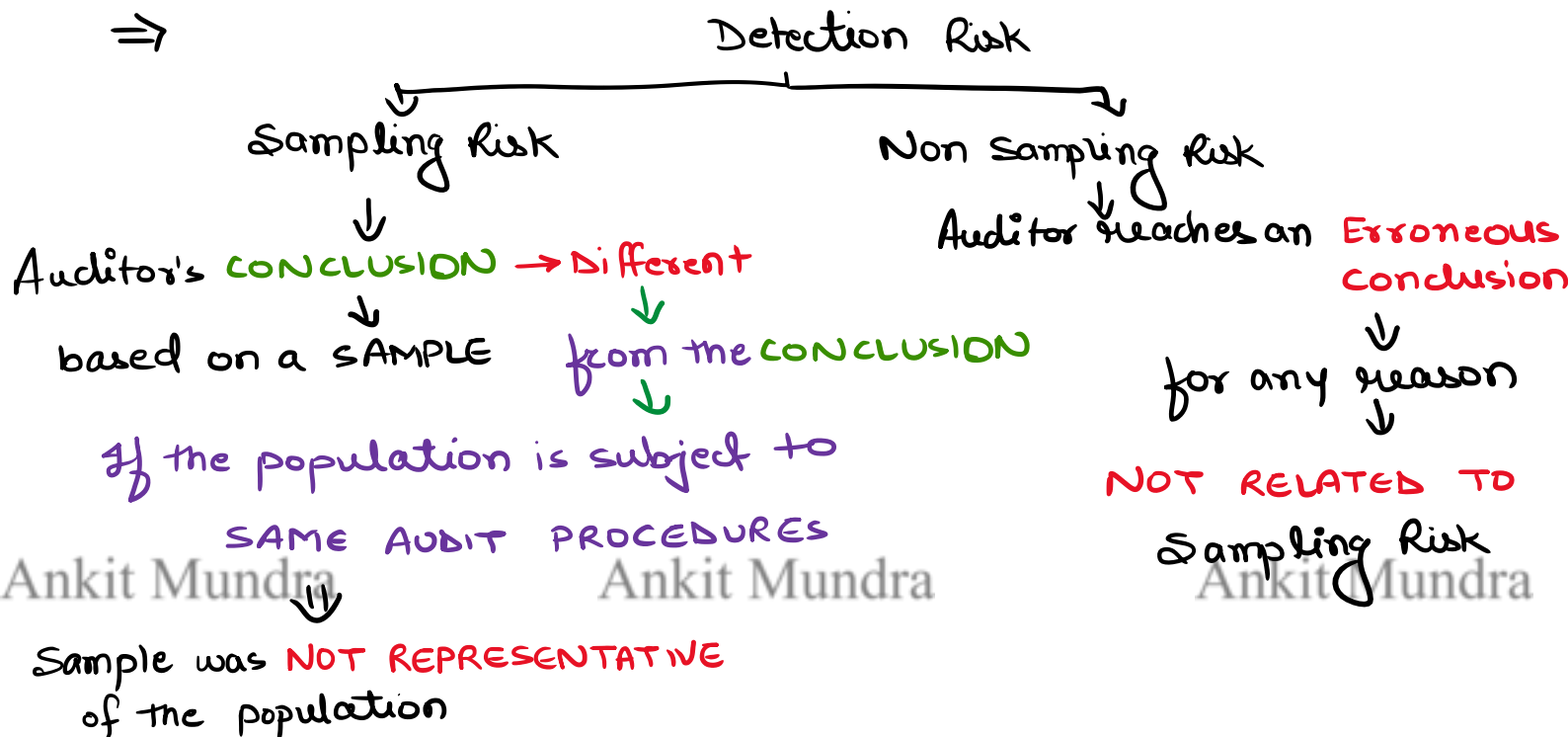
→ Examples of Control Risk

- ① Cash or Cheque Book controls
 - ② Fire Extinguishers or smoke detectors
- } Not working
-

→ Risk → procedures performed by the Auditor
 ↓
 To reduce the risk to an Acceptably Low level
 ↓

WILL NOT DETECT A MM → that exists
 ↓
 Individually Aggregate

⇒



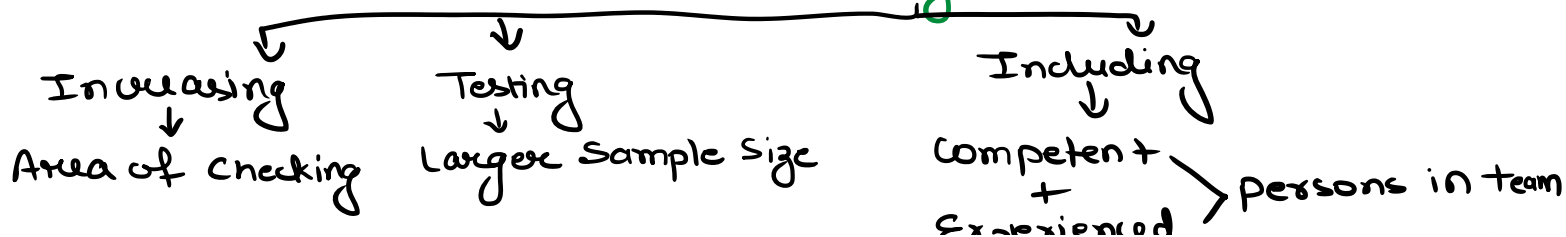
⇒

Risk	Influenced by
Inherent Risk	Entity
Control Risk	
Detection Risk	Auditor

↓
 must REDUCE Detection Risk

↓
 To keep low Audit Risk

↓
 By



Ankit Mundra

Area of checking

Larger Sample Size

Ankit Mundra

Competent
+
Experienced

Ankit Mundra

persons in team

Ankit Mundra

Ankit Mundra

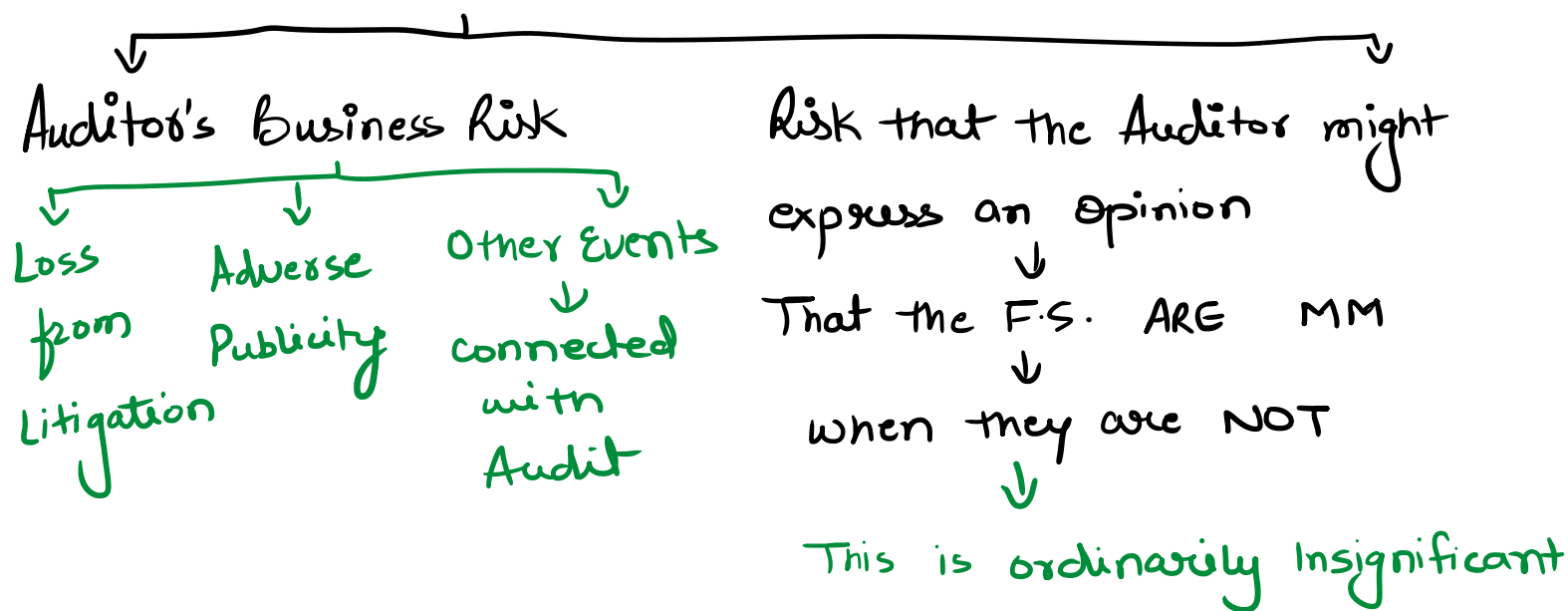
Ankit Mundra

Ankit Mundra

Ankit Mundra

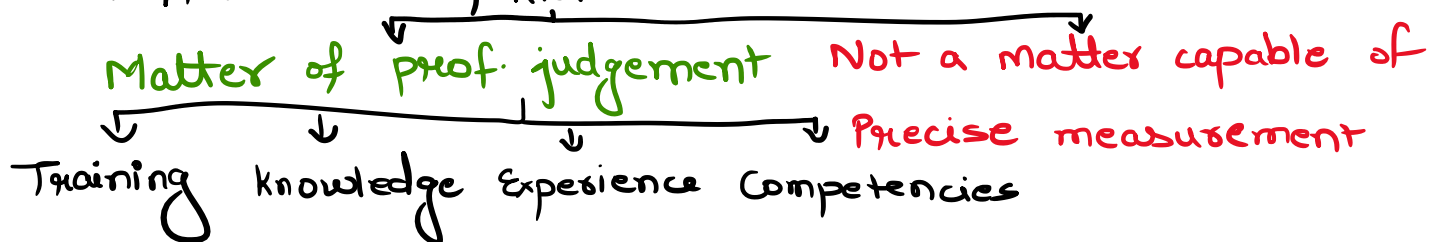
Ankit Mundra

1.4 - Audit Risk - What is Not Included?



* Audit Risk = f(RoMM x Detection Risk)

→ Assessment of Risk



* 1.5.1 - Combined Assessment of RoMM

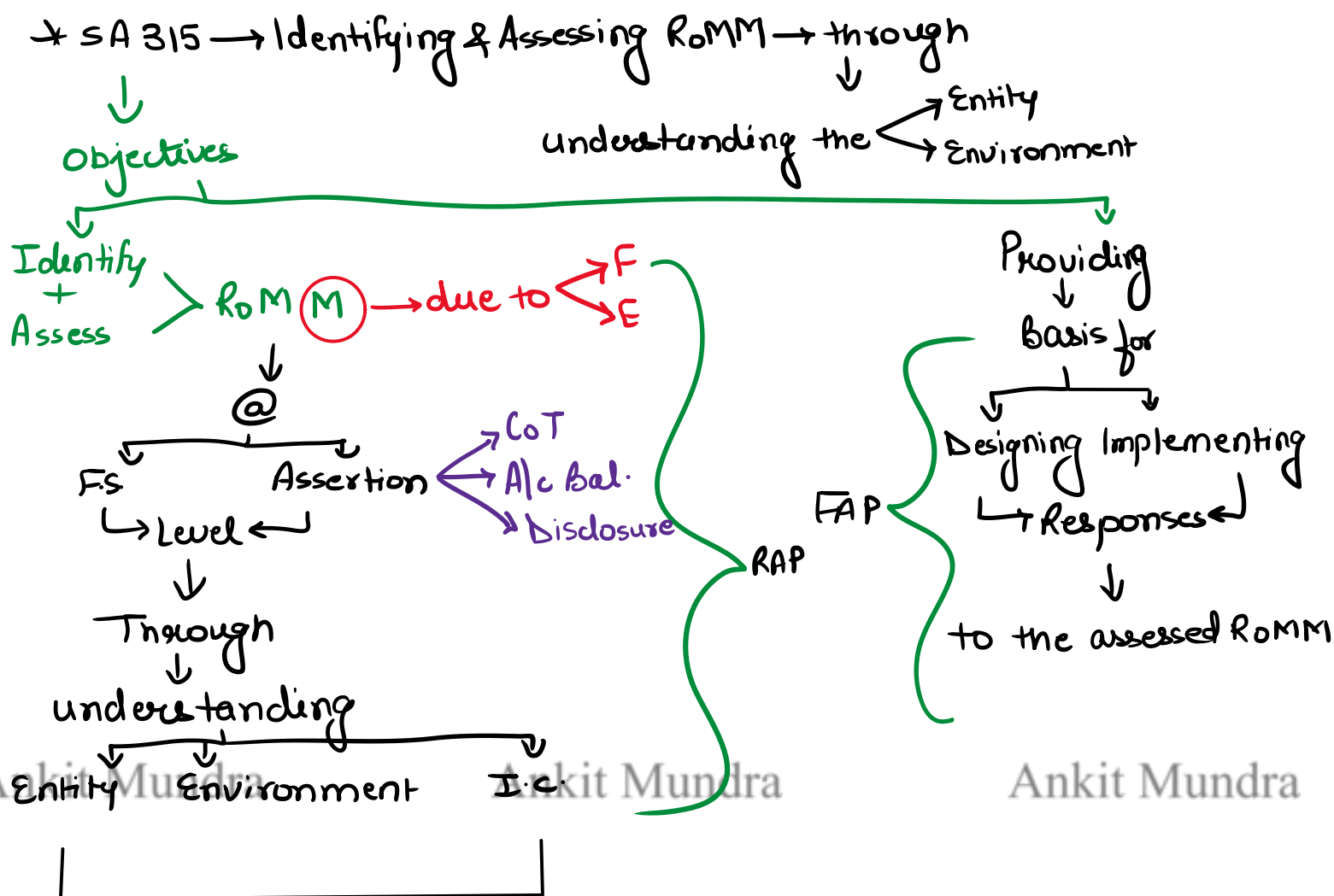
Generally $\rightarrow$ Inherent Risk $\times$ Control Risk = ROMM

→ COMBINED ←

But → Auditor may make
 Combined
 Separate
 Assessment
 Quantitative NonQuantitative

