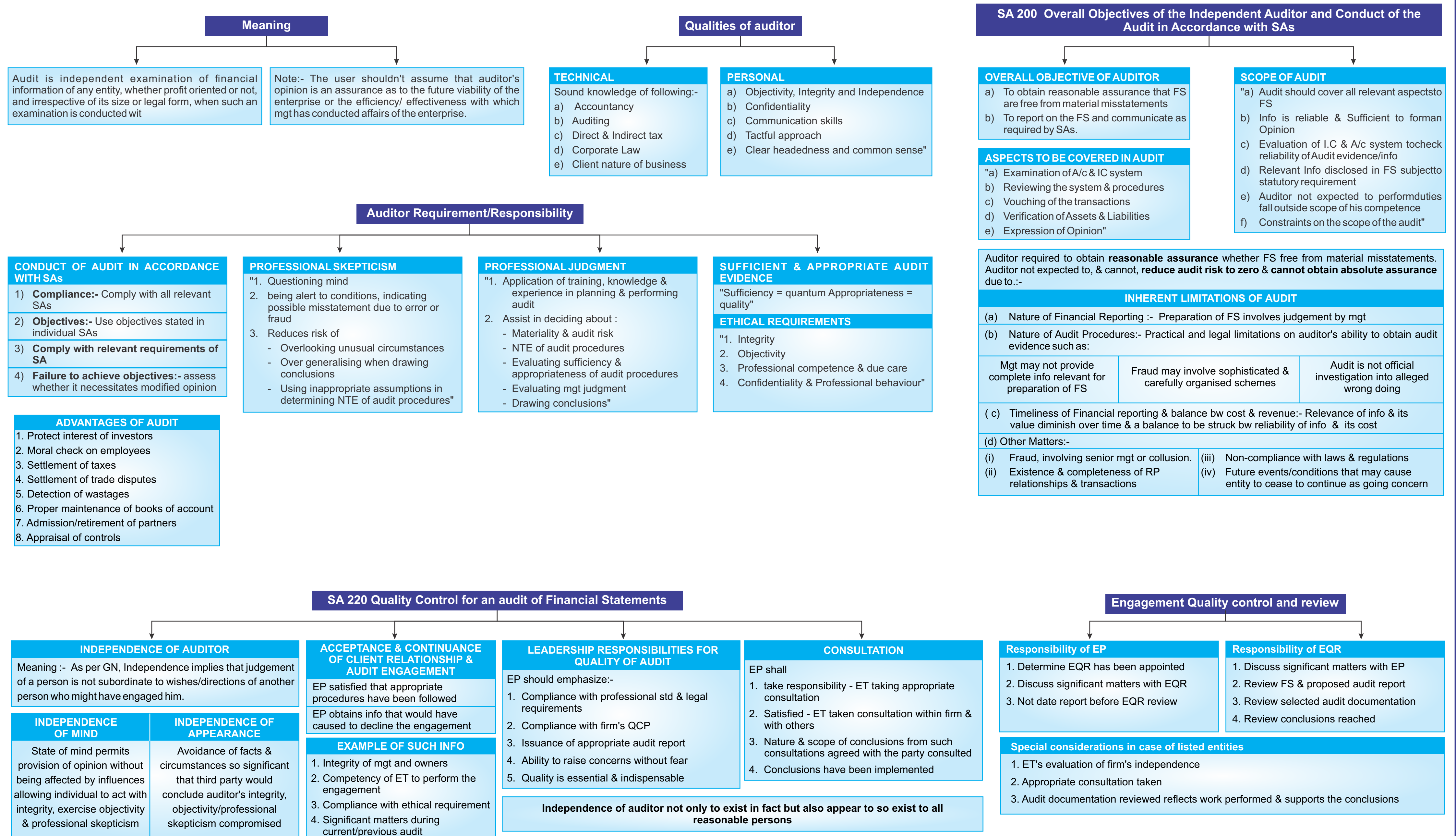


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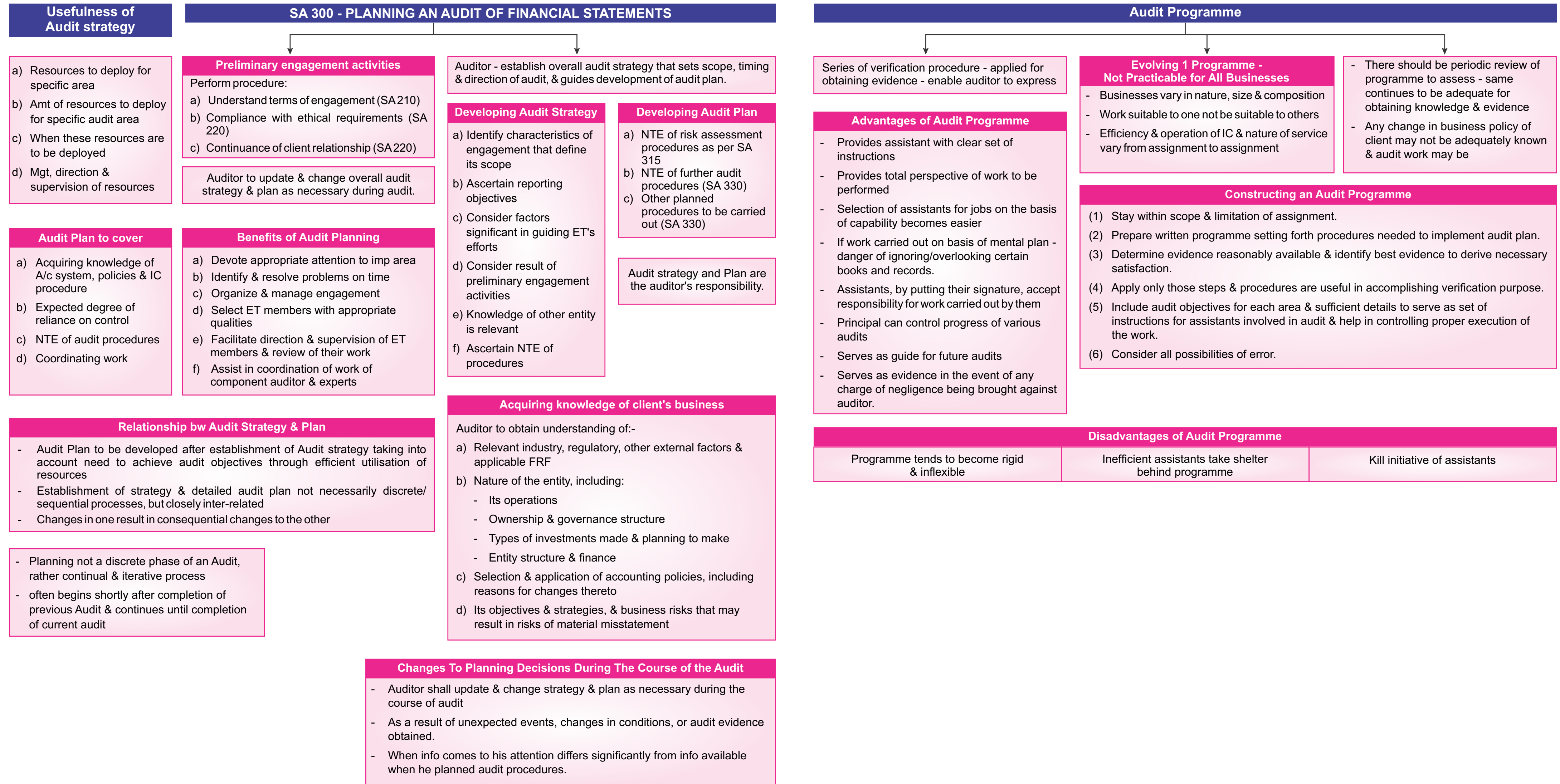
Chapter No.	Chapter Name	Colour
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# CHAPTER 1 - NATURE, SCOPE AND OBJECTIVES OF AUDIT





# CHAPTER 2 - AUDIT STRATEGY, PLANNING AND PROGRAMME



# CHAPTER 3 - AUDIT DOCUMENTATION AND AUDIT EVIDENCE

## SA 230 AUDIT DOCUMENTATION

**Meaning :-** It refers to record of audit procedures performed, relevant audit evidence obtained, & conclusions auditor reached

**"It provides:**

- Evidence of auditor's basis for a conclusion about achievement of overall objectives; and
- Evidence that audit was planned & performed in accordance with SAs & legal & regulatory requirements."

