Chap - ~~4~~ 3 Risk Assessment & Internal Control

- Part - I Risk Assessment
- Part - II Materiality
- Part - III Internal Control
- Part - IV Automated Env.
- Part - V SA 330 Responses [FAP]

Part - I Risk Assessment

AUDIT RISK

→ Inappropriate audit opinion देना

- when FS mm
  [जब 705 में Q/A/D देना चाहिए था But clean 700 वाली Report issue कर दी]
- ~~when FS not mm~~
  what is not included ?
  → Auditor's Business risk (litigation, adverse publicity)
  → जब Fault में 705 issue कर दी ×

→ Rmm × DR
→ [IR × CR] × DR

Rmm : chances हैं FS में :

misstate : Amt / disc / class. / pres. } not as per FRF
A/P/C/D

material : itna कि user Decision affect हो जाए

Audit से पहले !

Eg: (Rmm) item of capex ⟶ Revenue में
difference in disclosure
" " a/c estimate
inappropriate a/c policy
fake expenses
Bad debt not written off
Inventory ↑↓

AUDIT RISK

Rmm

- Assertion level [AB/C/D]
  - **Inherent Risk**
    chance of mm ↑
    susceptibility to mm ↑
    why? ← [assume no controls]
    ↓
    Controls लगाओ
    higher for some assertions
    category < high / low } range of degrees
  - **Control Risk**
    controls नाकामयाब हैं : P/D/C mm में on timely basis
    (+)
    या फिर controls missing.
    ↓
    IC can only reduce not eliminate Rmm
    ↓
    because of inherent limitations of IC
    IC & CR में inverse relation
    IC ↑ efficient : CR ↓
    IC ↓ : CR ↑
    Eg: Fire Extinguisher है : but expired
    Smoke detector है : but not working
- Overall FS level : pervasive ✓
  affect many assertions ✓

Inverse relationship b/w RMM & DR

Detection Risk.

AP fails to detect mm that exists
↓
Types (covered in SA 530)
- Sampling → Sample not representative of popl^n
- Non-Sampling → Inappropriate AP

Auditor can only influence DR

DR ↓ करने के लिए :
- increase checking area
- larger samples
- competent & experienced ET in ET

IR↑ controls↑ ∴ CR↓ IR↓ Controls↓ ∴ CR↑

Rmm ↑ FAP ↑ ∴ DR↓ Rmm↓ FAP ↓ ∴ DR↑

overall AR ↓

→ Rmm ↑ × DR ↓ = AR ↓
→ Rmm ↓ × DR ↑ = AR ↓

Combined assessment
- SAs don't refer seperately
- Auditor may make separate/combined assessment
- depends on techniques / methodologies.

Rmm assessment is a matter of professional judgement

SA - 315 RAP

Understanding
- Entity
- Environment
- IC

} provides basis for designing (+) implementing responses - SA 330

Identify + Assess
↓
Rmm → Fraud / Error] Reason
- FS level [pervasively to FS as whole - affects many transactions]
- assertion level
  - class of transactions
  - account balances
  - disclosures
  AB/C/D

Risk Assessment Process
- Identify risks [understanding entity, env. & IC]
- Assess whether they relate more pervasively to FS
- Relate risks to WCGW at assertion level
- Consider likelihood of misstatement [multiple? material?]

Components

Inquiries
- mgmt
- TCWG
- 'yees recording unusual transactions
- In house legal counsel
- Internal Auditor
- marketing or sales personnel
- Risk mgmt function
- Info. system personnel

Analytical Procedures

helps identify
- aspects which auditor was unaware of
- unusual transactions, ₹, ratios, trends etc.
- Unusual relationships [Fraud?]

Observation & Inspection

of :
- Entity's operations
- Docs, records, IC manuals
- Reports by mgmt & TCWG
- Entity's premises & plant facilities

RAP ⟶ Info ⟶ AE ?
- to support Rmm assessment
- about AB/C/D & effectiveness of controls ऐसे ही Not planned as SP/TDC
- SP/TDC concurrently with RAP ✓

Panoramic Education
Learn Excel Achieve

Understanding Entity, Environment & IC ★

(A) → ① Industry, ② Regulatory, ③ external factors [FRF]
(B) → Nature of Entity : complex hai क्या ?
- operations — Revenue source, product, location, key customers / suppliers
- ownership (+) governance structure — RPTs?
- type of Investments making (+) plans — acquisitions ? subsidiaries ?
- way entity is structured & financed — debt ?

(C) → selection & application of a/c policy [change - reason?] — appropriate ? consistent with industry FRF ?
(D) → objectives (+) strategies (+) Risk — Eg: Industry developments, New products / service, Expansion.
(E) → measurement & review of entity's financial performance — Eg: KPIs, Budgets, forecasts, variance analyses, Credit rating agency reports
  ↳ creates pressure on mgmt. to misstate FS.

★ ① Industry factors
- Competitive Env.
- supplier & customer relⁿ
- technological developments.