↓
Depending on

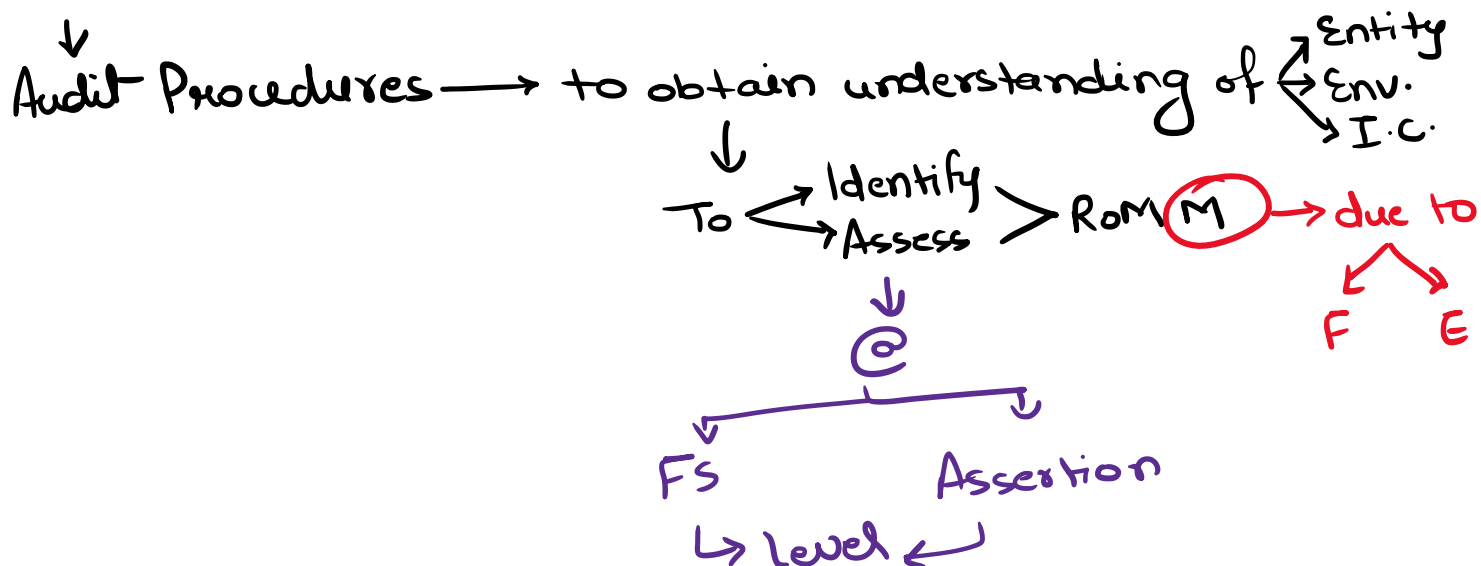
Preferred Audit Techniques Methodologies Practical Consideration



↓

Auditor shall

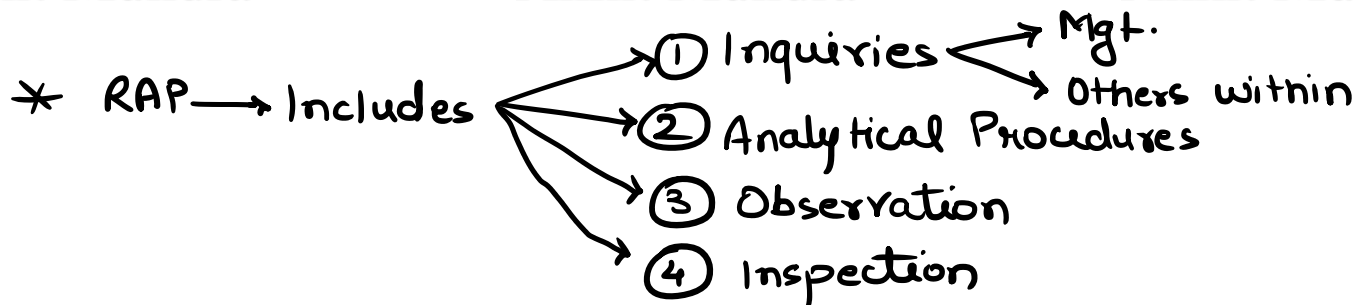
- ① Identify Risk → throughout the process
- ② Assess + Evaluate Risk → Relate pervasively to FS
→ potentially affect many assertions
- ③ Relate Risks to → WCGW @ Assertion level
↓
Taking Alc of ToC
- ④ Consider → likelihood of misstatement
→ possibility of multiple misstatement
→ misstatement could be material



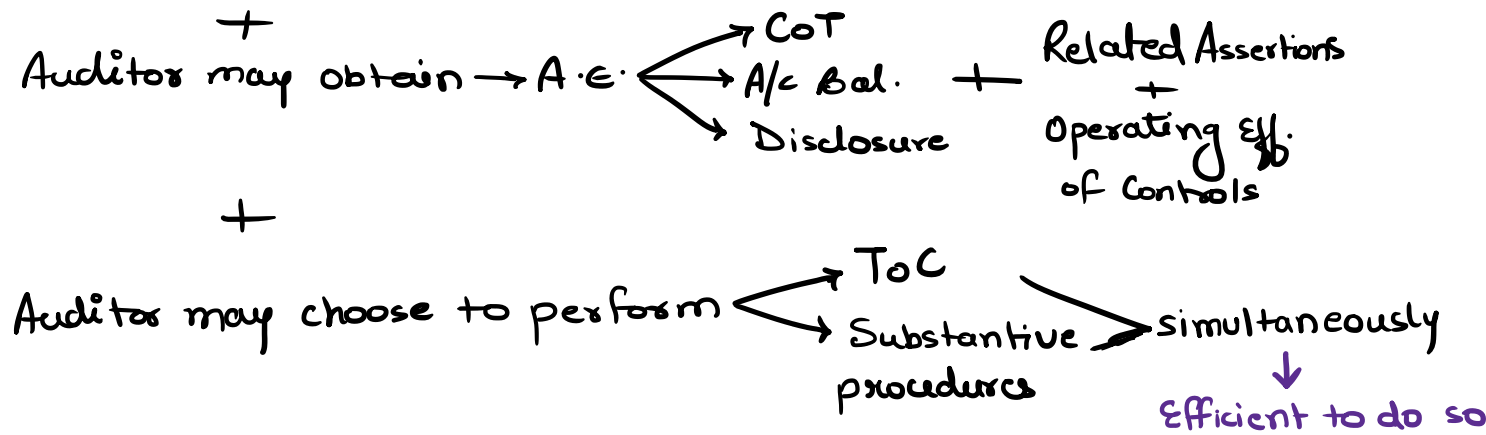
* RAP → by themselves → DO NOT PROVIDE → Suff. + Appso. A.E

↓

on which to base Audit Opinion

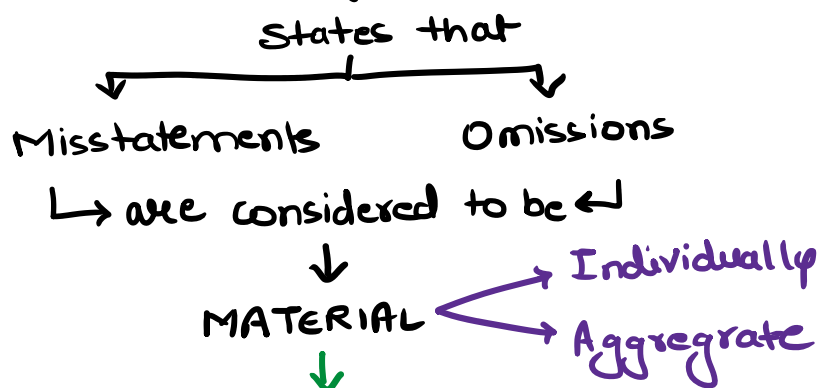


1.8 - Info. Obtained by performing R.A.P. - Used as A.E.



* 2.1 - What is meant by materiality?

SA 320 "Materiality in Planning & Performing an Audit"



If they could reasonably be expected → to influence
↓
The Economic Decision of the users

* Objective of Auditor → to obtain R.A. → F.S. as a whole
↓
are free from M.M. → due to
F E

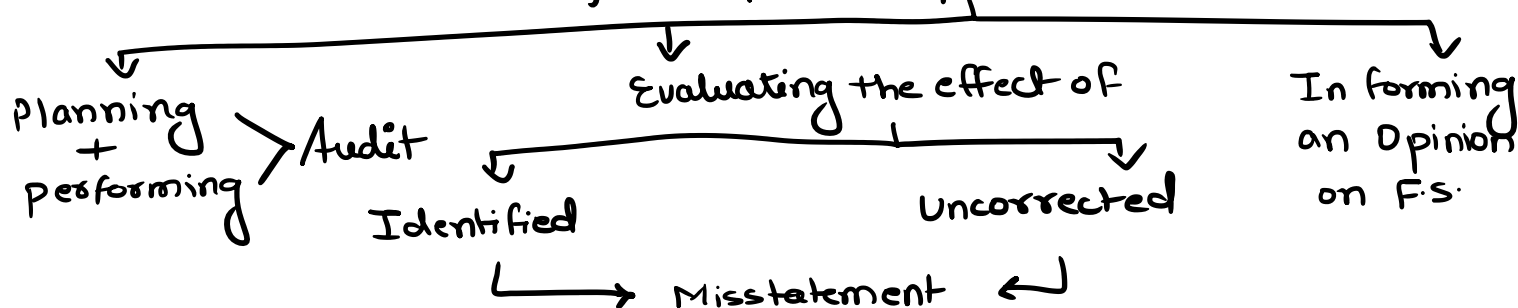
Thereby enabling an Auditor to Express an Opinion

↓
In ALL MATERIAL RESPECTS

↓
In accordance with App. F.R.F.

* Materiality → NOT ALWAYS → matter of size/volume

* Concept of Materiality → Applied by Auditor in



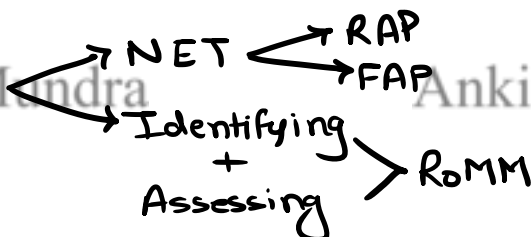
→ Judgements about materiality → Concept discussed in App. F.R.F.

IF NOT → based on:

- i) Surrounding circumstances
- ii) Size / Nature of misstatement
- iii) Common Financial Info. needs of users → As a Group

Specific Individuals → Not Considered

→ provide basis

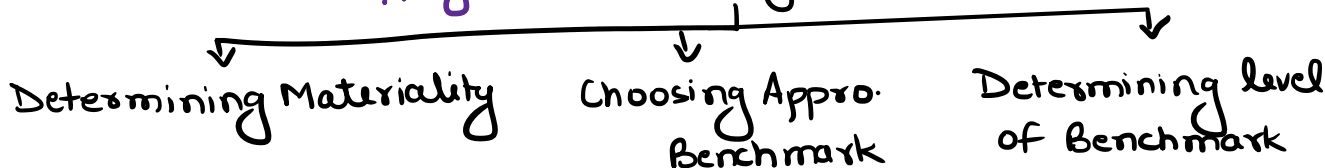


→ Circumstances → may cause the Auditor → to Evaluate
Amount < Materiality

→ Auditor Considers → Nature, Size, Occurrence → uncorrected misstatements
↓
When evaluating their effect on F.S.

+

Apply → Prof. Judgement in

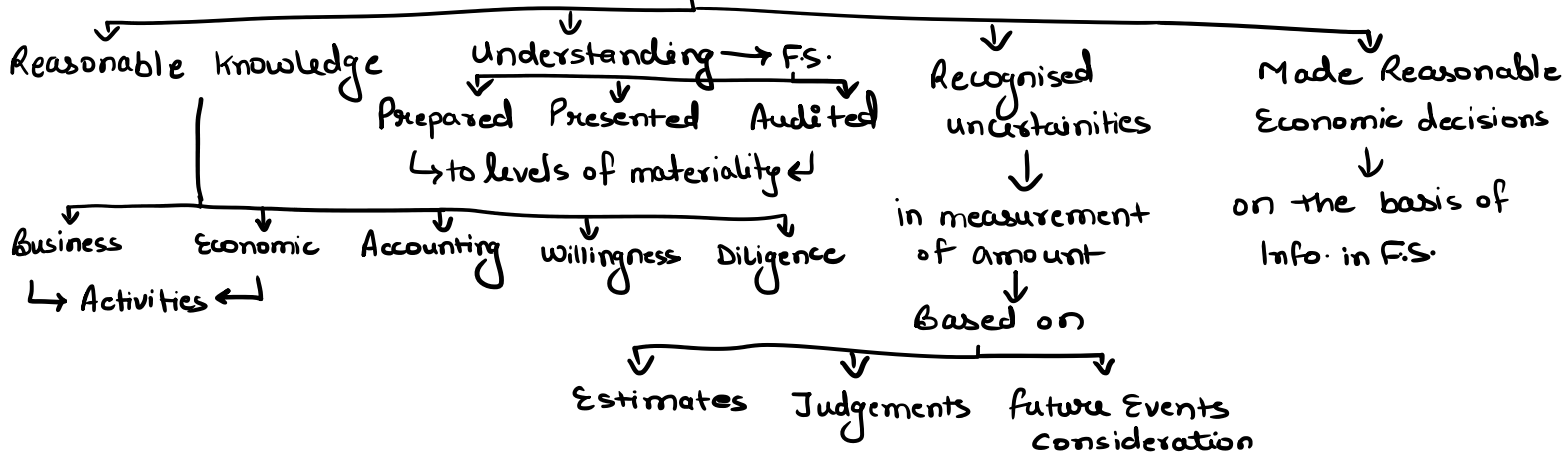


→ Materiality → forms Basis  Determination of Audit Scope
Level of testing the transaction

→ If → Statutory Requirement → ALWAYS MATERIAL

+
Affected by Auditor's perception of
↓
Financial Info. NEEDS of user of F.S.

* Auditor Assumes : user of F.S. has -



2.4 - Performance Materiality (PM) → Amount (\$) → set by the Auditor

At LESS than materiality for F.s. as a whole (08) → CoT
A/c Bal.
Disclosure

To reduce to an appropriately low LEVEL

Probability that the aggregate of
uncorrected undetected
misstatements

EXCEEDS materiality for F.s. as a whole

* $PM < OM$

* 2.5 - Determining Materiality (DM) & PM

↓
when establishing O.A.S.

↓
Auditor DM → F.s. as a whole (08) particular → CoT
A/c Bal.
Disclosure

2.6 - Benchmarks in DM for FS as a Whole

↓ involves → Exercise of Prof. Judgement

↓
A %age is often applied to a chosen benchmark

↓
As a STARTING POINT

* Factors → that may affect → Identification of Appro. Benchmark

i) Elements of F.S.

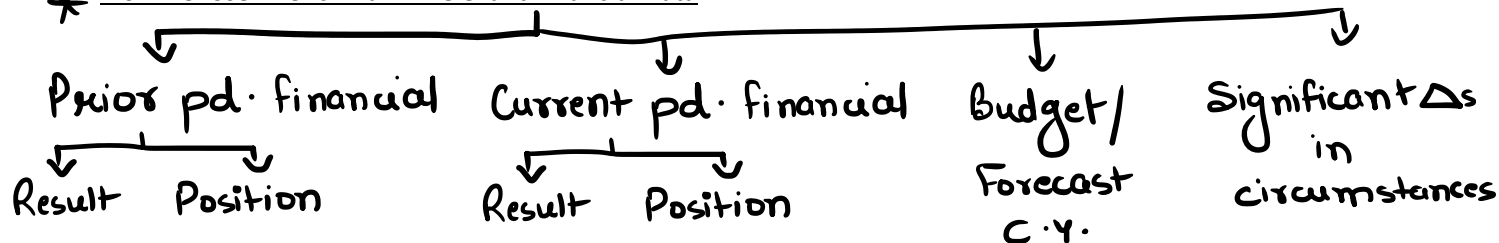
ii) Items in F.S. ← users tend to focus

iii) Nature of Entity + position at its Life Cycle + Industry
& Economic Environment + Ownership structure

iv) Volatility of Benchmark

Best Benchmark	Operations	Orientation
PBT	Continuing	Profit
GP or Sales	Volatile	NPO

* 2.6.1 - Chosen Benchmark - Relevant Financial Data



* 2.6.2.- Determining a %age - Involves Prof. Judgement

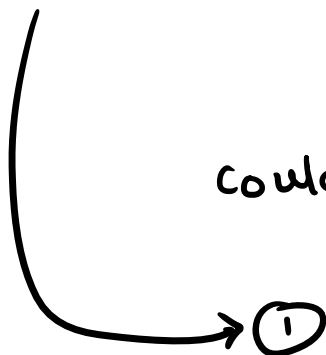
Best Benchmark	Operations	Orientation
PBT (Higher)	Continuing	Profit
GP or Sales (lower)	Volatile	NPO

Factors → that may indicate → Misstatements

↓
Amount < Materiality



could influence the economic decision of users



①

Law
Regulations

App. F.R.F.