**Purpose of Audit Documentation**

- Assisting RT to plan & perform audit.
- Assisting members of ET responsible for supervision to direct & supervise work.
- Enabling ET to be accountable for its work
- Retaining record of matters of continuing significance to future audits.
- Enabling conduct of quality control reviews and inspections.
- Enabling conduct of external inspections"

**Advantages**

- Provides guidance to audit staff.
- Responsibility of work can be fixed
- Act as a defence if charge of negligence is brought.
- Important for future planning.
- Contains basis for forming an opinion.
- Helps senior to review work"

**Form, content & extent of Documentation**

"Auditor prepare documentation sufficient to enable experienced auditor to understand:

- Size & complexity of entity
- Nature of audit procedures performed
- Identified ROMM
- Significance of audit evidence obtained
- Nature & extent of exceptions identified.
- Need to document conclusion/basis for conclusion not readily determinable from documentation
- Audit methodology & tools used."

**Assembly of the final audit file**

"Auditor to assemble documentation in an audit file in not more than 60 days after date of auditor's report.

After the assembly auditor not delete it before end of retention period (7 yrs).

Assembly of audit file - administrative process does not involve performance of new audit procedures/drawing of new conclusions. Changes may be made to documentation if administrative in nature."

**"Matters arising after date of the report:**

The auditor shall document:

- Circumstances encountered;
- New/additional procedures performed, evidence obtained, & conclusions reached, & their effect on the auditor's report; &
- When & by whom changes to documentation were made & reviewed."

**"Examples of changes include:**

- Deleting superseded documentation
- Sorting, collating & cross referencing Wp
- Signing off on completion checklists
- Documenting audit evidence - obtained, discussed & agreed"

**SA 510 INITIAL AUDIT ENGAGEMENT - OPENING BALANCES**

**Meaning:-** Engagement in which FS for prior period were not audited; or were audited by a predecessor auditor

**AUDIT PROCEDURES REGARDING OPENING BALANCES**

1. Read most recent FS & predecessor auditor's report
2. Obtain sufficient appropriate AE whether opening balances contain misstatements that materially affect the current period's FS by:
  - a. Determining prior period's closing balances have been correctly b/f or any adjustments have been disclosed as prior period items in the current year's SPL
  - b. Determining opening balances reflect the application of appropriate A/c policies
  - c. Performing one or more of the following:
    - i. Where the prior year FS were audited, perusing the copies of the audited FS
    - ii. Evaluating procedures performed in current period provide evidence relevant to the opening balances;
    - iii. Performing specific procedures to obtain evidence regarding opening balances."

"Auditor obtains AE that opening balances contain misstatements that could materially affect the current period's FS, he shall perform addn procedures as to determine the effect on the current period's FS.

If the auditor concludes that misstatements exist in the current period's FS, he shall communicate same with the mgt & TCWG in accordance with SA450."

**Completion Memorandum/ Audit Documentation Summary**

"Auditor may prepare & retain as part of documentation a summary that states:-

1. Significant matters identified during audit
2. How they were addressed This may facilitate effective & efficient review & inspection of documentation."

**Ownership of Audit Documentation**

- Ownership & custody of Wp rests with auditor. It is auditor's property.
- Client doesn't have any right to access audit W.P. kept by auditor.
- But auditor may, at his discretion, show some/ complete W.P. to client."

## SA 500 AUDIT EVIDENCE (AE)

**"Meaning:-** Info used by auditor in arriving at conclusions on which auditor's opinion is based. It includes both info contained in A/c records & other information."

**Reliability of evidence**

- Reliability increased - obtained from independent sources outside entity.
- If AE generated internally is reliability increased when related controls are effective.
- AE obtained directly by the auditor more reliable than AE obtained indirectly
- AE in documentary form more reliable than evidence obtained orally
- AE provided by original documents more reliable than by photocopies or facsimiles"

<b>Sufficiency of AE</b> Sufficiency = quantum	<b>Appropriateness of AE</b> Appropriateness = quality
<b>Factors affecting sufficiency and appropriateness</b>	
"a) Materiality - Low materiality, higher samples b) ROMM - Low ROMM, lower samples c) Size & characteristics of population - Small homogeneous - Low samples"	"a) Source of Evidence b) IPE of evidence - complete & accurate c) Nature & dependent on individual circumstances under which it is obtained."

**Info used as AE prepared using work of mgt expert**

- Evaluate competence, capabilities & objectivity of expert
- Obtain understanding of work of expert; &
- Evaluate appropriateness of expert's work as AE"

<b>Methods to obtain AE</b>					<b>Procedures to obtain AE</b> "- Risk Assessment Procedure - Compliance Procedure - Substantive Procedures"
Re calculation	Reperformance	Observation	Inquiry	Inspection	
External Confirmation		Analytical Procedures			

## SA 501 AUDIT EVIDENCE - SPECIFIC CONSIDERATIONS FOR SELECTED ITEMS

**Inventory - Existence**

When inventory material to FS, auditor obtain sufficient appropriate AE regarding existence & condition of same by:

**Attendance at physical counting, to**

- Evaluate mgt instructions for recording & controlling results of counting
- Observe performance of count procedure
- Inspect inventory; and
- Perform test counts.
- Performing procedures over final records - whether they accurately reflect actual inventory count results."

**Count conducted Other than at the date of FS**

Obtain AE whether change in stock properly recorded.

**Auditor unable to attend the count**

Observe count on other date & perform procedure on intervening transactions

**Attendance at Physical Counting Involves**

- Inspecting inventory - ascertain its existence & condition, & performing test counts
- Observing compliance with mgt instructions & procedures for recording & controlling results of count;
- Obtaining AE as to reliability of mgt count procedures."

**Inventory under control of 3rd Party**

- Request confirmation from the third party
- Inspection/other audit procedures as appropriate
- Obtain service auditors report w.r.t. adequacy of procedures of third party.
- Attending/arranging another auditor to attend third party's counting procedure.
- Inspecting documentation (Example - warehouse receipts)."

If the prior period's FS were audited by predecessor auditor & there was a modification to the opinion, auditor evaluate effect of matter giving rise to the modification in assessing ROMM in the current period's FS.

