

**CHAPTER 4 RISK ASSESSMENT AND INTERNAL CONTROL**

Q.no	Reference	Question	Answer
1	ICAI Module	<p>XYZ Ltd is engaged in the business and running several stores dealing in variety of items such as ready made garments for all seasons, shoes, gift items, watches etc.</p> <p>There are security tags on each and every item. Moreover, inventory records are physically verified on monthly basis.</p> <p>Discuss the types of inherent, control and detection risks as perceived by the auditor.</p>	<p><b>Inherent Risk:</b> Because items may have been misappropriated by employees, therefore, risk to the auditor is that inventory records would be inaccurate.</p> <p><b>Control Risk:</b> There is a security tag on each item displayed. Moreover, inventory records are physically verified on monthly basis. Despite various controls being implemented at the stores, still collusion among employees may be there and risk to auditor would again be that inventory records would be inaccurate.</p> <p><b>Detection Risk:</b> Auditor checks the efficiency and effectiveness of various control systems in place. He would do that by making observation, inspection, enquiry, etc. In addition to these, the auditor would also employ sampling techniques to check few sales transactions from beginning to end. However, despite all these procedures, the auditor may not detect the items which have been stolen or misappropriated</p>
2	ICAI Module	<p>The auditor of ABC Textiles Ltd chalks out an audit plan without understanding the entity's business. Since he has carried out many audits of textile companies, there is no need to understand the nature of business of ABC Ltd. Advise the auditor how he should proceed</p>	<p>Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The auditor should proceed accordingly</p>
3	ICAI Module	<p>Prince Blankets is engaged in business of blankets. Its major portion of sales is taking place through internet. Advise the auditor how he would proceed in this regard as to understanding the entity and its environment.</p>	<p>While understanding entity and its environment, internet sales is being perceived as risky area by the auditor and thereby would be spending substantial time and extensive audit procedures on this particular area</p>
4	ICAI Module	<p>Auditor GR and Associates, appointed for audit of PNG Ltd, a manufacturing company engaged in manufacturing of various food items. While planning an audit, the auditor does not think that it would be necessary to understand internal controls. Advise the auditor in this regard</p>	<p>The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit</p>
5	ICAI Module	<p>"The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over</p>	<p>(i) Monitoring of controls Defined: Monitoring of controls is a process to assess the effectiveness of internal control performance over time.</p>

		financial reporting” Explain	<p>(ii) Helps in assessing the effectiveness of controls on a timely basis: It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.</p> <p>(iii) Management accomplishes through ongoing activities, separate evaluations etc.: Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.</p> <p>(iv) Management’s monitoring activities include: Management’s monitoring activities may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.</p> <p>(v) In case of Small Entities: Management’s monitoring of control is often accomplished by management’s or the owner-manager’s close involvement in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to remedial action to the control.</p>
6	ICAI Module	“Risk of material misstatement consists of two components” Explain clearly defining risk of material misstatement	Q10 Chap 3
7	ICAI Module	“The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the “risks of material misstatement”” Explain	Q10 Chap 3
8	ICAI Module	“The auditor shall obtain an understanding of the control environment” Explain stating what is included in control environment.	<p>The control environment includes: (i) the governance and management functions and (ii) the attitudes, awareness, and actions of those charged with governance and management .</p> <p>(iii) the control environment sets the tone of an organization, influencing the control consciousness of its people.</p> <p>Elements of the Control Environment:</p> <p>(a) Communication and enforcement of integrity and ethical values</p> <p>(b) Commitment to competence</p> <p>(c) Participation by those charged with governance</p> <p>(d) Management’s philosophy and operating style</p> <p>(e) Organisational structure</p> <p>(f) Human resource policies and practices</p>