Disclosures

→ Related Party Transactions

→ Remuneration

→ Mgt.
TCWG

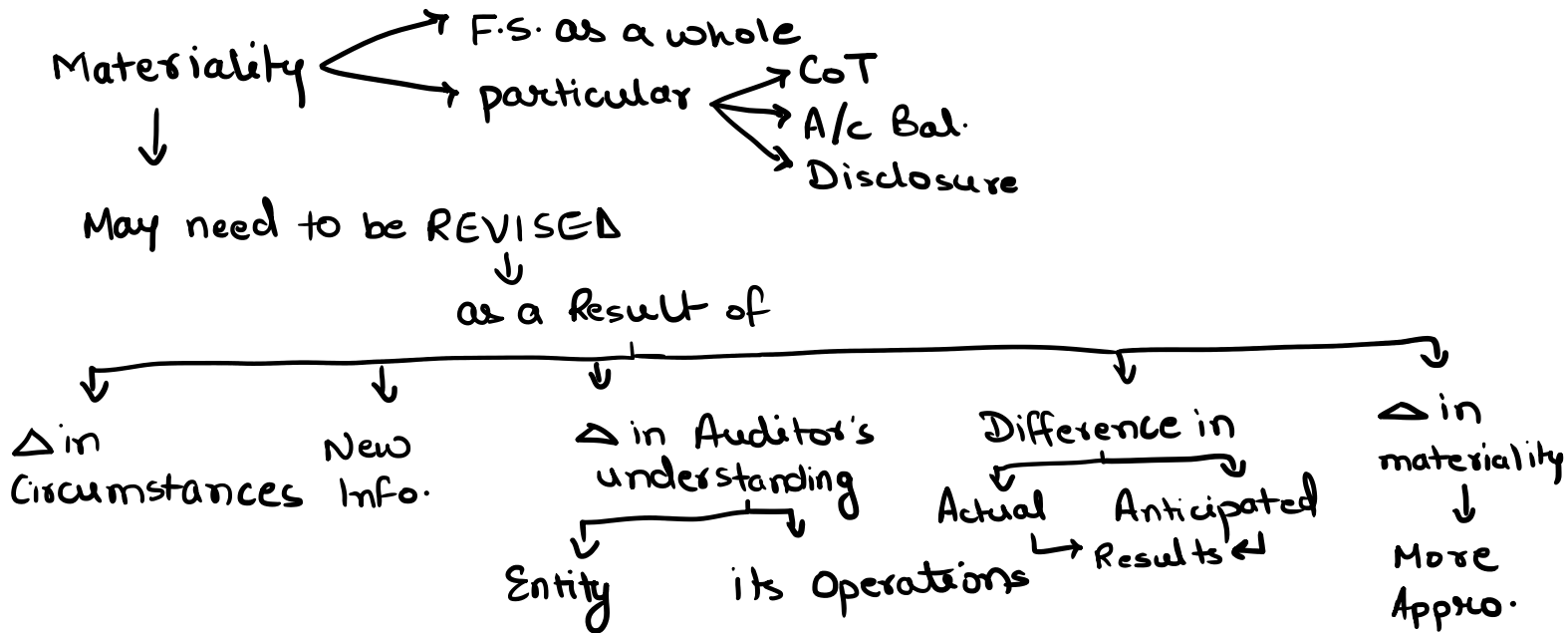
②

Key Disclosures

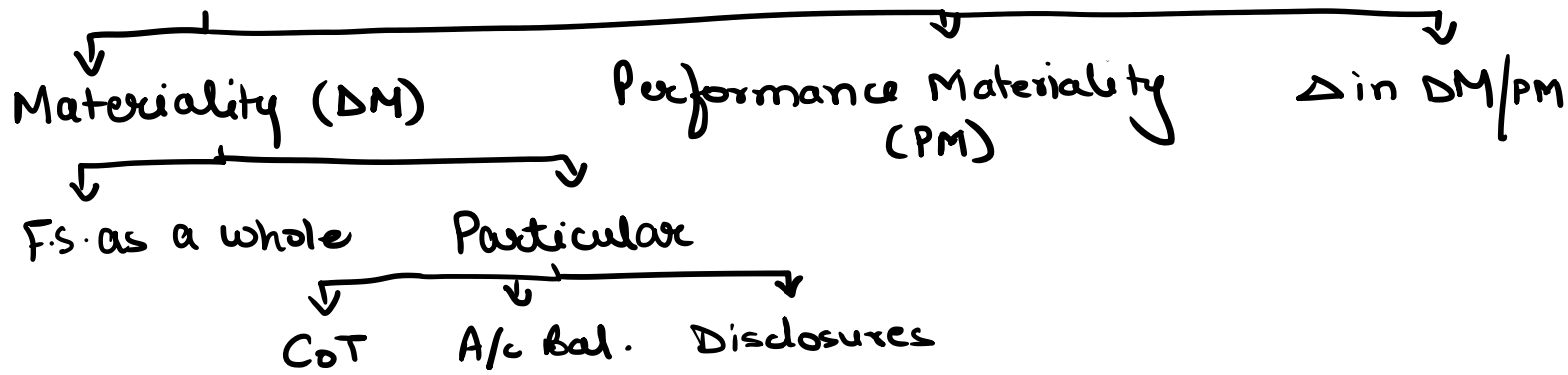
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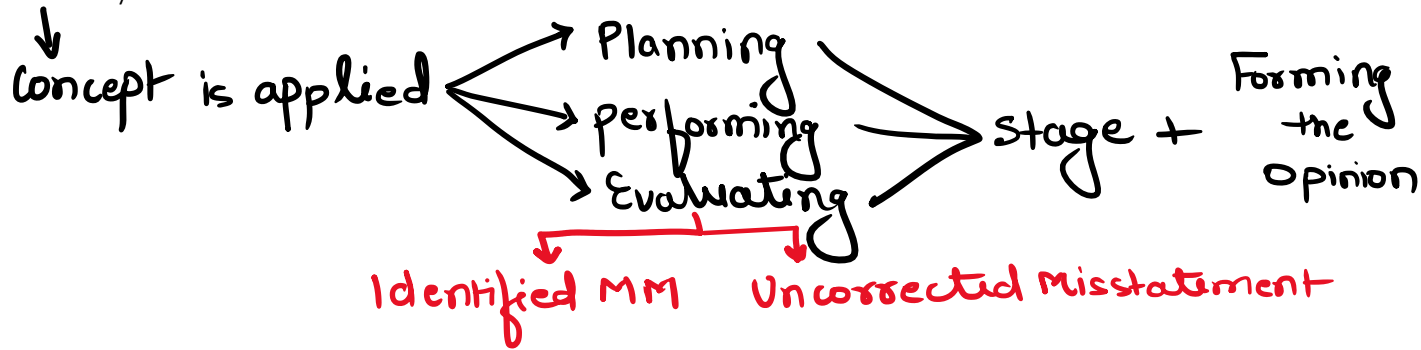
Particular aspects → separately disclosed

2.8 - Revision in Materiality Level (s) as the Audit Progresses

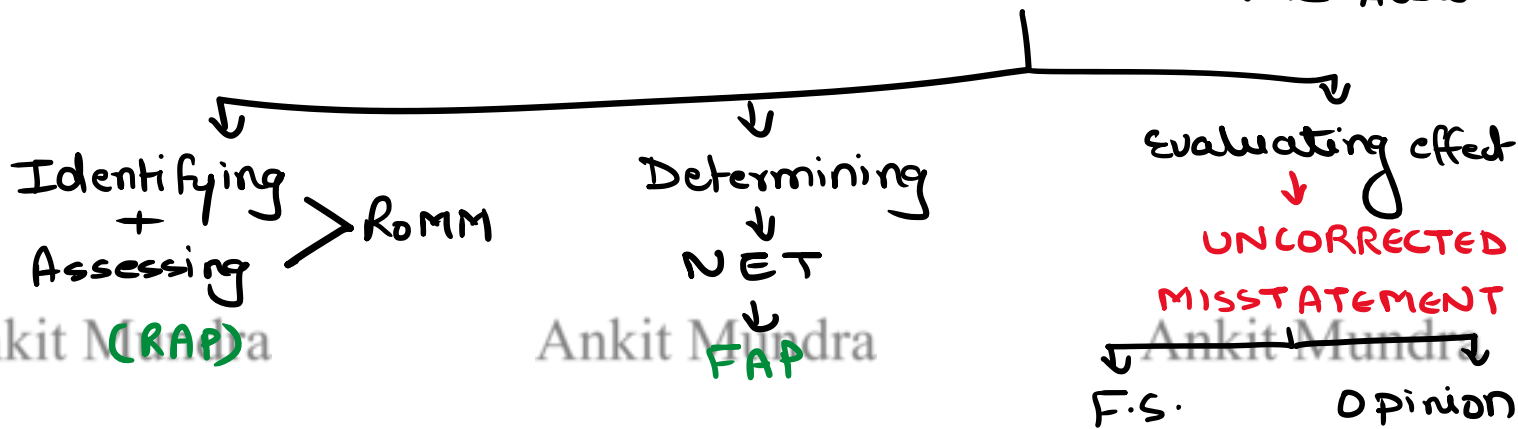


2.9 - Documenting the Materiality





* Materiality & Audit Risk → considered → Throughout the Audit



As per SA 315 → Auditor shall obtain understanding:

i) Relevant factors + App. F.R.F.

ii) Nature
operation
ownership
Governance
Financial structure of the entity

iii) Entity's Accounting Policies

iv) Entity's Objectives
Strategies
Business Risk

v) Measurement
Review Financial Performance

* 3.1 - Significance of Understanding → Helps Auditor in:

i) Planning the Audit

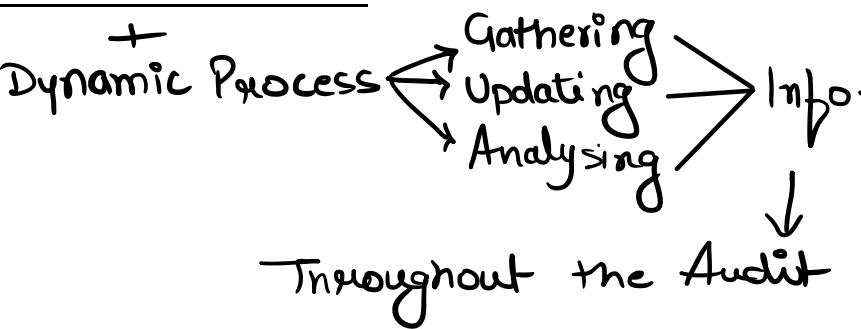
ii) Identify Areas → Special Attention

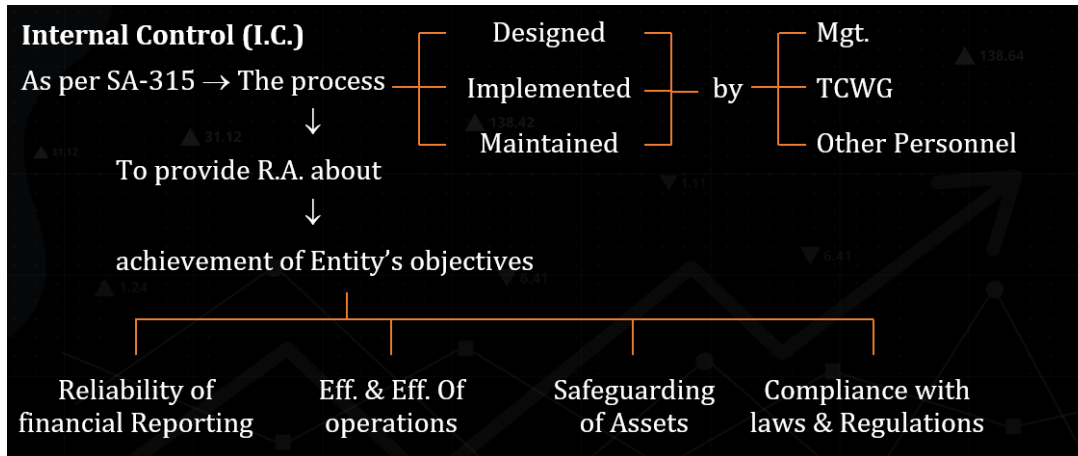
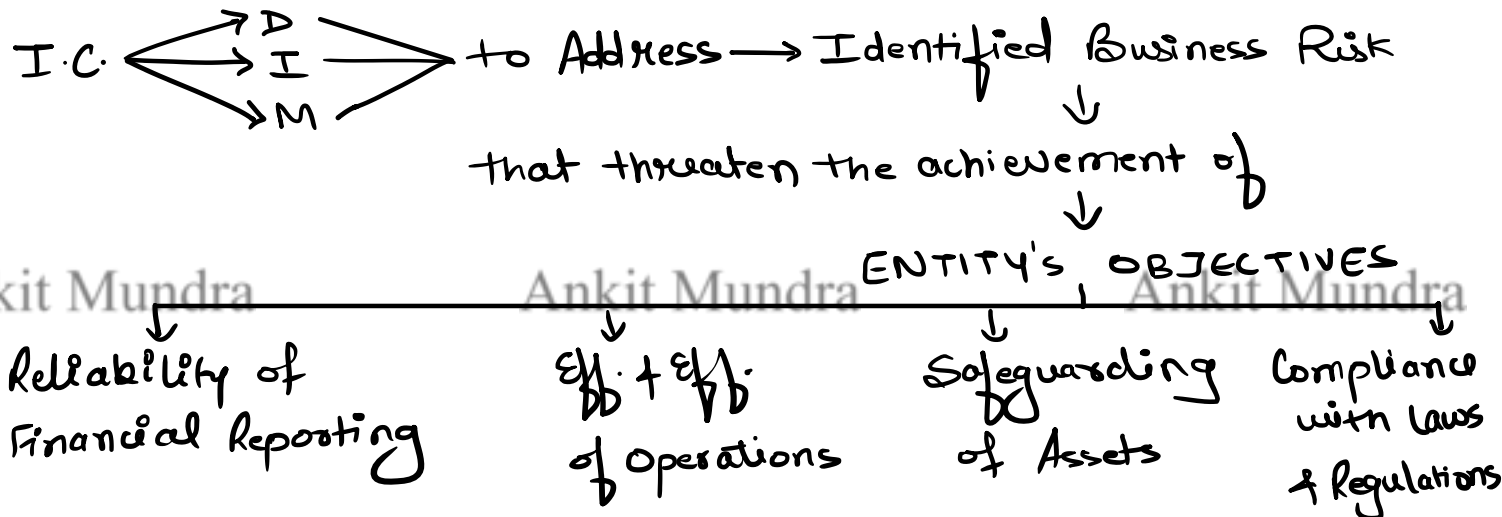
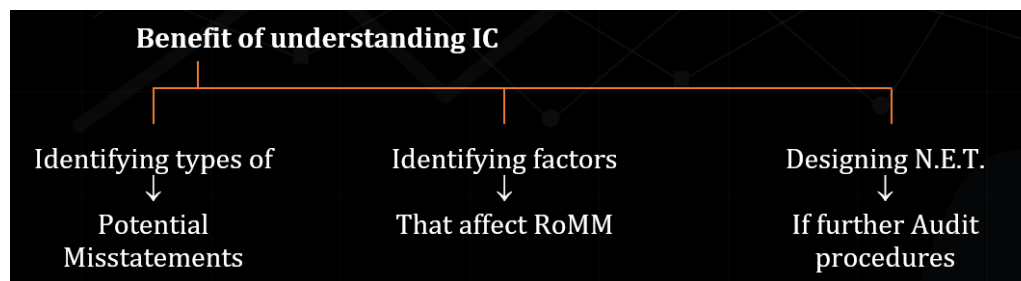
iii) Gaining knowledge → Client's Business → Imp. principles