**Litigation & claims**

- Inquiry of mgt & in-house legal counsel &
- Reviewing minutes of meetings of TCWG & correspondence between entity & external legal counsel
- Reviewing legal expense A/c"
- Obtain WR all know litigation disclosed to auditor
- Mgt. not permit auditor communicate with legal counsel -> then modify opinion

**Segment Info**

**"Sufficient AE:-** W.r.t. Presentation & disclosure of segment info

**Audit procedures:** understand methods used by Mgt.& evaluate consistency with applicable F.R.F"

## SA 505 EXTERNAL CONFIRMATION

AE obtained as a direct written response to auditor from a third party, in any form/manner.

<b>Positive confirmation</b> "Confirming party respond whether it agrees/ disagreeswith info"	<b>Negative confirmation</b> "Confirming party respondonly if it disagrees with info provided in request."
--	---

**Use Negative Confm only if all of following are present:**

ROMM is low	Effective I.C
Item contains small amt	Expected Low exception rate

No reason to believe recipient may disregard request

**Reliability of Response**

- Objectivity of confirming party:** Responses to not bereliable if confirming party related to the client.
- Knowledge about the matter:** Depends on knowledge of confirming party about subject matter being confirmed.
- Willingness of third party to respond:** Third party may consider responding time consuming /costly affair."

**External Confirmation Procedures**

1. Determine Info to be confirmed	2. Select appro. party	3. Designing request	4. Sending request including follow up request
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**Factors to consider when designing requests**

- Identified ROMM, including fraud risks.
- Layout & presentation of request.
- Prior experience
- Assertions being addressed.
- Method of communication- Mgt authorisation/encouragement to confirming parties to respond to the auditor.
- Ability of intended party to confirm or provide requested information"

**In case of no response:-** Perform Alt procedures

**"Mgt Refusal to allow to send Confirmation Request"**

- Inquire mgt's reasons for the refusal & seek AE for their validity & reasonableness
- Evaluate its implications assessment of ROMM & on NTE of other procedures
- Perform alt audit procedures"

**Mgt's refusal appropriate:** Perform Alt procedures

**Mgt's refusal not appropriate:** Communicate with TCWG & assess impact on opinion

# CHAPTER 3 - AUDIT DOCUMENTATION AND AUDIT EVIDENCE

## SA 560 SUBSEQUENT EVENTS

Subsequent events - Events occurring bw date of FS & the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

### Facts become known to auditor after date of auditor's report but before date FS issued

"Auditor has no obligation to perform procedures regarding FS after date of auditor's report.

When, after the date of report but FS issued, a fact becomes known had it been known may have caused auditor to amend report, auditor shall:

- Discuss the matter with mgt & TCWG
  - Determine FS need amendment and, if so,
  - Inquire how mgt intend to address the matter in FS-
- If mgt amends FS, auditor shall:
- Extend procedures referred to the date of the new auditor's report; and
  - Provide a new auditor's report"

"When mgt does not amend FS in but where auditor believes they need to be amended, then

- If the report has not yet been provided to the entity, the auditor shall modify the opinion; or
- If the auditor's report has already been provided, auditor shall notify mgt & TCWG, not to issue FS to 3rd parties If FS are issued without necessary amendments, auditor shall take appropriate action, to seek to prevent reliance on the auditor's report."

### "Facts which become known to the auditor after the financial statements have been issued"

"- After FS have been issued, auditor has no obligation to perform any procedures regarding such FS.

- When, after FS have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the report, may have caused auditor to amend the report, the auditor shall:

- Discuss the matter with mgt and TCWG.
- Determine whether FS need amendment and, if so,
- Inquire how mgt intends to address the matter in FS

- If mgt amends FS, auditor shall carry out the procedures necessary in the circumstances on the amendment & review steps taken by mgt to ensure that anyone in receipt of the previously issued FS is informed of the situation.

- If mgt does not take the necessary steps to ensure that anyone in receipt of the previously issued FS is informed of the situation, auditor will seek to prevent future reliance on the auditor's report."

### Events occurring bw date of FS and date of auditor's report

"- Obtain sufficient appropriate AE all events occurring between the date of FS & date of auditor's report that require adjustment of/disclosure in. FS have been identified.

- Auditor shall :
- Obtain understanding of any procedures mgt established to ensure that subsequent events are identified.
  - Inquiring of mgt and TCWG.
  - Read minutes of the meetings, of the entity's owners, mgt & TCWG held after date of FS
  - Read the entity's latest subsequent interim FS, if any."

## SA 570 GOING CONCERN

### Mgt Responsibilities

"- Assess entity's ability to continue as going concern.  
- In case FS not prepared on going concern basis - Fact to be disclosed in FS"

### Auditor responsibility/ Objectives

"- Obtain SAAE about appropriateness of mgt's use of going concern.  
- Consider whether there is material uncertainty about entity's ability to continue as going concern."

"If FS prepared using going concern basis but, in auditor's judgment, mgt's use of the basis is inappropriate, the auditor shall express an adverse opinion."

### Evaluating Management's Assessment

"- Auditor shall cover same period as that used by mgt. If mgt's assessment of the entity's ability to continue as going concern covers less than 12 months from the date FS, auditor shall request mgt to extend its assessment period to at least 12 months from that date.  
- In evaluating mgt's assessment, auditor consider whether mgt's assessment includes all relevant info of which auditor is aware"

### Use of Going Concern Basis appropriate but Material Uncertainty Exists

#### Adequate Disclosure of Material Uncertainty Made

"Express unmodified opinion & the report include a separate section under heading Material Uncertainty Related to Going Concern to:

- Draw attention to note in FS that discloses the matter;
- State that these events indicate that a material uncertainty exists & that opinion is not modified in respect of matter"

#### Adequate Disclosure of Material Uncertainty Not Made

"a. Express a qualified opinion/adverse opinion, as appropriate, in accordance with SA 705; and  
b. In the Basis for Qualified Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that FS do not adequately disclose this matter."

## SA 550 RELATED PARTIES (RP)

### Risk assessment procedures and related activities

#### 1. Understanding the entity's related party relationships and transactions

"Inquire mgt regarding:

- Identity of entity's RP, including changes from the prior period;
- Nature of the relationships between the entity & these RP; and
- Whether entity entered into any transactions with these RP during the period &, if so, the type & purpose of transactions.

Obtain understanding of controls that has been established to:

- Identify, account for, & disclose RP relationships & transactions
- Authorise & approve significant transactions & arrangements
- Authorise & approve significant transactions & arrangements outside the normal course of business."

#### 2. Maintaining alertness for RP info

"Auditor shall remain alert, when inspecting records/documents, for arrangements /other info that may indicate existence of RP relationships/transactions not previously identified or disclosed to the auditor.

If the auditor identifies significant transactions outside the entity's normal course of business he shall inquire mgt about nature of these transactions & whether RP could be involved."

"In forming an opinion on the FS, auditor shall evaluate:

- Identified RP relationships & transactions appropriately accounted for & disclosed in accordance with the applicable FRF; and
- Whether Effects of the RP relationships & transactions prevent the FS from achieving true and fair presentation; or cause the FS to be misleading."

### Identification of previously unidentified/undisclosed RP or significant RP transactions

- "- Communicate relevant info to the other members of ET
- Where applicable FRF establishes RP requirements:
    - Request mgt to identify all transactions with newly identified RP for the auditor's further evaluation; and
    - Inquire why entity's controls over RP relationships & transactions failed to enable identification / disclosure
  - Perform appropriate substantive procedures relating to such newly identified RP or RP transactions;
  - Reconsider risk that other unidentified RP or significant RP transactions may exist
  - If the non-disclosure by mgt appears intentional evaluate the implications for the audit."

