

Risk Assessment Procedure → Audit Pro.

- to obtain **understanding** of Entity / Its Environment & I.C.
- to **Identify & assess R.O.M.M** (due to F/E)
- at F.S. & assertion level.



Achieves?

- **Identify risks** through understanding E/Env/I.C.
- **Assess risks** & evaluate if they potentially affect many assertions. (F.S. level).
- **Relate risks** to $\begin{matrix} \rightarrow \\ \rightarrow \end{matrix}$ what can go wrong (WCGW) at assertion level. considering controls auditor intends to test.

eg if no process of checking Qty (Goods) recd. (Risk)

WCGW
Lead to fictitious purchases

Control?
Company Inv. Qty to G.R.N.
(Goods receipt Note)

- Consider $\begin{matrix} \rightarrow \\ \rightarrow \end{matrix}$ Likelihood (i) & Magnitude (ii) of risk that could lead to m.m.

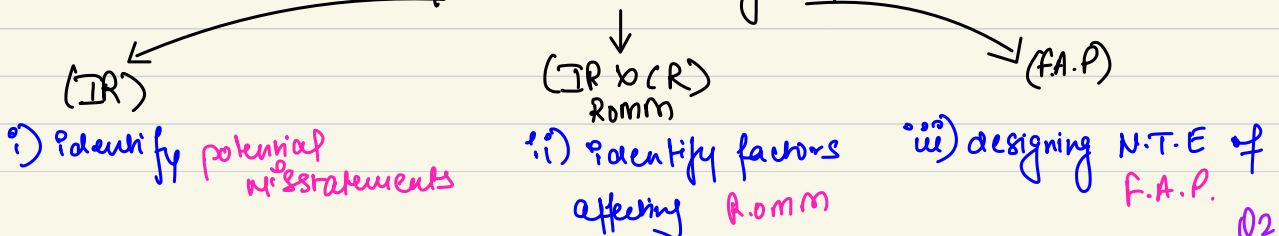
Internal Control

Process → **Designed, Implemented & Maintained (DIA)** by **mgmt/Executives/ others**

- to provide **R.A.** about ⇒ achievement of **entity's objectives**.

- Safeguarding of assets. (cash → locker → keys → Authorised B's)
- Compliance with L/R (B's duty → TDS deposit timely)
- Reliability of F.R. (B's fs. prepare → comply with Atc. Stats)
- Effectiveness & efficiency of operations. (Training of workers)

"Benefits" of Understanding of I.Cs.



Limitations of J.C.

J.Cs can provide only R.A. about achieving F.R. objectives due to J.L. of J.C.

Reasons: ① mgt judgment: Its mgt judgment to decide where to assume risks & Nature & Extent of controls to implement.
 eg No controls for issuance of stationery.

② Human decisions can be faulty & JCs can breakdown due to human error.
 eg error in design of J.C. kaam nahi kiya

P.O. Authorisation (limits)
 0 - 100000
 1,00,001 - 10,00,000
 10,00,001 - 1cr
 > 1cr

Authorise?
 Mgr
 Sr. mgr
 CFO
 CEO/MD

P.O. 1009000.50 B?
 ↓
 Exception Report
 Bx

③ (Buddha Person) JCs may be ineffective if info. produced for J.Cs

↳ person receiving info. doesn't understand purpose / fails to take corrective action.
 (Exception Reports) ↓

④ a) collusion: controls can be circumvented (avoided) by collusion of 2/more persons.

eg Side Agreement entered with customer to alter T&Cs of std. sales contract, resulting in improper R/R.

Std. sales → R/R on delivery of goods → R/R ⇒ Improper R/R

customer → Side Agreement ⇒ R/R on customer's approval (notwithstanding sales contract)

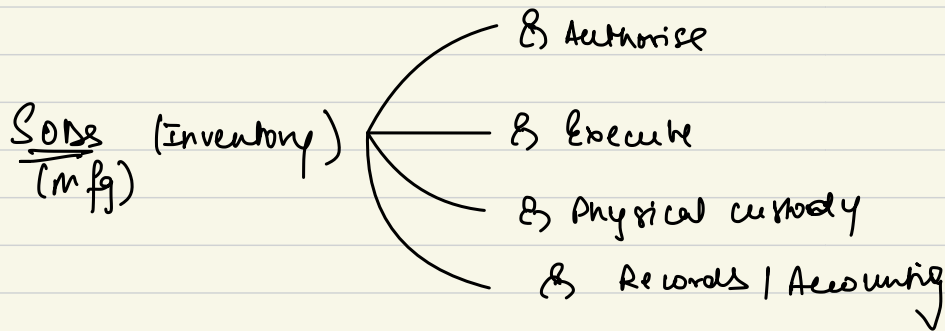
b) Inappr. mgt override of controls: Edit checks in software designed to

identify & report transⁿ > specified cr. limit.

↓
 maybe overridden / disabled by mgt.

mgt (BIL → Another ir how) ⇒ Sale ₹15 lakh (> cr. limit) ⇒ Report override → Approve feature Disable

⑤ Small Entities: They have fewer employees, Segregation of Duties (SODs) not possible.
 ∴ owner mgr exercise effective oversight over entity.