iv) without knowledge → proper Audit → **NOT POSSIBLE**

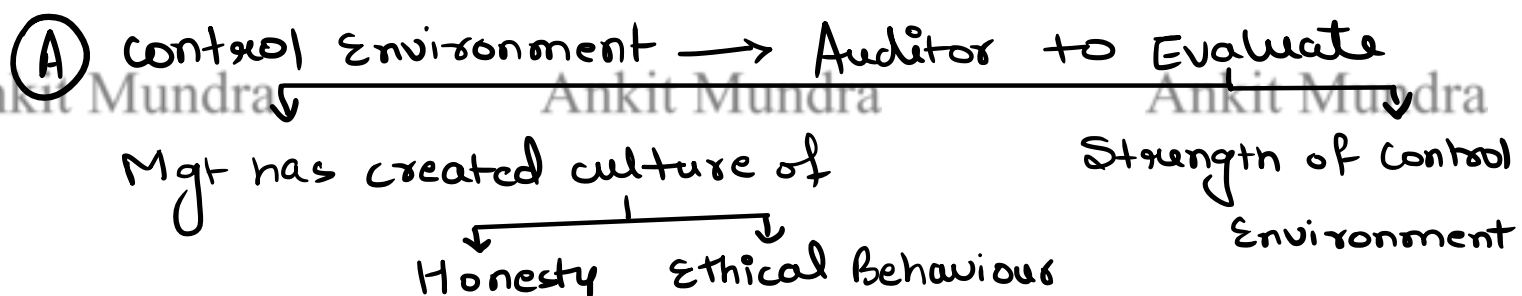
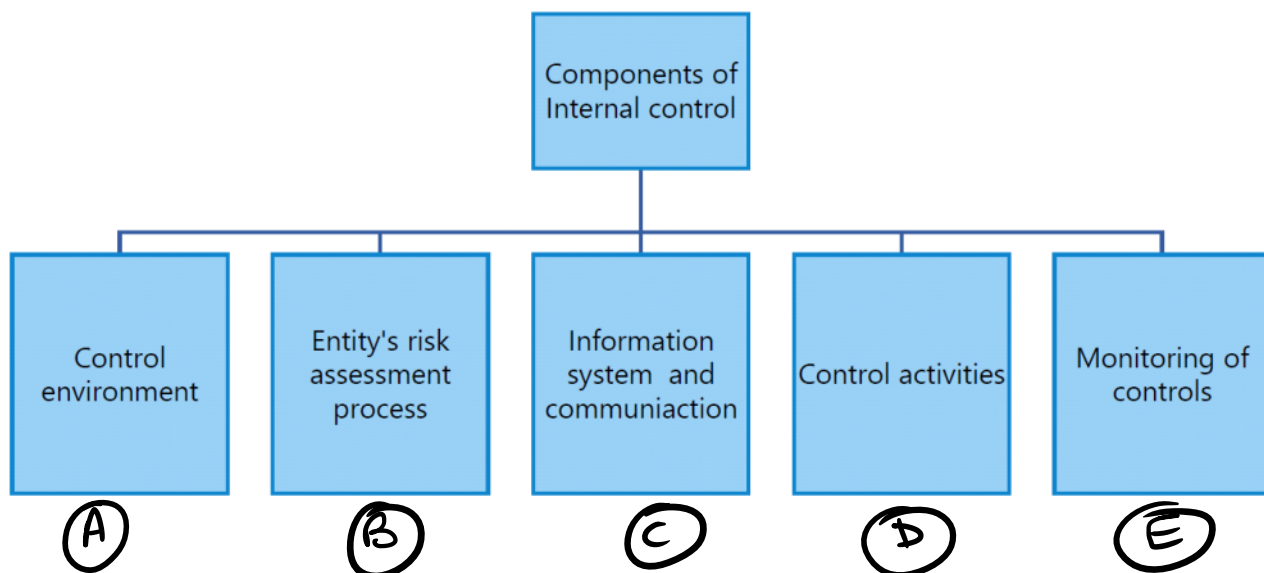
* 3.2 - Understanding Entity - CONTINUOUS PROCESS

✧ 3.2 - Understanding Entity - CONTINUOUS PROCESS



4.1 - Meaning of Internal Control4.2 - Purpose of Internal Control✱ 4.3 - Benefits of Understanding I.C.✱ 4.4 - Limitations of I.C.

- (i) Only R.A.
- (ii) Human Judgement in Decision Making
- (iii) Lack of understanding of purpose
- (iv) Collusion among people
- (v) Judgement by Mgt.
- (vi) Limitations in case of small Entities



→ Elements of Control Environment

- i) Communication + Enforcement
↳ Integrity & Ethical values
- ii) Commitment → to Competence

- iii) Participation → by TCWG
- iv) Mgt.'s $\begin{cases} \rightarrow \text{philosophy} \\ \rightarrow \text{operating style} \end{cases}$
- v) Organisational Structure
- vi) Assessment of $\begin{cases} \rightarrow \text{Authority} \\ \rightarrow \text{Responsibility} \end{cases}$
- vii) H.R. $\begin{cases} \rightarrow \text{Policies} \\ \rightarrow \text{Practice} \end{cases}$

→ Existence of Satisfactory Control Environment



NOT AN ABSOLUTE DETERRENT TO FRAUD



can be a POSITIVE FACTOR → when Auditor assess

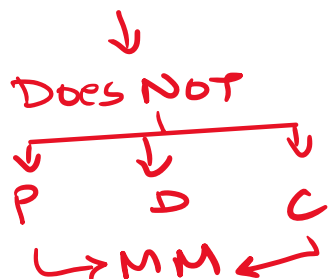


RMM

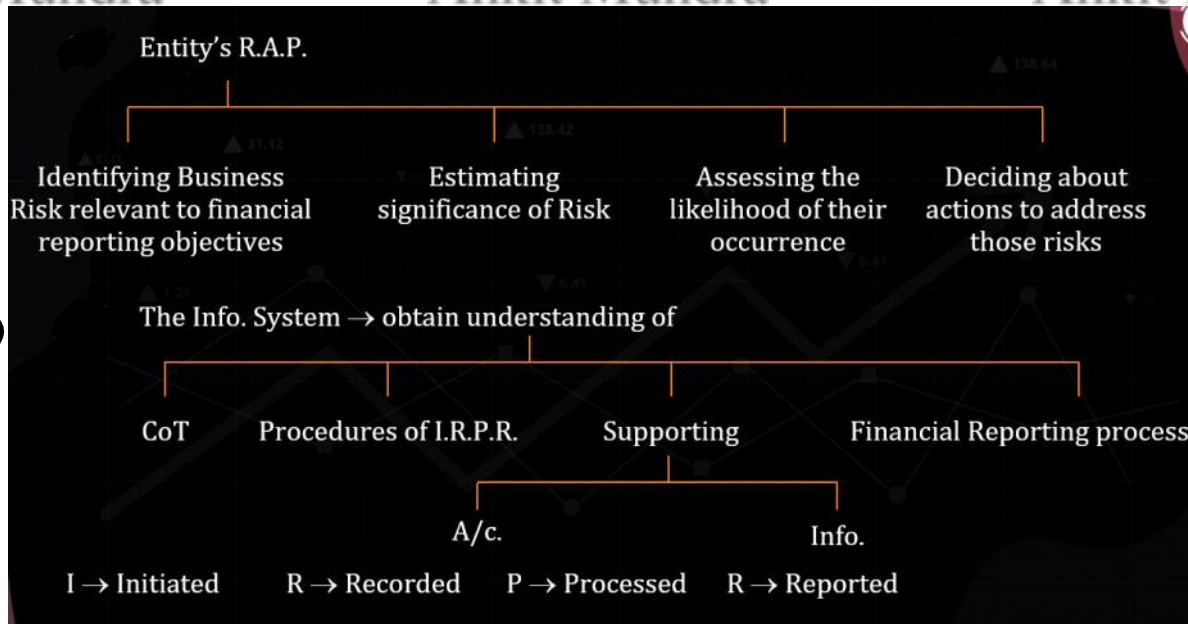
→ Control Environment → influence → Auditor's Evaluation



of eff. of controls



B



C

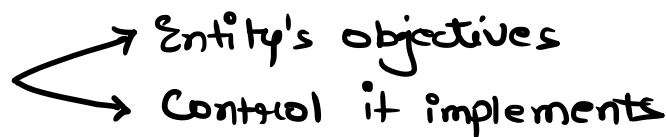
D

Control Activities → Relevant to → Significant Risk → As per Auditor → Identified by R.A.P.

E

Monitoring → helps in assessing → effectiveness of control → on timely basis

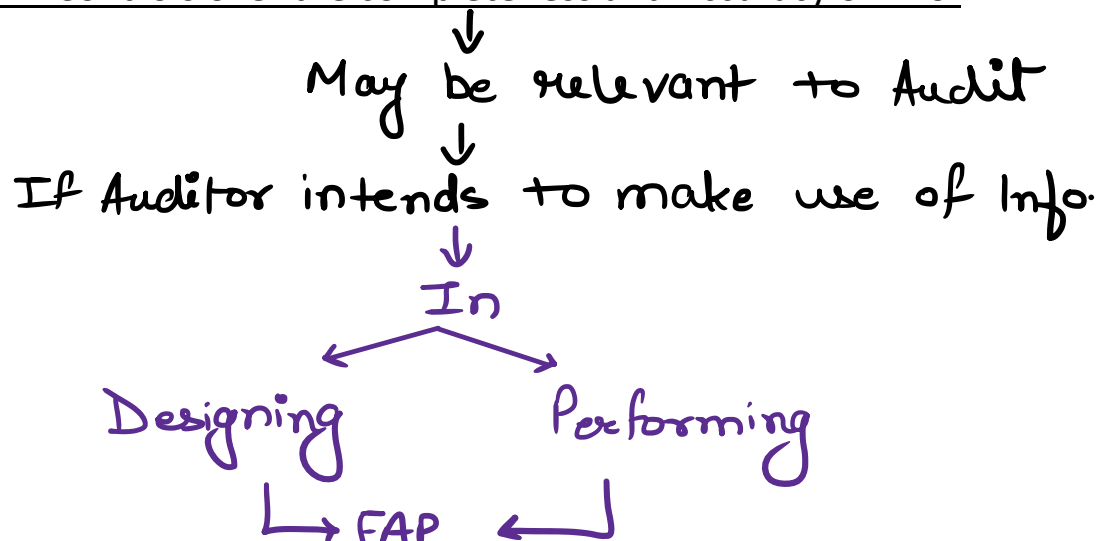
4.6 - Controls Relevant to Audit

* Direct Relationship → b/w 

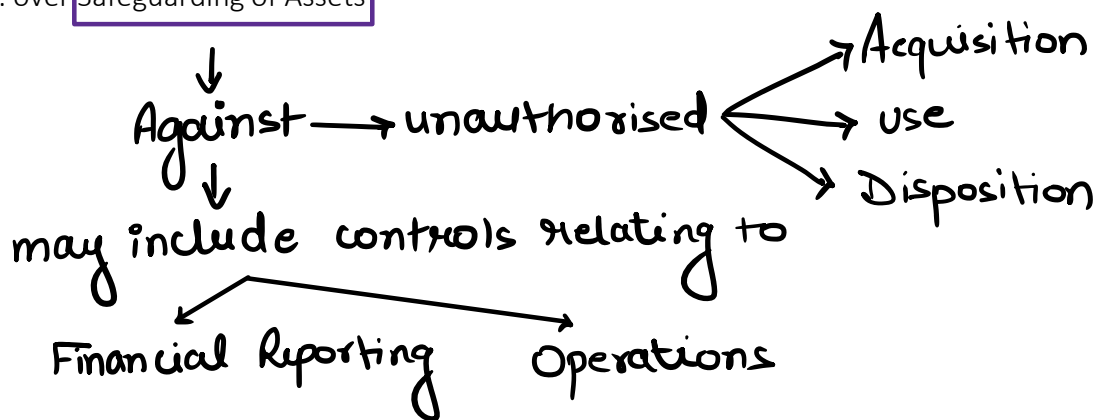
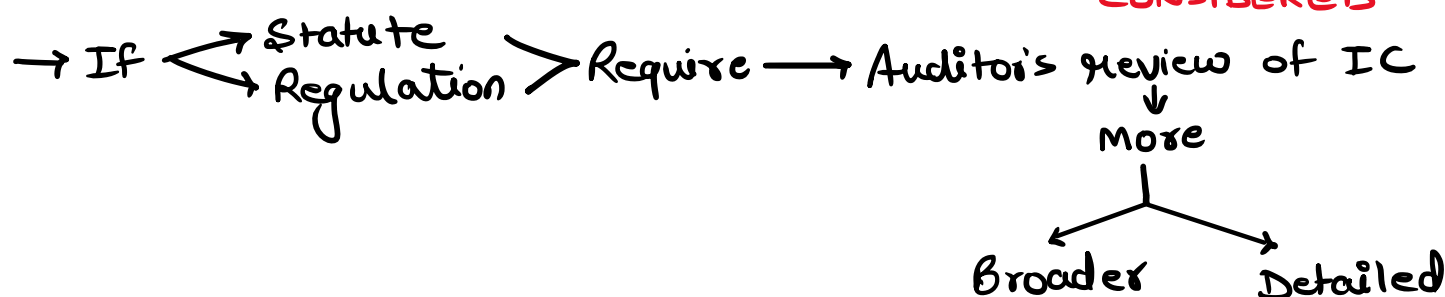
* Relevant Factors

- Materiality.
- Significance of → related risk.
- Size of the entity.
- Nature of the entity's business
- Organisation + Ownership characteristics
- Diversity + Complexity of operations.
- Applicable legal + regulatory requirements.