### Identified significant RP transactions outside the entity's normal course of business:-

- "- Inspect underlying contracts/agreements & evaluate:
- Business rationale of transactions
  - Terms of transactions are consistent with mgt's explanations; and
  - Transactions appropriately accounted for & disclosed in accordance with the applicable FRF; and
- Obtain AE transactions have been appropriately authorised & approved."

## SA 580 WRITTEN REPRESENTATIONS (WR)

"A written statement by mgt provided to auditor to confirm certain matters or to support other AE. WR do not include FS, the assertions therein or supporting books and records.  
Auditor request WR from mgt with for the FS and knowledge of matters concerned."

### Objectives of the auditor

- "- To obtain WR from mgt that mgt believes that it has fulfilled the fundamental responsibilities.  
- To support other AE by means of WR and  
- To respond appropriately to WR provided by mgt"

Date and period covered by WR:- As near as practicable to, but not after, the date of the auditor's report. WR shall be for all FS and periods) referred to in the auditor's report.

### Doubt as to the reliability of written representations

"- If auditor has concerns about competence, integrity, ethical values or diligence of mgt, auditor shall determine their effect on reliability of representations.  
• In particular, if WR inconsistent with other AE, auditor perform procedures to attempt to resolve the matter  
• If the auditor concludes that WR are not reliable, auditor shall take appropriate actions, including determining possible effect on the opinion."

### Requested written representations not provided

He shall discuss the matter with mgt. & re-evaluate reliability & integrity of mgt. Also consider its effect on audit report.

### Additional Procedures if Event/Condition Identified

"Auditor obtain SAAE whether or not material uncertainty exists may cast significant doubt on the entity's ability to continue as a going concern through performing addn procedures.

Procedures shall include:

- Mgt not performed assessment, requesting mgt to make its assessment.
- Evaluating mgt's plans for future actions
- Evaluating the reliability of underlying data to prepare the cash flow forecast; & determining there is adequate support for assumptions underlying forecast
- Considering any addn facts or info become available since date on which mgt made its assessment.
- Requesting Wr from mgt & TCWG, regarding their plans for future actions"



# CHAPTER 4 - RISK ASSESSMENT AND INTERNAL CONTROL

## Audit Risk (AR) and its components

<b>Audit Risk (AR) and its components</b>			<b>What is not included in Audit Risk</b>	
Audit risk - risk that auditor may give inappropriate opinion when FS materially misstated			"i. Risk that auditor might express an opinion that FS are materially misstated when they are not. This risk is ordinarily insignificant. ii. It does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of FS"	
<b>Inherent Risk (IR)</b>	<b>Control Risk (CR)</b>	<b>Detection Risk (DR)</b>		
"Susceptibility of an account balance/class of transaction to a material misstatement, assuming that there were no internal controls."	Risk that material misstatement will not be prevented/detected & corrected on timely basis by the IC system.	Risk that the substantive procedures performed by the auditor fails to detect material misstatement.		
<b>Risk of Material Misstatement (ROMM)</b>			<b>Relationship b/w</b>	
ROMM exists at 2 levels:-				
<b>Overall FS level</b>	<b>Assertion level</b>			
Refer to ROMM that relate pervasively to FS as a whole & potentially affect many assertions.	Refer to ROMM that relate to particular classes of transactions, account balances, & disclosures.		<b>IR and CR</b>	<b>ROMM and DR</b>
			Mgt reacts to IR by designing accounting & IC systems & therefore, in many cases, IR and CR are highly interrelated.	Inverse relationship bw DR and the combined level of IR and CR.

$$AR = CR \times IR \text{ (ROMM)} \times DR$$

<b>Conditions which increase risk of fraud/Risk requiring special audit consideration</b>	<b>Assertions evaluated</b>						
"1. Weaknesses in design of IC system & non-compliance with the laid down procedures. 2. Doubts about the integrity or competence of the mgt. 3. Unusual pressures within the entity. 4. Unusual transactions such as transactions with related parties. 5. Problems in obtaining SAAE, e.g., inadequate documentation."	<table border="1"> <tr> <th>Transactions during year</th> <th>Balances at year end</th> <th>Presentation &amp; Disclosure</th> </tr> <tr> <td>Occurrence Completeness Accuracy Cut off Classification</td> <td>Existence Rights &amp; Obligations Completeness Valuation</td> <td>Rights &amp; Obligations Completeness Classification Accuracy</td> </tr> </table>	Transactions during year	Balances at year end	Presentation & Disclosure	Occurrence Completeness Accuracy Cut off Classification	Existence Rights & Obligations Completeness Valuation	Rights & Obligations Completeness Classification Accuracy
Transactions during year	Balances at year end	Presentation & Disclosure					
Occurrence Completeness Accuracy Cut off Classification	Existence Rights & Obligations Completeness Valuation	Rights & Obligations Completeness Classification Accuracy					

IC and IT Environment	
<b>Benefits of IT to IC</b>	<b>Risk to IC imposed by IT</b>
"- Consistently apply predefined business rules & perform complex calculations - Enhance timeliness, availability, & accuracy of info; - Facilitate addn analysis of info; - Enhance ability to monitor performance of entity's activities - Reduce risk that controls will be circumvented- Enhance ability to achieve effective SOD"	"- Reliance on systems or programs inaccurately processing data, processing inaccurate data or both- Unauthorised access to data - Possibility of IT personnel gaining access beyond those necessary to perform their assigned duties there by breaking down SOD - Unauthorised changes to data in Master files. - Unauthorised changes to systems or programs. - Failure to make necessary changes to systems or programs.- Inappropriate manual intervention - Potential loss of data or inability to access data as required."

Internal Check				
Check on day to day transactions, Operating continuously as part of routine system, whereby work carried out by one person is automatically checked by another to prevent fraud/error, & early detection of fraud and error.				
General consideration in framing system of internal check				
Distribution of Powers	No independent control	Custody record distribution	Check by another	Job rotation
Budgetary Control	Accounting control	Stock control	Cash control	Leave

## SA 315 IDENTIFYING AND ASSESSING RISK OF MATERIAL MISSTATEMENT

<b>Risk Assessment Process</b>	<b>Risk Assessment Procedures</b>	
"a. Identify risks throughout process of obtaining understating of entity & its environment including the entity's IC; b. Assess identified risks & evaluate whether they relate more pervasively to the FS as a whole; c. Relate identified risks to what can go wrong at the assertion level; & d. Consider the likelihood of misstatement"	Inquiries of mgt & others within the entity	Observation & Inspection
	Analytical Procedures	
<b>Objectives of IC</b>	<b>Internal Control (IC)</b>	
"a. Transactions are executed in accordance with mgt general/specific authorization; b. All transactions are promptly recorded in the correct amt; appropriate accounts; accounting period c. Assets safeguarded from unauthorised access, use/ disposal. Recorded assets compared with existing assets & appropriate action taken with regard to any differences."	"Process designed, implemented & maintained by TCWG, mgt & other personnel to provide reasonable assurance about achievement of an entity's objectives with regard to, > reliability of financial reporting, > effectiveness & efficiency of operations, > safeguarding of assets, and > Compliance with applicable laws and regulations."	
	<b>Limitations of IC</b>	
	IC provide reasonable assurance	Human judgment in decision making
		Collusion among people
		Mgt judgement
	Lack of understanding the purpose	Limitation in case of small entities