Summary

① R.A. for g.c. (due to S.L. of I.C)

② Mgt judgment

Risk ✓

Control Implement ✓

Collusion among ppl. → side agreement (RIR)
 Mgt override of GCs → edit checks (disabled / overridden)

④ [B Samajdar]

③ [B Buche]

Resp. individual
 X understand purpose (or)
 X fail to take corrective action

⑤ Small Entities [x SODs ⇒ ∴ owner mgr. effective oversight]

Components of Internal Control (Body Parts)

1. Control Environment (Rooj / Arma)

- a) Evaluate? a) mgt created & maintained culture of { Honesty
& Healthy
Ethical Behaviour.
- b) Strength of C.E. provides foundation for other components.

b) What's included in C.E.?

- 1) Governance & mgt fr → 2) Attitude, Awareness & Actions of mgt & Twp
↓
- 3) C.E. sets tone of organisation.

c) Elements

- 1) Communication & enforcement of ^(Honesty) Integrity & Ethical values
- JCs effectiveness depends on integrity & ethical values of ppl.
eg. policies, code of conduct etc.

- 2) Commitment to Competence: Mgt considers competence levels for jobs & translates it to reqd. skills & knowledge.
[eg. Atc jobs ⇒ AS + Tally]

- 3) Participation by Twp ⇒ Attributes (Qualities) of Twp
- Independent from mgt
 - Experience & Stance
 - Extent of Involvement & Scrutiny of acts.

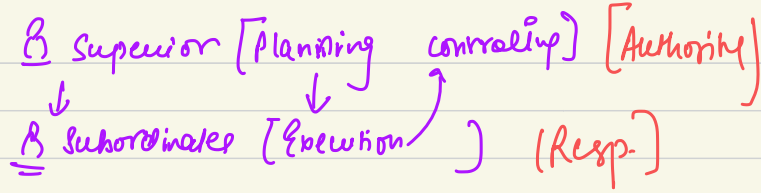
- 4) Mgt's philosophy & operating style: Mgt's attitude towards
- F.R.
 - & Atc fr & persons.

- 5) Org. Structure: Framework in which Acts. are
- Planned,
 - Executed &
 - Controlled.

- 6) Assigning Authority & Responsibility: How A & R assigned & reporting relationships made.

- 7) H.R. policies: P&P eg Recruitment, training, Evaluation, Compensation, Promotion etc.

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Existence of Satisfactory C.E. ⇒ Not Absolute Determinant to Fraud

{ C.E. not enough to P/D/C M.M. due to fraud }
 ⇒ we need other components also

(Achha)

(Bura)

① Existence of Satisfactory C.E. ✓
 can be a positive factor
 in assessing Ro.M.M. ↓

② It may help in reducing risk of fraud.

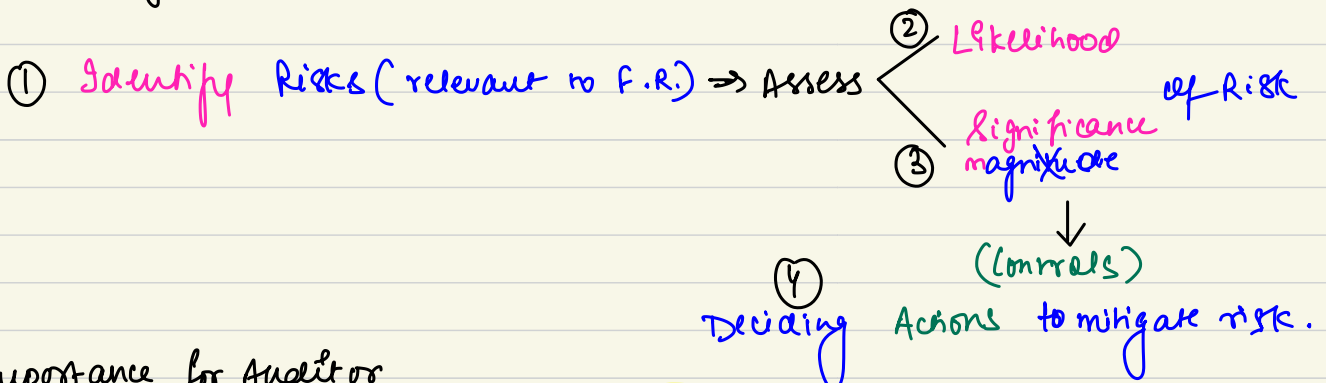
③ Conversely, deficiency in C.E., can reduce effectiveness of I.C.s.

eg. mg's failure to commit resources for IT security
 ↓
 can lead to improper changes in data.

Conclusion: • C.E. doesn't P/D/C M.M.
 • It may influence evaluation of effectiveness of I.C.s. & Ro.M.M.

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② Entity's Risk Assessment Process (R.A.P)



Importance for Auditor

Entity's R.A.P provides basis for risks to be managed.

Assists auditor to identify Ro.M.M. if R.A.P is appt.

↓?
 whether R.A.P. is appt. is a matter of P.J. operating environment

eg Risk can arise due to New technology ← Business Models products.