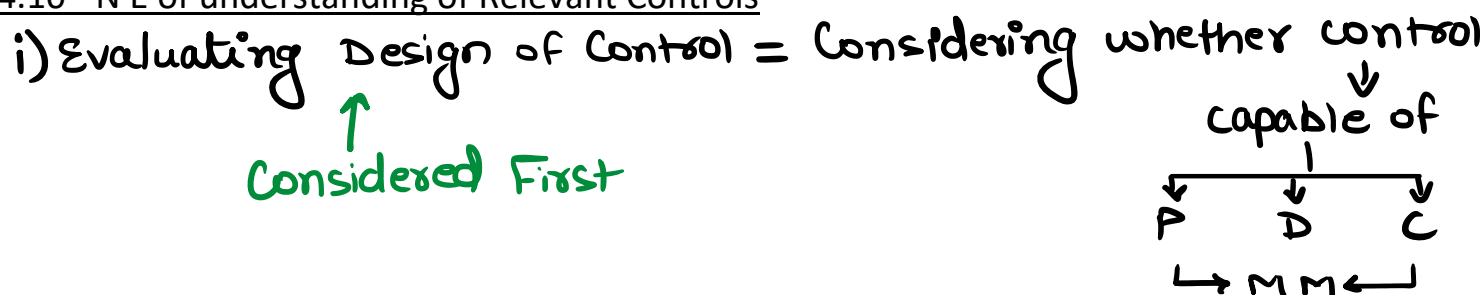
- Circumstances + applicable component of IC
- Nature + Complexity of the systems
- Whether → control → prevents, or detects and corrects → material misstatement.

* 4.7 - Controls over the completeness and Accuracy of Info.

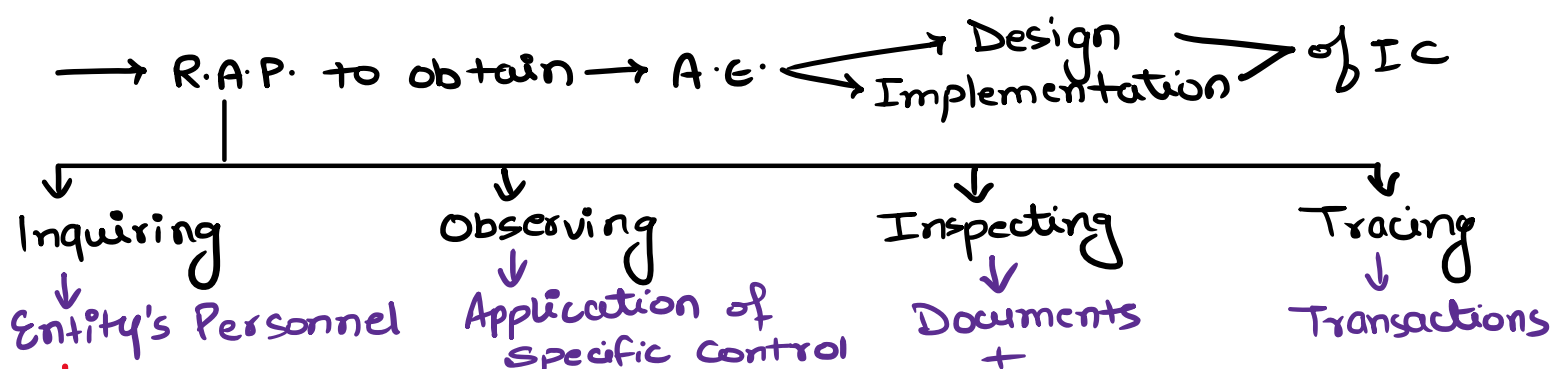
4.8 - I.C. over Safeguarding of Assets

4.9 - Controls relating to Objectives - Not relating to Audit → **NEED NOT BE CONSIDERED**

4.10 - N E of understanding of Relevant Controls



ii) Implementation of Control = Control EXISTS + Entity USING it



Entity's Personnel



Alone → NOT SUFFICIENT

Application of
Specific ControlDocuments
+
Reports

Transactions

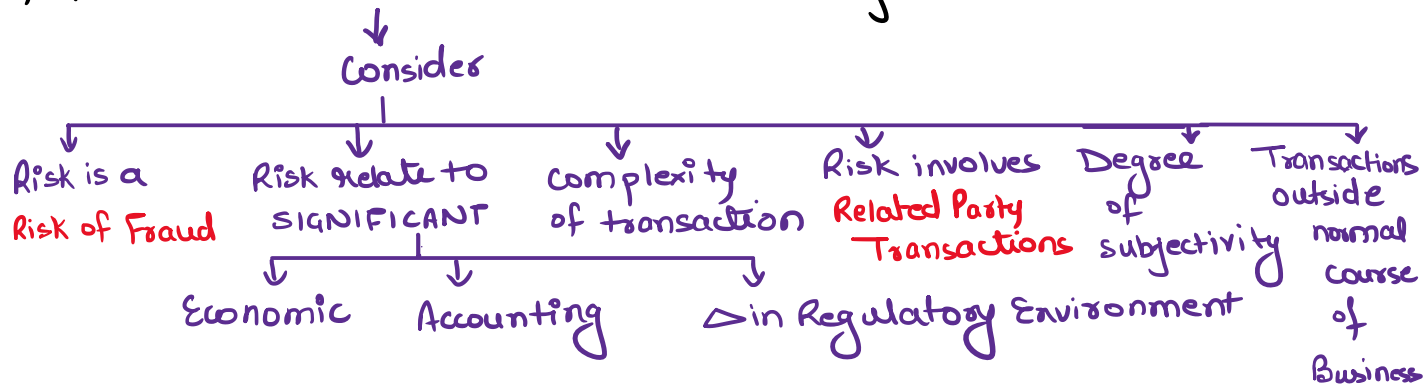
→ Understanding I.C. → NOT SUFFICIENT

Unless there is SOME AUTOMATION

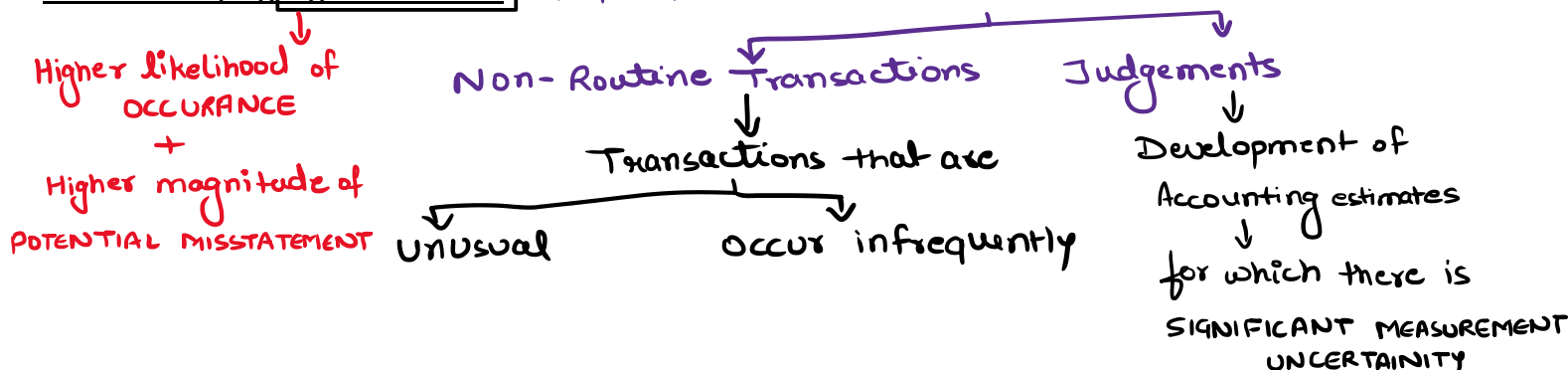
Provides for consistent operation of control

5 - Risk that require Special Consideration

* In R.A.P. → Auditor shall determine → Any Risk ⇒ **SIGNIFICANT RISK**



5.1 - Identifying **Significant Risk** → often relate to **SIGNIFICANT**



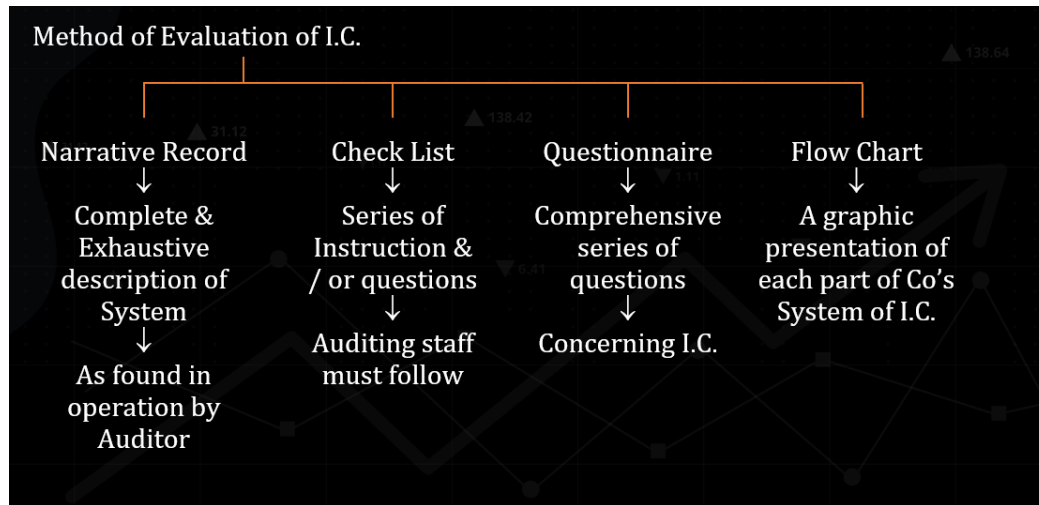
6 - Evaluation of IC System



Indispensable part of overall Audit Program

6.1 - Benefits of Evaluation of IC

- i) $\frac{F}{E} >$ likely to be located $\rightarrow$ ordinary course of business
- ii) Adequate IC $\begin{cases} \rightarrow \text{in use} \\ \rightarrow \text{operating as planned} \end{cases}$
- iii) Effective $\rightarrow$ Internal Auditing Dept.
- iv) Administrative control $\rightarrow$ has a bearing on Auditor's work
- v) Controls $\rightarrow$ Adequately safeguards assets
- vi) How Mgt. is $\rightarrow$ Discharging its functions
- vii) Reliability of $\begin{cases} \rightarrow \text{Report} \\ \rightarrow \text{Record} \\ \rightarrow \text{Certificates} \end{cases}$
- viii) Areas $\rightarrow$ where $\rightarrow$ controls are weak



↓ Disadvantages

- i) Difficult to comprehend → System in operation
- ii) Identify $\begin{matrix} \nearrow \text{weakness} \\ \searrow \text{gap} \end{matrix}$ in system
- iii) Incorporate Δ s → arising out of → Reshuffling of Manpower

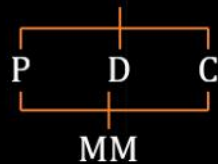
Testing of I.C. → How far I.C. is actually in operation?

On selective basis

→ ToC are performed → to obtain A.E. → about effectiveness of → operation of I.C. → through the audit

↓
Design of A/c. & I.C. System

↓
i.e. whether they are suitably designed to



ToC may include

- (1) Inspection → of Document supporting transactions & other events to gain A.E. → that I.C. has operated properly.
- (2) Inquiries + observation → about I.C. → which leaves → No Audit trail
- (3) Reperformance → involves the Auditor's Independent execution of

Procedures

Controls

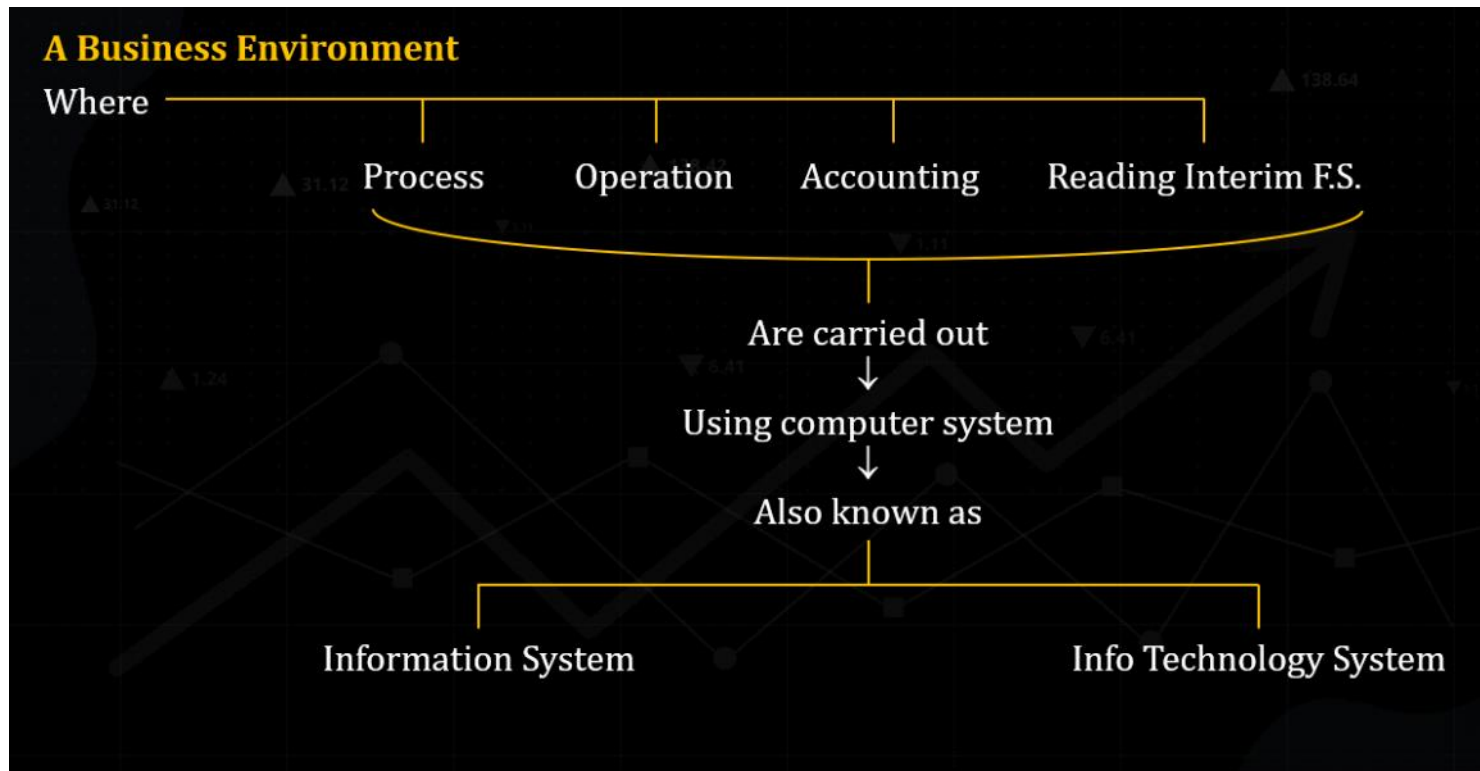
That were originally framed

- (4) Testing → of I.C. → operating on specified computerized application

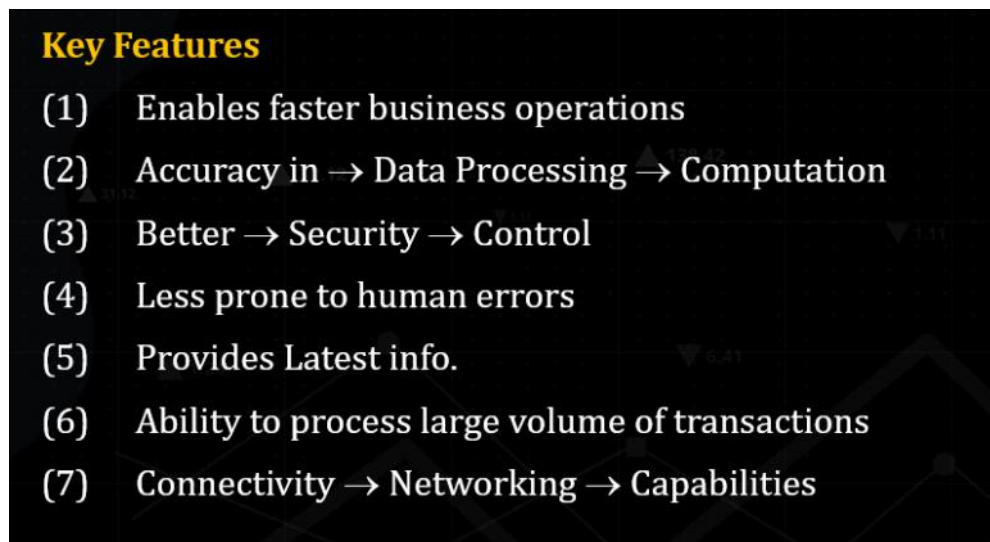
OR

over the overall Infor. Technology function

8 - What is an Automated Environment



8.1 - Key Features of Automated Environment



8.2 - Understanding and Documenting Automated Environment

- (1) Info system being used (One/more application system + What they are)
- (2) Their purpose (Financial or Non-Financial)
- (3) Location of IT system (Local V/s Global)
- (4) Architecture (Desktop Based, Cloud Based, Client – Server Based)
- (5) Version (Functions & Risks could vary in different versions)
- (6) Interfaces with systems (in case of multiple → Entries → Exits)
- (7) In house v/s packaged
- (8) Outsourced Activities
- (9) Key Persons (CIO)