Components of IC System			
<b>1. Control Environment</b>	<b>3. The info system, including the related business processes, relevant to financial reporting &amp; communication</b>		
"Control environment includes: I. governance & mgt functions ii. attitudes, awareness, & actions of TCWG & mgt. iii. It sets the tone of an organisation"	Auditor to obtain understanding of: a. Classes of transactions significant to FS b. Procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to GL and reported c. Related A/c records, supporting info & specific accounts used to initiate, record, process and report transactions; d. How info system captures events & conditions significant to FS e. The financial reporting process f. Controls surrounding journal entries.		
<b>Elements of Control Environment</b>	Obtain understanding of how entity communicates financial reporting roles & responsibilities b/w mgt & TCWG and external communications		
"- Communication & enforcement of integrity & ethical values - Commitment to competence - Participation by TCWG - Mgt's philosophy & operating style- Organisational structure - Assignment of authority & responsibility - HR policies & practices"	<table border="1"> <tr> <th>Following pts need consideration</th> <td>- Understanding of Roles &amp; Responsibilities - Understanding relation of activities</td> </tr> </table>	Following pts need consideration	- Understanding of Roles & Responsibilities - Understanding relation of activities
Following pts need consideration	- Understanding of Roles & Responsibilities - Understanding relation of activities		
<b>2. Entity's Risk assessment process</b>	- Policy Manuals & Financial Reporting Manuals		
<b>4. Control Activities</b>	- Open communication channel - Less structured for small entities		

<b>Evaluation of IC by auditor</b>	<b>Satisfactory control environment not absolute deterrent to fraud</b>	<b>5. Monitoring of Control</b>
Review of IC will enable auditor to know: - Errors & frauds likely to be located - Adequate IC system is in use & operating as planned by mgt - Effective internal audit dept is operating - Any admin control has a bearing on work - Controls adequately safeguard assets; - How far & adequately mgt is discharging its function - how reliable reports, records & the certificates to mgt can be;	• Work as positive factor when the auditor assesses the ROMM • Deficiencies in control environment may undermine the effectiveness of controls, in particular in relation to fraud. • Control environment influences the NTE of auditor's further procedures. • Control environment does not prevent, or detect & correct, a material misstatement. Influence the auditor's evaluation of the effectiveness of other controls and thereby auditor's assessment of ROMM.	"- Helps in assessing the effectiveness of controls on a timely basis - Mgt accomplishes it through ongoing activities, separate evaluations, or a combination of the two. - Mgt's monitoring activities may include using info from communications from external parties - In case of Small Entities: Mgt's monitoring of control is often accomplished by mgt's or owner-manager's close involvement in operations
<b>Testing of IC system (TOC) - includes</b>		
Inspection of documents to gain AE that IC have operated properly.	Inquiry & observation of IC	Re performance of IC
		Testing on computerised application



# CHAPTER 4 - RISK ASSESSMENT AND INTERNAL CONTROL

## SA 320 MATERIALITY IN PLANNING AND PERFORMING AN AUDIT

**Meaning of Materiality**

"- Misstatements are material if they influence economic decisions of users

- Judgments are made in light of surrounding circumstances, & are affected by size/ nature of a misstatement
- Based on consideration of common financial info needs of users as a group."

**Revision in materiality**

1. Revise materiality for FS as a whole in event of becoming aware of info that would have caused him to determine a different amount initially.
2. If the auditor concludes that a lower materiality for FS as a whole than that initially determined is appropriate, he shall determine whether it is necessary to revise performance materiality, & whether the NTE of the further audit procedures remain appropriate."

Auditor's determination of materiality is a matter of professional judgment, & is affected by the auditor's perception of the financial info needs of the users.

In this context, it is reasonable for the auditor to assume that users:

- Have reasonable knowledge of business & economic activities & A/c
- Understand that FS are prepared, presented & audited to level of materiality
- Recognize uncertainties inherent in measurement of amts based on use of estimates, judgment & the consideration of future events; and
- Make reasonable economic decisions on the basis of the info in the FS

**Judgement of materiality provides basis for :-**

"- Determining NTE of risk assessment procedures

- Identifying & assessing ROMM- Determining NTE of further audit procedures"

**"Performance materiality means amt set by auditor < materiality for FS as a whole to reduce to an appropriately low level probability that aggregate of uncorrected & undetected misstatements exceeds materiality for FS."**

**Use of Benchmarks in determining Materiality**

"Factors that may affect identification of appro. Benchmark includes:-

- Elements of the FS• Items on which attention of users tends to be focused
- Nature of entity, where entity is at in its life cycle, & industry & economic environment in which entity operates;
- Ownership structure & the way it is financed
- Relative volatility of benchmark."

Methods to review IC system				
Particulars	Narrative record	Check List	Questionnaire	Flow Chart
<b>Intro</b>	Exhaustive description of system as found in operation by the auditor.	Series of questions which a member of the auditing staff must answer.	Comprehensive series of questions concerning internal control.	Graphic presentation of each part of the company's system of internal control.
<b>Advantages</b>	- identify weaknesses/gaps - incorporate changes on account of change in team	- Motivating as on the job requirement - Easy location of weakness	- Recommendation can be easily provided by auditor - Easy location of weakness	- Concise presentation - Easily understandable - Complete view of system
<b>Disadvantages</b>	- Time consuming - Doesn't identify weakness in the system	- Time consuming - Requires intelligence to prepare proper checklist	- Time consuming - Client may answer in haste - Manipulation in answers	- Time consuming - Weakness can't be readily located

## SA 610 USING THE WORK OF INTERNAL AUDITORS

**INTERNAL AUDIT**

**Objectives and Scope of Internal Audit Function**

- Independent appraisal activity, within an org for review of activities & providing suggestions for improvement thereof.
- Activities relating to governance**
- Activities relating to risk management**

**Requirement for Internal Audit (Sec 138)**

<b>a) Every listed co.</b>	<b>b) Every unlisted public co having</b>
<b>c) Every Pvt co having</b>	"- Share capital Rs. 50 cr or more in PY- Turnover Rs. 200 or more in PY- Loans/borrowings Rs. 100 cr or more at any time during PY- Deposits Rs. 25 cr or more at any time during PY"
"- Turnover Rs. 200 or more in PY- Loans/borrowings Rs. 100 cr or more at any time during PY"	

**INTERNAL FINANCIAL CONTROL (IFC)**

Section 134(5)(e) - IFC means policies & procedures adopted by company for ensuring orderly & efficient conduct of its business, including adherence to company's policies, safeguarding of its assets, prevention & detection of frauds & errors, accuracy & completeness of the accounting records, & timely preparation of reliable financial info.

**Reporting under The Companies Act 2013**

- 143(3)(l) - By Auditor
- Rule 8(5)(vii) - Board Report of company to state details in respect of adequacy of IFC with reference to FS.
- Inclusion of matters relating to IFC in directors responsibility statement
- Sec 177 - AC to call for comments on IC by stat auditors"

**Objectives of Auditor**

Objectives of external auditor, where external auditor expects to use internal auditor's work or use internal auditors to provide direct assistance, are:

- To determine work of the internal audit function/direct assistance can be used, and if so, in which areas & to what extent
- If using work of the function, to determine that work is adequate for his purpose
- If using internal auditors to provide direct assistance, to appropriately direct, supervise & review their work

**Activities relating to IC**

- Evaluation of IC
- Examination of financial & operating info
- Review of operating activities
- Review of compliance with laws & regulations

"Internal Auditor - CA/CS/CMA or any other professional He may/may not be an employee"

**Determining whether, in which areas, and to what extent IA can be used to provide direct assistance**

**"Determining whether IA be used to provide direct assistance for purposes of the audit"**

1. External auditor evaluate existence & significance of threats to objectivity & level of competence of IA.
2. External auditor not use IA to provide direct assistance if:
  - There are significant threats to objectivity of IA
  - IA lacks sufficient competence to perform proposed work"

**Determining nature & extent of work that can be assigned to IA providing direct assistance**

"External auditor shall consider:

- The amount of judgment involved in:
  - Planning and performing relevant audit procedures; and
  - Evaluating the audit evidence gathered;
- Assessed ROMM"

**Using IA to provide direct assistance**

- Obtain written agreement from entity that IA be allowed to follow external auditor's instructions, & entity will not intervene in work
- Obtain written agreement from IA will keep confidential matters as instructed by external auditor & inform him of any threat to their objectivity.

External auditor direct, supervise & review work performed by IA in accordance with SA220."

**Determining Whether, in Which Areas, and to What Extent Work of Internal Audit Function Can Be Used**

Evaluating internal audit function

- Extent to which the function's organizational status & relevant policies & procedures support objectivity of IA;
- Level of competence of the function; and
- Whether function applies a systematic & disciplined approach, including quality control."

**Determining nature & extent of work of the function that can be used**

1. Consider nature & scope of work performed/planned to be performed
2. External Auditor make all significant judgments and, use less work of the function & perform more of work directly.
3. External auditor evaluate whether, using work of IA would still result in him being sufficiently involved in audit. External auditor communicate how he has planned to use the work of the function."

**Using the work of the internal audit function**

1. External auditor read reports of IA
2. External auditor perform sufficient procedures on body of work of IA
3. External auditor to determine adequacy for purposes of the audit, including evaluating whether:
  - Work of IA properly planned, performed, supervised, reviewed and documented;
  - Sufficient appropriate evidence had been obtained to enable function to draw reasonable conclusions; and
  - Conclusions reached are appropriate & reports are consistent with results of the work performed."





# CHAPTER 5 - FRAUD AND RESPONSIBILITY OF AUDITOR IN THIS REGARD

**Meaning of Fraud:-** Intentional act by one/more individuals among mgt, TCWG, employees, or 3rd parties, involving use of deception to obtain unjust/illegal advantage

**Risk of not detecting material misstatement resulting from fraud higher than risk of not detecting one resulting from error**

"- Fraud involve sophisticated & carefully organized schemes designed to conceal it - Concealment even more difficult to detect when accompanied by collusion.- Difficult to determine misstatements in judgment areas such as accounting estimates"

**Risk of not detecting a material misstatement resulting from mgt fraud is greater than for employee fraud**

Primary responsibility for prevention & detection of fraud rests with TCWG and mgt.		
<b>Defalcation of cash</b>		
<b>Types of misstatement relevant to auditor</b>	<b>Inflating payment</b>	<b>Suppressing receipts:- Teeming and lading</b>

**Misstatements resulting from fraudulent financial reporting**

- Incentives/Pressure** - High competition with declining margin; High vulnerability to rapid changes; Decline in customer demand
- Opportunities** - Known history of violation of laws; significant RP transactions; Ability to dominate the industry
- Attitudes/Rationalization** - Mgt unable to remedy deficiency in IC; Excessive pressure by Mgt in maintaining earning trend"

**Misstatements resulting from misappropriation of assets**

- Incentives/Pressure** - Personal financial obligation of employee; Adverse relationship with employee
- Opportunities** - Large amt of cash on hand; Inventory item with high value & small size; Inadequate IC over assets
- Attitudes/Rationalization** - Disregard for need of reducing risk related to misappropriation of asset; Disregard for IC over assets"

**Fraud Risk Factors**

**Circumstances relating to possibility of fraud**

Discrepancies in A/c records	Conflicting/missing evidence	Others
Problematic/unusual relationship with mgt		

**Manipulation of Accounts - generally committed to**

avoid taxes	declaring dividends	Withhold declaration of dividend
Receiving high salary		
<b>By:-</b> Inflating/suppressing purchases/expenses/sales		
Inflating/deflating closing stock	Charing capex to revenue/ vice versa	
failing to adjust o/s liability/prepaid expense	Misapplication of A/c policies	

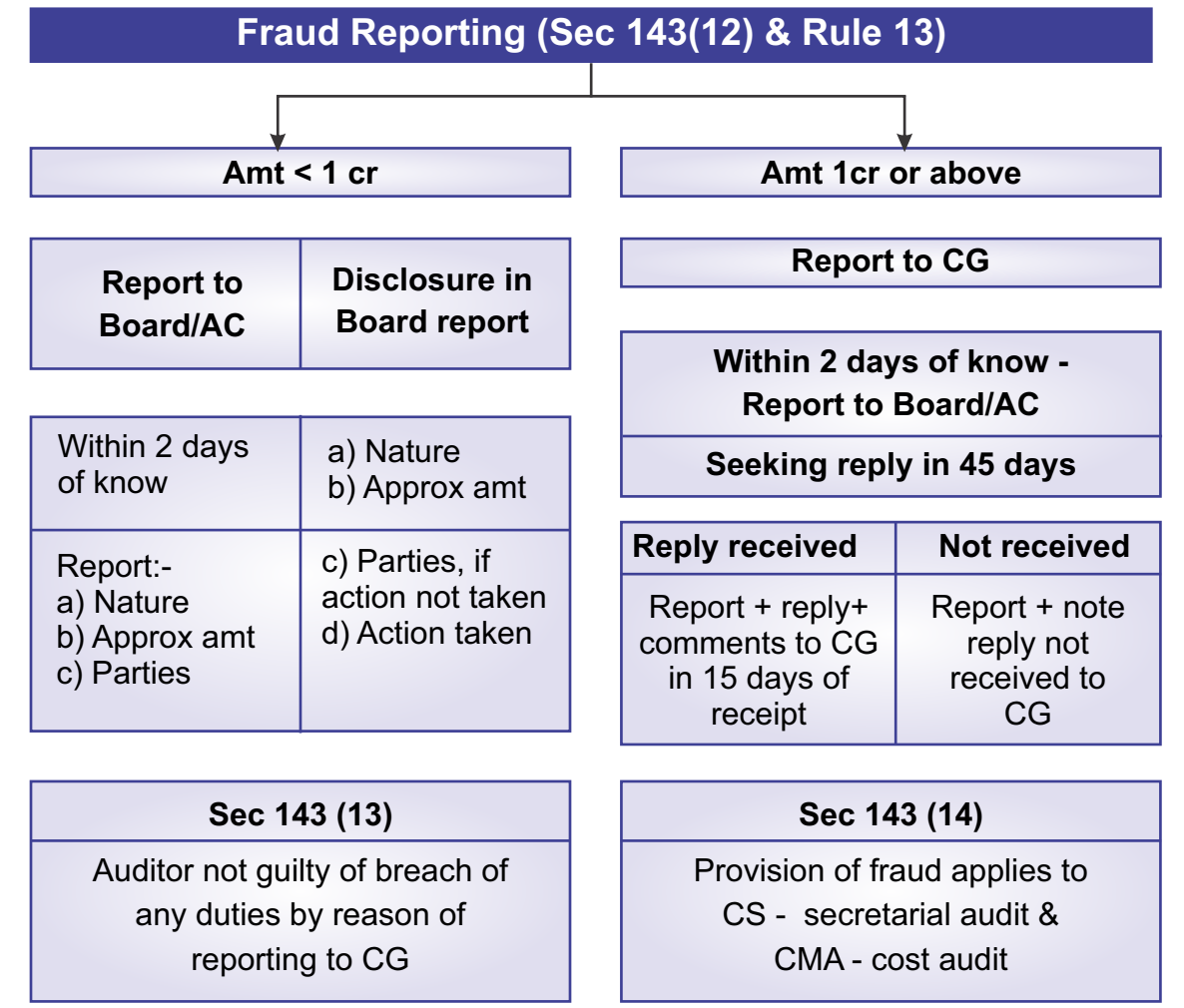
**Auditor unable to continue engagement**