8.3 - Risks arising from use of IT Systems

- (1) Inaccurate processing of data, processing in accurate data, or both
- (2) Unauthorised access to data
- (3) Direct Data Δs
- (4) Excessive Access / Privileged (Super Users)
- (5) Lack of Adequate Segregation of Duties
- (6) Unauthorized Δs to → Systems → Programs
- (7) Lose of Data

8.4 - Impact of IT related Risks

(1) Substantive Audit

(a) Cannot rely on data Obtained from system

(b) System → Data → Reports → Should be tested substantively for more → Completeness → Accuracy

(2) Controls

(a) Cannot rely on automated controls, system calculations & A/c.ing procedures

(b) More substantive Audit work is needed

(3) Reporting

(a) Communication to TCWG

(b) Modified Audit Report

8.5 - Types of controls in an Automated Environment

Types of Controls in Automated Environment**General IT Controls**

- (1) P & P → that relates to many → Applications + Support effective function of Application controls
- (2) They apply to → Main frames → Mini frames
- (3) General IT controls that → Maintain integrity of info → Security of Data → Commonly includes controls over



Application Controls

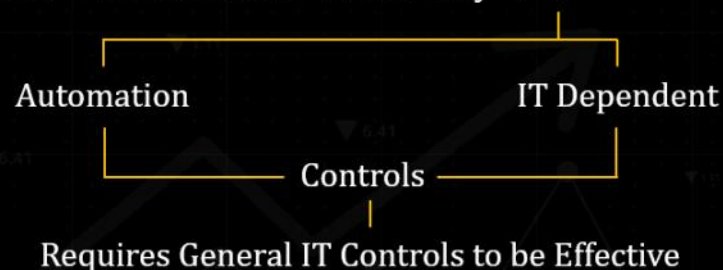
- (1) Include → Automated → Manual → Controls → that operate at Business process level
- (2) Automated controls are embedded into IT applications via ERPs



IT Dependent Controls

- (1) Basically → Manual Controls → That make use of some form of
 - Data
 - Info.
 - Report
 Produced from
 - IT Sys.
 - Applications

- (2) Even though → Controls are performed manually → The → Design → Effectiveness → of such controls → Depends upon → The reliability of Source of Data
- (3) Due to Internet dependency on IT → The → Effectiveness → Reliability → of



8.6-General IT Controls vs. Application Controls

General IT controls V/s Application Controls

- These 2 category of controls over IT system → Interrelated
- The relationship between them is such that

General IT controls are needed to support the functioning of application controls

Both are needed to ensure complete & accurate info. Processing through IT System

8.7 - Testing Methods in an Automated Environment

Testing Methods

➤ Inquiry + Reperformance + Inspection + Observation

➤ Inquiry → Most efficient → But gives least A.E.



➤ Reperformance → most effective + gives Best A.E. → But → Time Consuming → Least Efficient

➤ Inspection → Most Eff. & Eff. A.E. → But → Which → When → What → Test to use

+
Inquiry

Is a matter of professional Judgement

↓
Depends up on

Risk
Assessment

Control Env.

Desired
Level of A.E.
required

History of
Errors /
Mistakes

Complexity
of Business

Assertions
being
addressed?

➤ Auditor should document the Test + Judgement Applied (SA 230)

Most Common Method of Testing

(1) Obtain Understanding → of how an Automated Transaction is processed

By doing → Reperformance → Using

Inquiry

Observation

Inspection

(2) Observe → How user processes transaction → under different scenarios

(3) Inspect → the configurations defined in application

→ An entity's system of IC → contains $\begin{matrix} \nearrow \text{Manual} \\ \searrow \text{Automated} \end{matrix}$ elements

→ Use of $\begin{matrix} \nearrow \text{Manual} \\ \searrow \text{Automated} \end{matrix}$ elements in I.C. → affects the manner
 ↓
 in which transactions are
 ↓
 I R P R

→ Controls in Manual

① Procedures $\begin{matrix} \nearrow \text{Approval} \\ \nearrow \text{Review} \\ \nearrow \text{Reconciliations} \\ \nearrow \text{Follow up} \end{matrix}$

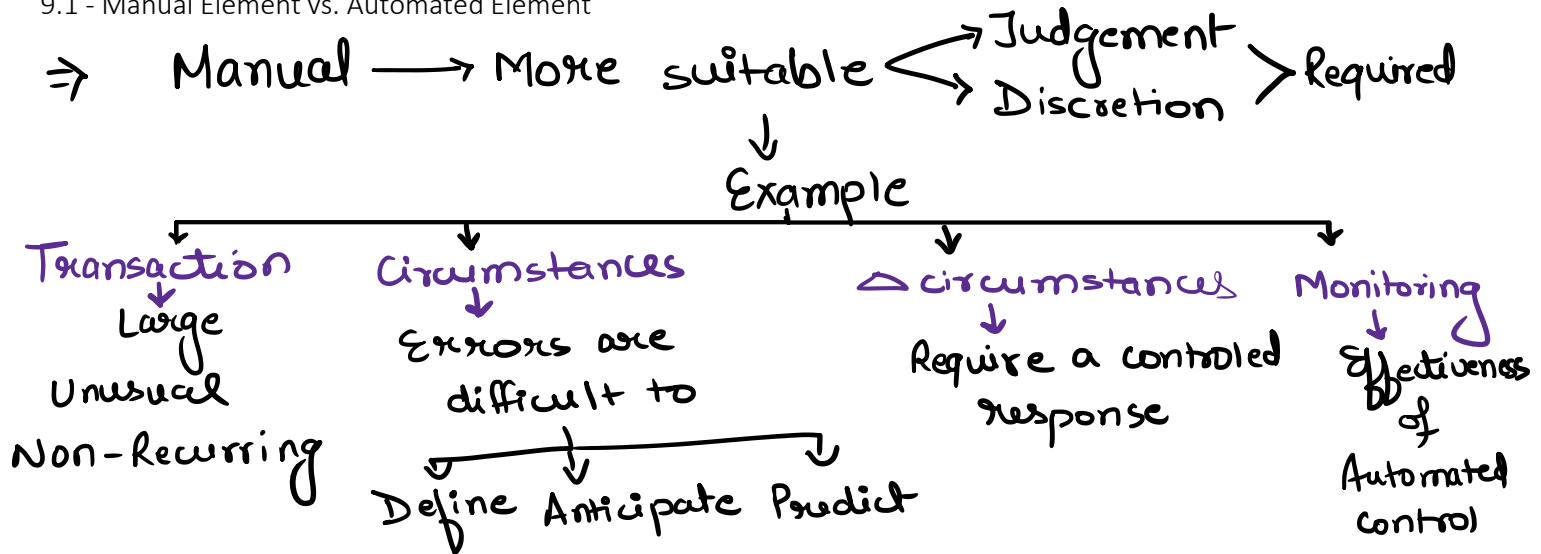
② May use Automated Procedures → Electronic format
 ↓
 Replaces paper document

→ Controls in IT System

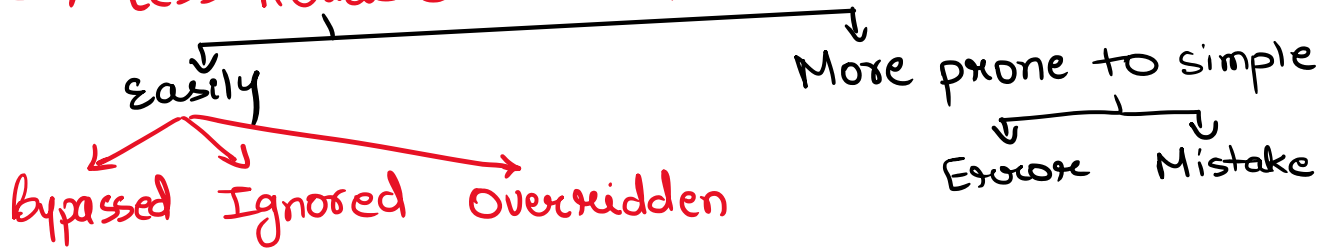
① Combination of $\begin{matrix} \nearrow \text{Automated} \\ \searrow \text{Manual} \end{matrix}$ controls

② Manual Controls → may be → Independent of IT
 → use Info. produced by IT
 → limited to monitoring
 → Handling exceptions

9.1 - Manual Element vs. Automated Element

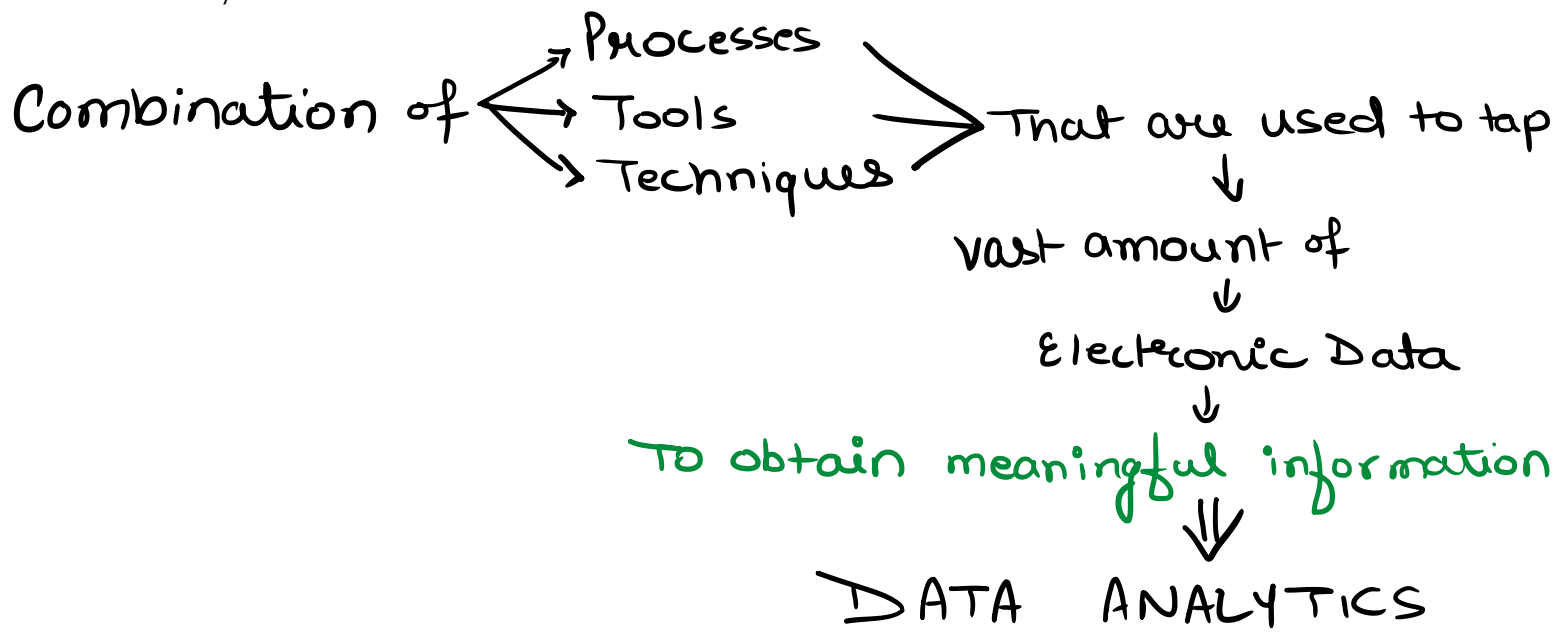


→ Less Reliable than Automated

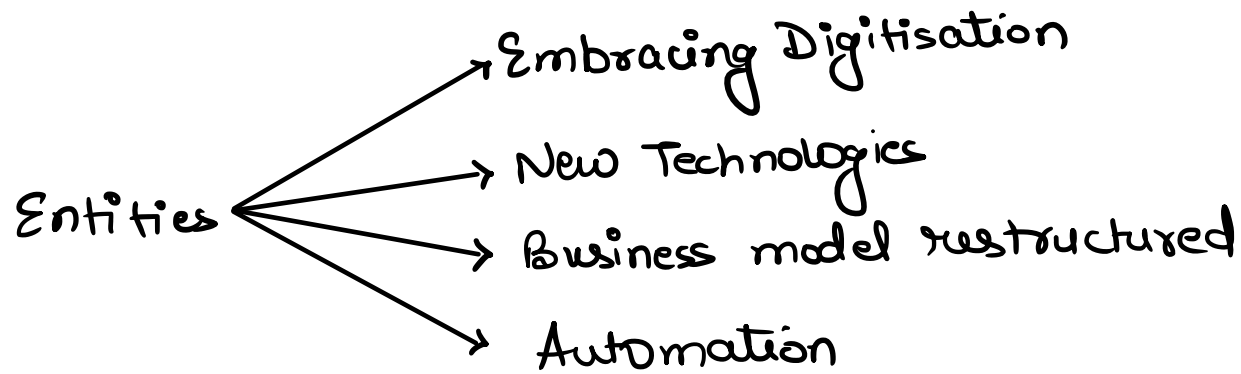


→ Consistency → cannot be assumed

→ Less suitable $\begin{cases} \text{High volume / Recurring transaction} \\ \text{where specific way to perform} \end{cases}$