"- Determine professional & legal responsibilities- Whether it is appropriate to withdraw from engagement

- If auditor withdraws:-

- Discuss with mgt & TCWG along with reasons for withdrawal
- Whether any requirement to report to any person"

Fictitious JE	Inappropriate assumptions	Concealing facts
Omit/advance/delay recognition		Altering records
Engaging in complex transactions		



**Sec 143(15)**

Penalty for non compliance of Sec 143(12)

- Listed co. - 5L and Any other co - 1L

**Reporting under Clause (xi) of CARO 2020**

Any fraud by co or any fraud on Co has been **noticed/reported**. If yes, nature & amt involved is to be indicated.



# CHAPTER 6 - AUDIT IN AUTOMATED ENVIRONMENT

**Meaning:-** Business environment where processes, operations, A/c & even decisions carried out using computer systems - also known as Information Systems (IS) or Information Technology (IT) systems.

**Features of Automated environment**

- Enables business operations at a faster speed
- less prone to human errors
- Provides better security & IC features
- Process large volume of transactions in less time
- Accuracy in computations & data processing
- Providing latest info
- Networking capabilities. better connectivity & integration bw business operations is possible."

**Relevance of IT in an audit**

"When business operates in automated environment - we will see several business functions & activities happening within the systems. Consider the following aspects instead of"

- Computation & Calculations automatically carried out
- A/c entries posted automatically
- Business policies & procedures, including IC, applied automatically
- Reports produced from systems. Mgt & other stakeholders rely on these reports & info produced
- User access & security controlled by assigning system roles to users"

**Some situations in which IT will be relevant to an audit**

- "• Increased use of Systems & Application software
- Complexity of transactions has increased
- Hi-tech nature of business
- Volume of transactions are high
- Company Policy
- Regulatory requirements -Companies Act 2013 IFC
- Required by Indian & International Standards - ISO
- Increases efficiency & effectiveness of audit."

**Understanding automated environment**

Info System being used	Its purpose	Location of IT system	
Interface with system	Architecture	Version	Key persons (CSO, CISC)
Inhouse Vs packages	Outsourced activities		

**Risks in IT system**

Inaccurate data processing	Unauthorized access	Loss of Data
Direct data changes	Excessive access	
Inadequate SOD	Unauthorized Changes	

**Testing Methods**

- Obtain understanding how an automated transaction is processed by doing a walkthrough
- Observe how user processes transactions in diff scenarios
- Inspect configuration defined in application.
- Inspect system logs to determine changes made
- Inspect user manual of systems & applications.
- Carry out test check & observe error message displayed
- Re-performance using raw source data"

**Impact of IT risks on controls, substantive procedures & reporting**

Substantive Procedures	Reporting	Control
- can't rely on data processed	- Communicate with TCWG	- Can't rely on automated controls
- Need to test the program	- Report u/s 143(3)	- High control risk
- Completeness & accuracy of reports to be tested	- Modification of opinion	- Test system data & report
- Obtain more evidence		

**Types of controls in automated environment**

1. **General IT Controls:-** Policies & procedures relate to many apps & support effective functioning of application controls. They include controls over the following:

	Data Centre & Network oper	Program Change	Access Security	App system
Objectives	"Production systems processed to meet financial reporting objectives"	"Modified systems continue to meet financial reporting objectives"	Access to programs & data authenticated & authorized	Systems developed, configured & implemented to meet the objectives
Activities	"- Mgt of computer operations activities - Failure recovery - Documentation - Service lvl agreement - Performance monitoring"	"- Change mgt process - Change requests - record, manage. Track - Making changes - Test changes - Apply changes in production"	"- Security mgt & organization - Application security - Data security - Operating system security - Network security"	"- Mgt of development activities - Project initiation - Analysis & design - Construction - Data conversion"

2. **Application Controls:-** Include automated & manual controls operate at business process level. Automated Application controls are embedded into IT applications & help in ensuring completeness, accuracy & integrity of data in those systems.

3. **IT Dependent Controls:-** Manual controls that make use of some form of data produced from IT systems & applications. Effectiveness & reliability of application controls & IT dependent controls require General IT Controls to be effective.

**General IT Vs Application Control:-** These two control are interrelated. General IT Controls are needed to support functioning of application controls, & both are needed to ensure complete & accurate information processing through IT systems.

**Data Analytics**

**Meaning:-** Combination of processes, tools & techniques used to tap vast amts of data to obtain meaningful info

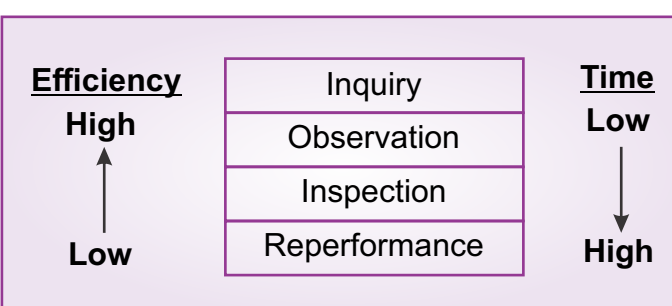
"Tools & techniques used in applying principles of data analytics - Computer Assisted Auditing Techniques (CAAT)"

**Steps in use of CAAT**

1. Understand business env including IT
2. Define Objectives & criteria
3. Identify source & format of data
4. Extract Data
5. Verify completeness & accuracy of data
6. Apply criteria on data obtained
7. Validate & confirm results
8. Report & document results"

**Use of Data Analytics**

- Check completeness of data & population- Selection of audit samples
- Re-computation of balances- Re-performance of mathematical calculations
- Analysis of JE as required by SA 240
- Fraud investigation.
- Evaluating impact of control deficiencies
- Identifying inconsistencies or significant fluctuations"



**Audit Approach**

Risk assessment	Understand & evaluate	Testing for effectiveness	Reporting
"- Identify A/c and disclosures - Qualitative & quantitative consideration - Relevant FSA - Identify source- Consider IT risk"	"- Document understanding of business process - Prepare RCM - Understand design of controls through walkthrough - Process wise consideration for ELC/SOD - IT general, App controls"	"- Assess NTE of control testing - Assess reliability & completeness of source data - Test key reports - Sample testing - Competence/ capability/ independence of staff/team"	"- Evaluate deficiencies - Remediation of weakness - IC Memo/ Mgt letter- Auditor report"

# CHAPTER 7 - AUDIT SAMPLING (SA 530)

**Meaning:-** Application of audit procedures to less than 100% of items within a population - all sampling units have a chance of selection in order to provide auditor with a reasonable basis on which to draw conclusions about entire population.