→ Tools
Techniques] → that Auditor uses → CAATs



Auditors → use Digital Technology → Planning to Final opinion

13 - IFC as per Regulatory Requirements

Internal Financial Controls (IFC) as per Regulatory Requirements

↓
Defined V/s 134 (5)(e) of the companies Act, 2013

↓
P&P → Placed by Co. for ensuring

Reliability of
Financial Reporting

Compliance with app.
→ Laws → Regulations

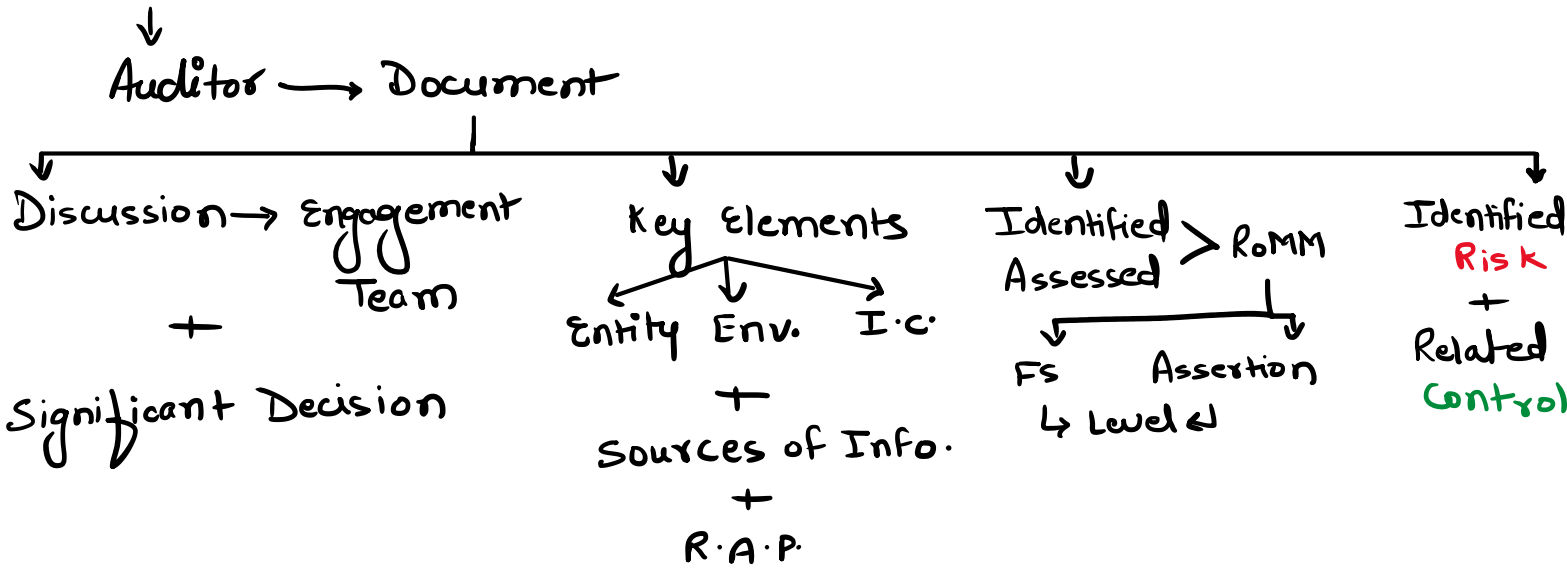
Eff. & Eff. of
Operations

Safeguarding
of Assets

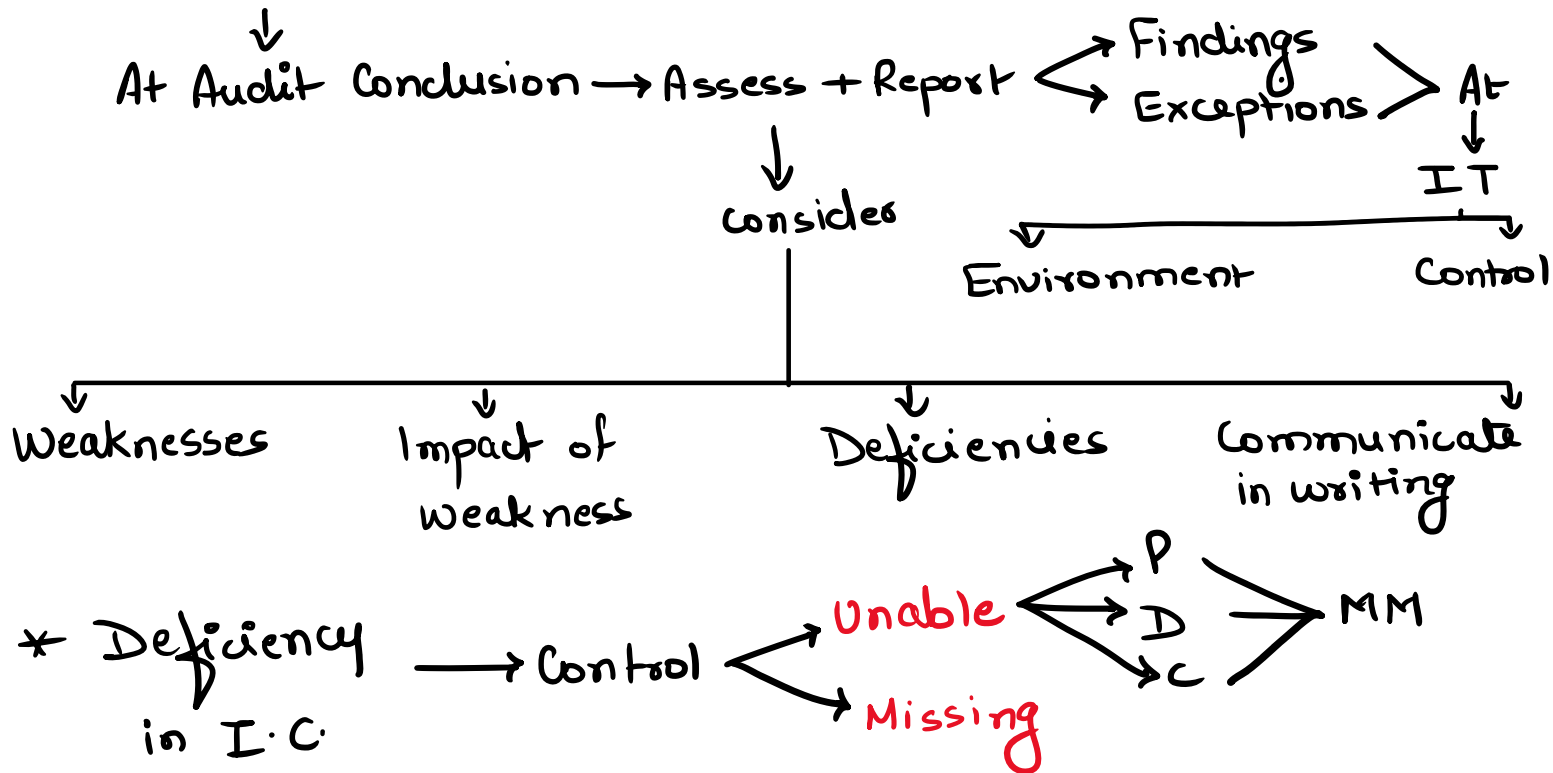
P & D of Fraud

Requirements of :

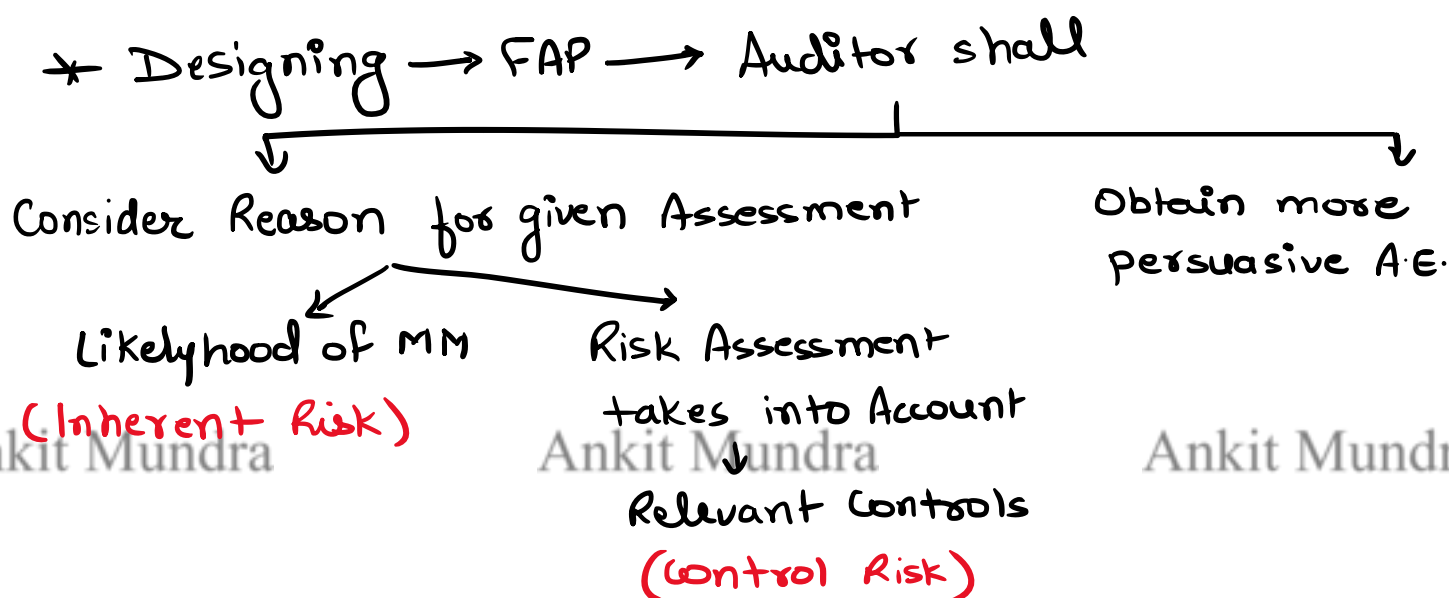
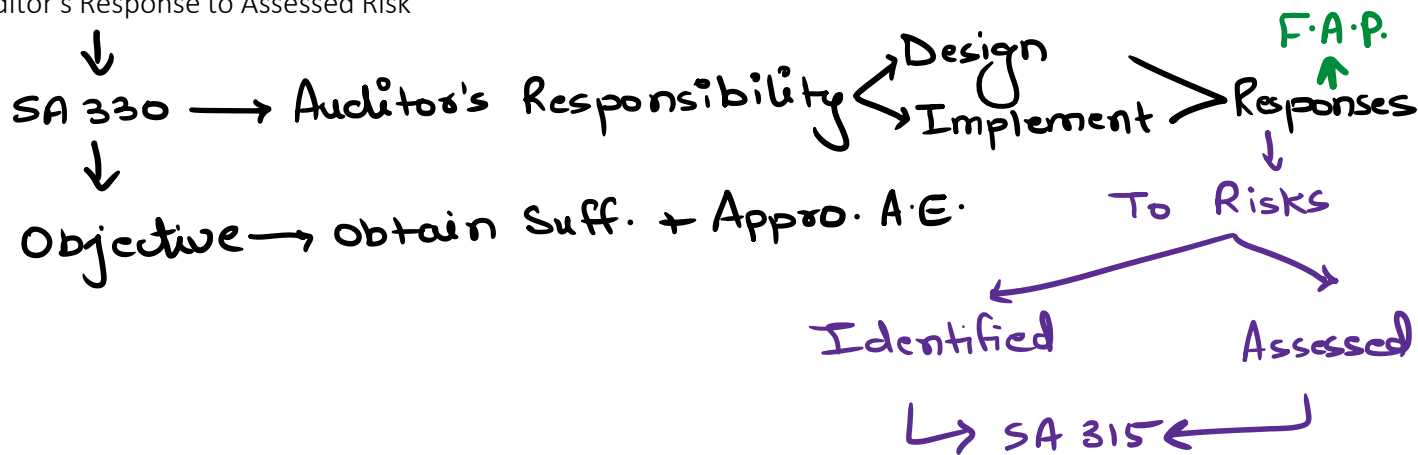
Ack./Rule	Section/Rule	Responsibility	Applicability
The companies Act, 2013	Sec.134(5)(e)	B.O.D.	Check – Ch.4
	Sec.149(8) & Schedule IV	Independent Director (I.D)	All Companies having I.D.
	Sec.177	Audit Committee (A.C.)	All Companies Having A.C.
	Sec.143(3)(i)	Statutory Auditor	All Companies
The Companies (Accounts Rules, 2014	Rule 8(5) (viii)	BOD	All Companies

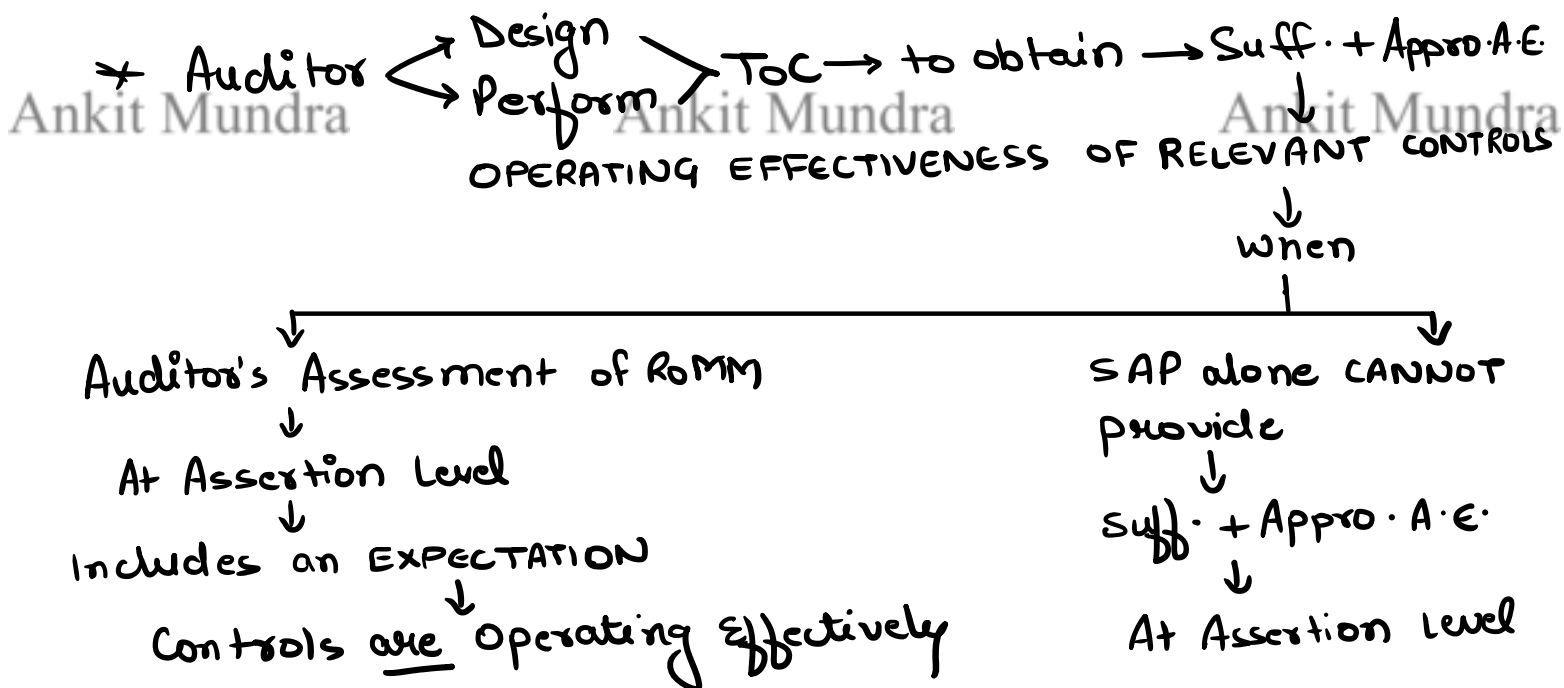
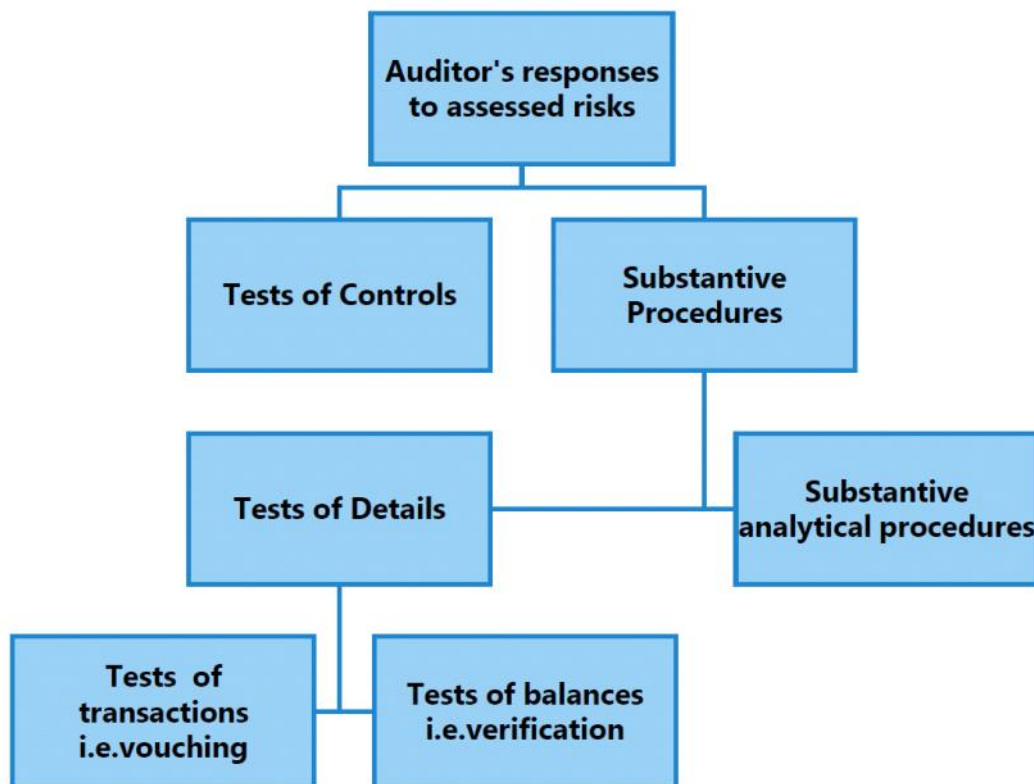


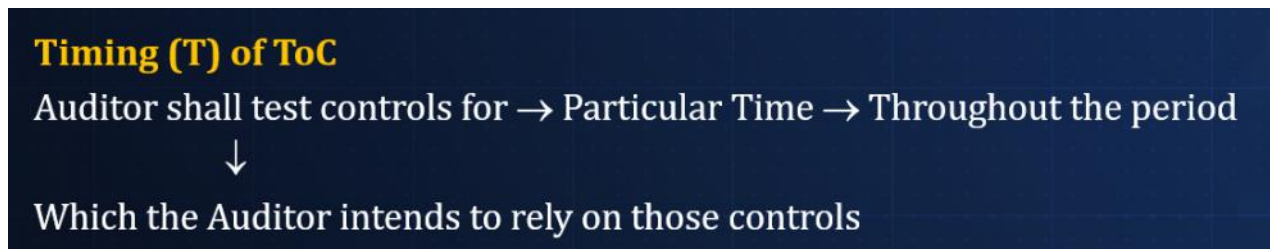
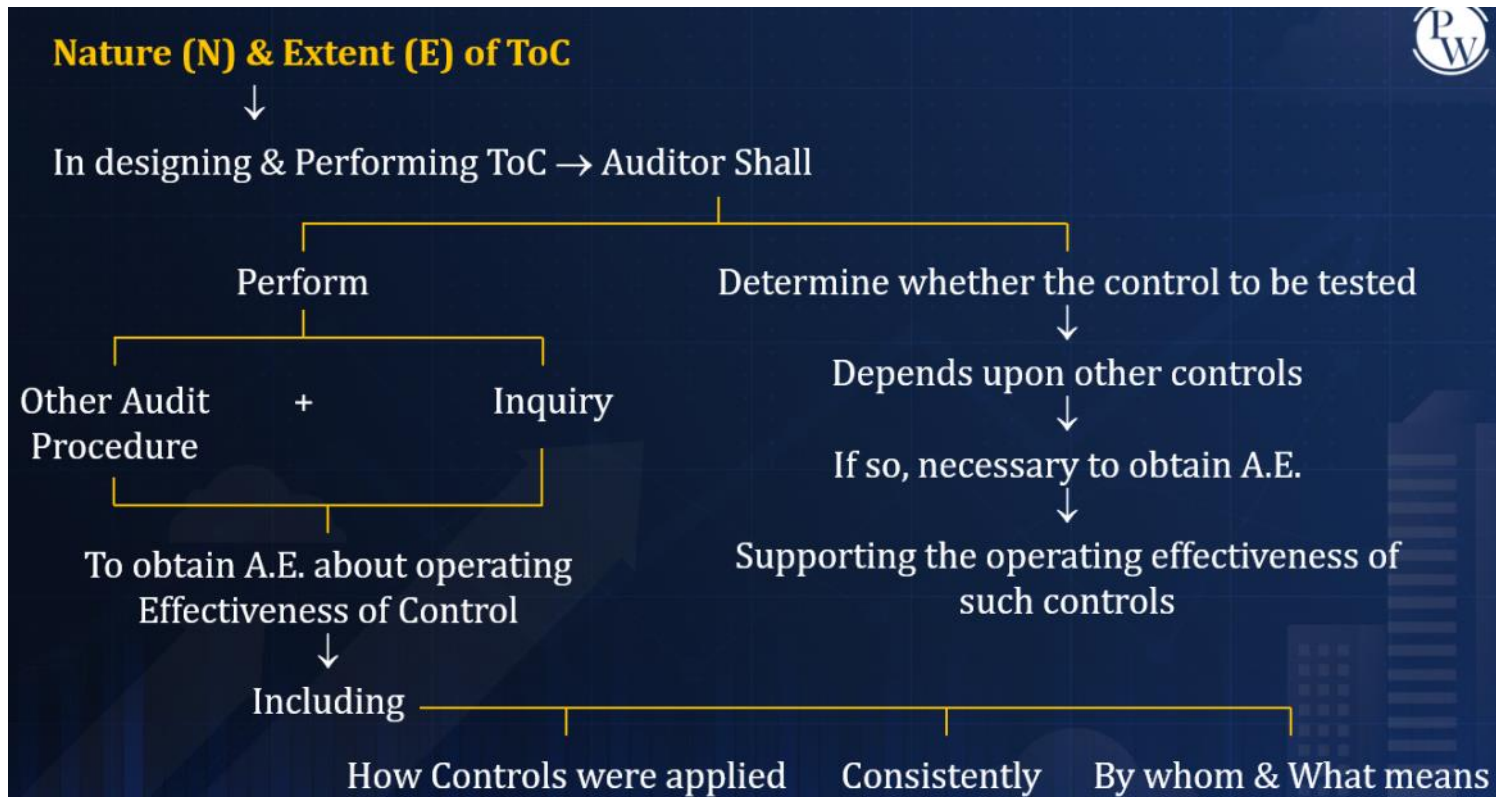
15 - Assess and Report Audit Findings



16 - Auditor's Response to Assessed Risk







✱ 16.3 - Using AE obtained in Previous Audit

In determining whether → It is appropriate to use A.E. → about operating effectiveness of controls → Obtained in the previous Audit → Length of time period that may elapse before retesting the controls

The Auditor may consider the following points:

- (1) The effectiveness of other elements of I.C.

Control
Environment

Entity's Monitoring of
Control

Entity's R.A.P.

- (2) The risk arising from → Characteristics of control → Manual → Automated
- (3) The effectiveness of → General IT Controls
- (4) The effectiveness of Control + its application by entity
+
N.E. of deviation in application → Noted in previous audit
+
Whether any personnel Δ s → That significantly affect application of control
- (5) Whether lack of Δ s in particular control → Poses a risk Δ s → Due to Δ ing circumstances
- (6) The RoMM & the extent of reliance on control

* 16.4 - Evaluating the Operating Effectiveness of Control

Evaluating operating effectiveness of controls

Auditor should evaluate → whether Misstatement → detected by substantive procedure

Indicate that control are not operating effectively
→ Absence of Misstatements → Does not provide A.E. → That control are effective

* 16.5 - Specific Inquiries when deviation from controls are detected

Specific Inquiries when deviation from control are detected

Auditor to make specific Inquiries to understand the matter

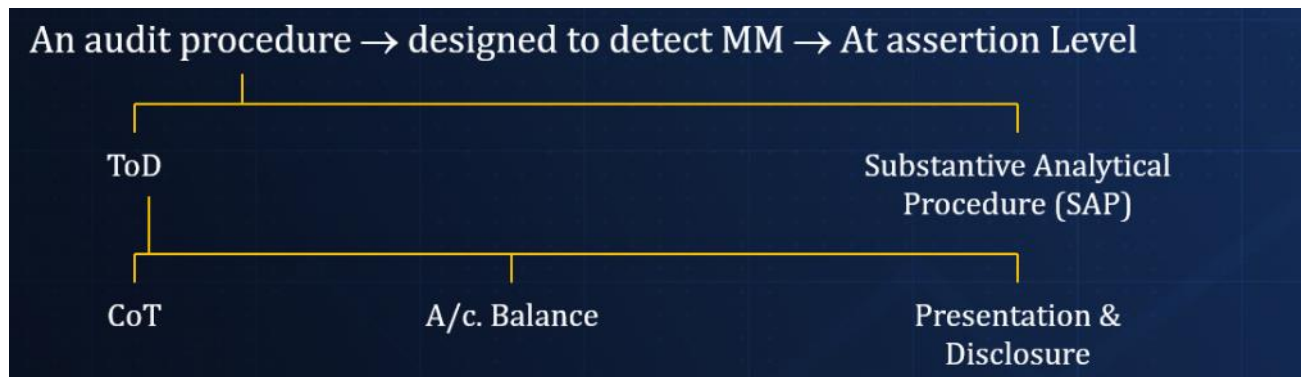
+
Potential consequences

+
Determining

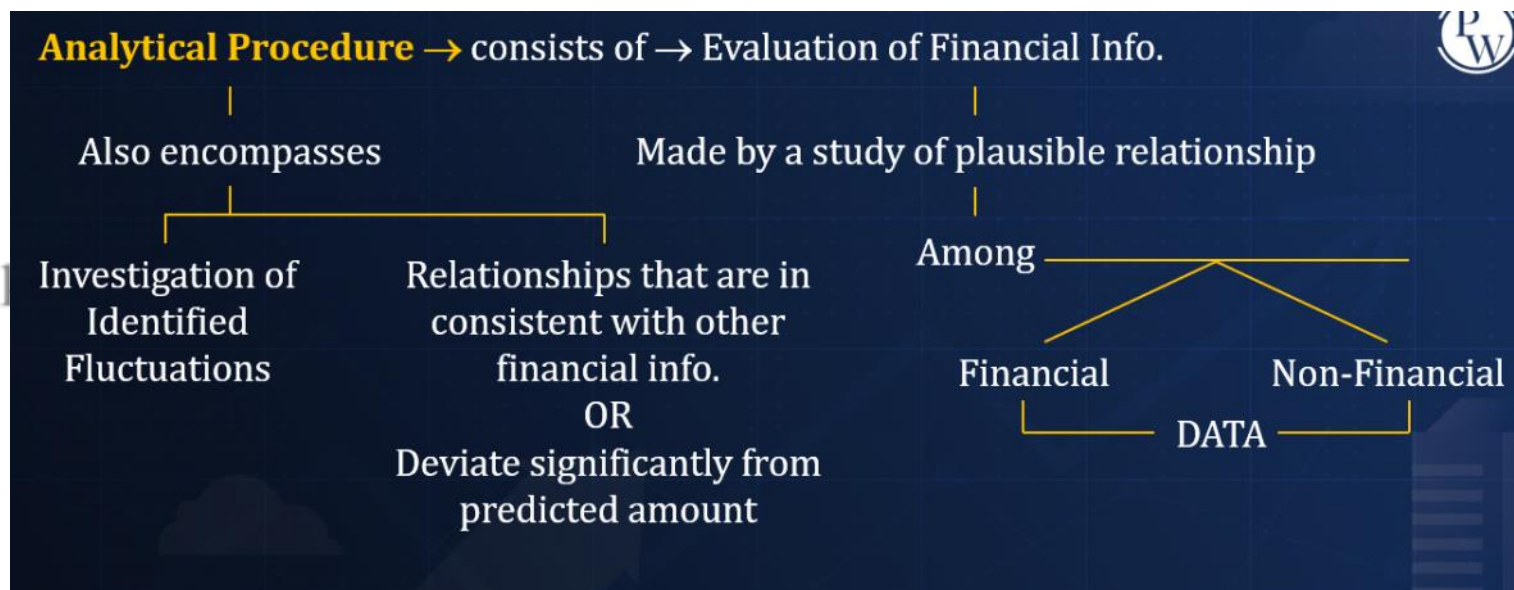
ToC provide appropriate
basis for reliance on
control

Additional ToC
necessary

Potential RoMM needs to be
addressed using Substantive
procedure



✧ 16.7 - Substantive Analytical Procedures



✧ 16.7 - N E of Substantive Procedures

- (1) It reflects that → Auditor may not identify all RoMM → There are inherent limitations to I.C. including Mgt. Override
- (2) Auditor may determine
 - (i) SAP will be sufficient
 - (ii) Only ToD will be appropriate
 - (iii) Combination of (i) & (ii)
- (3) SAP are generally more applicable → To Large volume of transactions



(3) SAP are generally more applicable → To Large volume of transactions



That tends to be predictable over time

(4) The Nature of → Risk → Assertion → is relevant to design ToD

(5) Because of Assessment of RoMM → Takes account of I.C.



Extent of substantive procedures may need to be increased



When the result from ToC are unsatisfactory

(6) In designing ToD → the extent of Testing → is ordinarily thought of → In terms of sample size