**Precautions while conducting test checking**

- Thorough understanding of A/c & IC system
- Area not suitable for sampling (Bank confirmation)
- Proper planning and classification
- No bias and Analysis of misstatement"

Population			
<b>Meaning:-</b> Entire set of data from which sample is selected & about which auditor wishes to draw conclusions.			
Characteristics of population	Appropriateness	Accuracy	Completeness

Approaches to Sampling	
Statistical	Non Statistical/Judgmental
"- More scientific - Use of law of probability - No personal bias"	Based on personal experience & knowledge of auditor  "Limitation of non statistical method:- a) Neither objective nor scientific b) Risk of personal bias"

- "Advantages of Statistical Sampling:-**
- Sample size not increase proportion to increase in size of area
  - Objective method
  - provides means of estimating min sample size
  - Reduced sampling risk
  - Better description of large mass of data"

**Performing Audit Procedures**  
 Auditor perform procedures on each item selected. If procedure not applicable, auditor perform procedure on replacement item. If auditor unable to apply designed procedures, treat that item as deviation in case of TOC, or a misstatement, in case of TOD.

Projecting misstatement	Basis	Test Checking	Routine Checking
"Obtain broad view of scale but it may not determine amt to be recorded. When misstatement established as anomaly, excluded when projecting misstatements For TOD, the auditor project misstatements to population whereas for TOC, no projection of deviations necessary"	<b>Meaning</b>	Examine < whole population	Detailed checking of all aspects of transactions
	<b>Objective</b>	Form opinion on FS	Ensure accuracy of entries
	<b>Nature</b>	Judgmental/statistical	Mechanical process
	<b>Level of function</b>	By higher lvl audit staff	Junior audit staff
	<b>Time</b>	Saves time of audit staff	More time consuming

**Sample Design**  
 "When designing an audit sample, Auditor to consider:-  
 • Specific purpose to be achieved  
 • Determine stratification/value-weighted appropriate"

Stratification	Value Weighted Selection
"Reduce variability of items with in each stratum This allows greater audit effort to be directed to larger value items Results of procedures applied to sample of items within stratum can only be projected to that stratum."	"Identify sampling unit as individual monetary units Examine particular items contain the units Effort directed to larger value items This may be used in conjunction with systematic method of sample selection"

- Sample selection Method**
1. Random :- Simple random; Stratified random
  2. Interval Sampling
  3. Monetary Unit
  4. Haphazard
  5. Block selection

Samples Size (High - H; Low - L)	
Factor affecting sample size in TOC	Factor affecting sample size in TOD
"Increased samples size:- H - reliance on control L - tolerable deviation rate H - Expected deviation rate H - Desired assurance lvl H- Population size"	"Increased samples size:- H - ROMML - Reliance on substantive L - tolerable misstatement H - Desired assurance lvl H- Expected misstatement"

Sampling Risk	
Auditor's conclusion based on sample diff from conclusion if entire population subject to same procedure. Can lead to two types of erroneous conclusions :	
a) TOC - controls are more effective/TOD - material misstatement doesn't exist	b) TOC - Controls less effective/ TOD - material misstatement exists
Affects audit effectiveness & lead to inappropriate audit opinion	Affects audit efficiency & lead to additional work

**Non Sampling Risk**  
 The risk that auditor reaches an erroneous conclusion for any reason not related to sampling risk.

# CHAPTER 8 - ANALYTICAL PROCEDURES (SA 520)

**Meaning:-** Evaluation of financial info through analysis of plausible relationship among both financial & non-financial data

Auditor's choice of procedures, methods & level of application is matter of professional judgment.

## Timing of Analytical Procedures

- "1. **At planning stage** - assist in risk assessment procedure & help in determining NTE of other procedures.
2. **While performing audit**
  - a. Procedures at assertion level may be TOD, substantive analytical procedures, or a combination of both.
  - b. Decision about which audit procedures to perform based on auditor's judgment
  - c. Inquire mgt as to availability & reliability of info needed to apply substantive analytical procedures
3. **Near end FS** are consistent with his understanding"

## Nature of Analytical Procedures

- "Consideration of comparisons of financial info with:•  
Comparable info for prior periods.
- Anticipated results
  - Similar industry info"
- "Consideration of relationships such as:
- Among elements of financial info
  - Bw financial info & relevant non-financial info"

## Factors to be considered for substantive analytical procedures

- "1. **Availability of Data** - Availability of reliable & relevant data will facilitate effective procedures
2. **Disaggregation** - Degree of disaggregation directly affect degree of its usefulness
3. **Account Type** - Analytical procedures more useful for certain accounts than for others. Income statement accounts tend to be more predictable, whereas balance sheet accounts are subject to greater mgt judgment
4. **Source** - Some classes of transactions tend to be more predictable as they consist of numerous similar transaction
5. **Predictability** - More appropriate when account balance/relationships bw items of data are predictable
6. **Nature of Assertion** - More effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations].
7. **Inherent Risk** - When IR higher, design TOD to address it. When significant risks identified, AE obtained solely from analytical procedures is unlikely to be sufficient."

## Techniques available as substantive analytical procedures

- "1. **Trend analysis** - Comparison of current data with prior period balance or with trend in 2 or more prior period
2. **Ratio analysis** - Useful for analysing asset & liability A/c & revenue & expense A/c. Individual balance sheet A/c difficult to predict on its own, but its relationship to another account often more predictable Ratios can be compared over time or to ratios of separate entities within group, or with ratios of other companies in same industry.
3. **Reasonableness tests** - Rely upon non-financial data for audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). More applicable to income statement accounts and certain accrual or prepayment accounts.
4. **Structural modelling** - Constructs statistical model from financial and/or non- financial data of prior accounting periods to predict current account balances (e.g., linear regression) ."

## Considerations in designing analytical procedures

- "1. Determine the suitability of particular procedures for given assertions, taking account of the assessed ROMM & TOD, if any, for these assertions;
2. Evaluate reliability of data from which auditor's expectation of recorded amts/ratios developed, taking account of source, comparability, & nature & relevance of info available, & controls over preparation;
3. Develop expectation of recorded amts/ratios & evaluate expectation sufficiently precise to identify a misstatement 4. Determine amt of any diff of recorded amts from expected values acceptable without further investigation."

## Suitability of particular analytical procedures for given assertions

- "1. Analytical procedures more applicable to large volumes of transactions that tend to be predictable over time. Based on expectation relationships among data exist & continue in absence of known conditions to the contrary
2. In some cases, even unsophisticated predictive mode maybe effective as analytical procedure.
3. Different types of analytical procedures provide different levels of assurance.
4. Determination of suitability of particular analytical procedures influenced by nature of assertion and ROMM"

## Extent of reliance on procedures influenced by:-

- a. Source of the information available
- b. Comparability of the information available.
- c. Nature and relevance of the information available
- d. Controls over the preparation of the information

## Evaluation whether expectation is sufficiently precise

- a. Accuracy with which expected results can be predicted
- b. Degree to which info can be disaggregated.
- c. Availability of info, both financial & non-financial

## Investigating results of analytical procedures

- "If analytical procedures performed identify fluctuations or that differ from expected values by a significant amount, auditor shall investigate such differences by:-
- i. Inquiring mgt & obtaining appropriate AE
  - ii. Performing other procedures as necessary in the circumstances:"

## Considerations specific to Public sector entities

- "- Relationship bw individual FS items traditionally considered may not always be relevant
- Expense on acquisition of assets not capitalised.
- Industry data/statistics for comparison not available"