② Regulatory factors
- FRF - a/c principles
- legal - Regulatory framework
- political - govt policies, taxation

③ External Factors
- Economic conditions
- interest rates
- finance availability
- inflation

→ Continuous, dynamic process of gathering, updating info throughout audit.
↓
Professional Judgement ★
Eg:
- assessing RMM 315
- determining materiality 320
- appropriateness of a/c policy 540
- Identifying special audit consideration areas RPT, going concern etc. 550, 570
- developing expectations 520
- evaluate SAAE 500

Risks that require special audit consideration [Significant Risks] ★ → higher inherent risk

→ Fraud Risk
→ Risk related to recent developments [a/c, economic etc.] - changes
→ complexity of Transaction
→ Risk in RPT (O/S normal course)
★ → degree of subjectivity (judgemental, uncertain) Eg: a/c estimate — arise from
- a/c principles for estimates / revenue : differing interpretation
- complex or require assumptions about future events.

★ → Significant unusual transactions (Non routine)
arise from
- mgmt intervention to specify a/c treatment
- manual intervention for data collection
- complex calcⁿ
- difficult for entity to implement effective controls

Part-II materiality

Materiality SA-320 Materiality in Planning & Performing an Audit
↓
Meaning: Misstatements [Individual / aggregate] could influence economic decisions of users

4000 → 3999
4000 → 40,000

It is not always a matter of size. कभी कभी amt से below भी material हो सकता है. size (+) Nature (+) circumstances – सब consider करता है Auditor
apply prof. judgement in determining materiality (+) choosing benchmark
materiality determines scope (+) levels of testing — material ↑ Testing ↑ & vice versa
Consider impact on P/L or B/S
Statutory disclosure : material irrespective of value Eg: Sch III of TCA, 2013 1% of revenue or 1L w.e.h. disclose separately

★ FRF discusses materiality in preparation of FS & generally explains — (Eg: Ind AS.)
→ Misstatements are material if expected to influence economic decisions of users
→ Judgements about materiality — affected by size (+) nature of misstatement
→ Judgements are based on common financial info needs of users as a group ~~Individual users~~

} provides frame of reference to auditor to determine materiality

★ Auditors assumptions about users of FS [Perception of financial info needs]
→ have reasonable knowledge of business (+) economic activities (+) willingness to study with reasonable diligence
→ Understands FS are prepared (+) audited to levels of materiality
→ Recognise uncertainties in use of estimate amounts. (+) judgement (+) future events
→ make reasonable economic decisions on basis of FS.

Levels
① FS level — Eg : 1L [Profit - 20L x 5%]
② Particular [AB/C/D]
- a/c balance
- class of transactions
- disclosures

Eg: 60K

amt. less than materiality for FS as whole — Factors that indicate lesser amt than materiality for FS as whole could influence economic decisions of users :
→ law, regulation, FRF affects user's expectations
  Eg: Related Party, mgmt remuneration
→ key disclosures in relation to industry
  Eg: R&D : pharma co.
→ attention is focused on particular aspect
  Eg: Newly acquired business

Performance materiality (MDS ✓)
Amt set at less than materiality to reduce to appropriately low level probability that uncorrected (+) undetected misstatements exceeds materiality
- FS as a whole
- AB / C / D

Eg: materiality - 1L
PM - 75% of → = 75K

Benchmark — Relevant financial data

A % is applied to chosen benchmark
PBT → % higher eg: 5%
Revenue → % lower eg 1%
} exercise professional Judgement

→ Prior period
→ Period to date
} financial results (+) Position
→ Budgets / Forecasts for current period adjusted for changes

★ Factors affecting identification of appropriate benchmark
→ Elements of FS (Asset, Liability, Equity, Revenue, expense)
→ items on which user attention focused (profit, revenue etc...)
→ Nature of entity, life cycle, industry, economic env.
→ ownership structure (+) way it is financed (Debt → assets ; equity → earnings)
→ Relative volatility

Eg: Exceptional ↑ or ↓ in Profit ✗ Normalise PBT based on past ✓

Revision
→ Reasons:
- Change in circumstances during audit
- new info
- change in auditor's understanding of the entity after performing FAP

→ Revise if info would have caused determination of different amount initially
↓
lower materiality appropriate → Determine need to revise PM
→ NTE of FAP remain appropriate?

① 1L → FAP.
② 1.5L — FAP ↓ ✗
③ 50K → FAP ↑ ✓

Documentation
- (a) Materiality - For FS as whole — 1L → 75K
- (b) Materiality - For particular AB/C/D — 60K → 45K
- (c) Performance materiality
- (d) Any Revision

★ Materiality & Audit Risk
- planning & performing audit
- evaluating misstatements in forming opinion

— inappropriate audit opinion

considered throughout audit when:
- identifying & assessing RMM
- determining NTE of FAP
- evaluating effect of uncorrected misstatements on opinion in AR

Part-III Internal control

Process — DIM by

Mgmt/TCWG

☆ Objectives/Purpose

reasonable assurance — achievement

- Compliance with L&R ✓
- FR Reliability ✓
- op EEE ✓
- safeguard assets ✓

☆ Benefits of understanding IC :

→ Identifying potential misstatements
→ Identifying factors that affect RMM
→ Designing NTE of FAP

☆ Limitations [reasonable assurance only]

- Human Judgement / Error in decision making
- Lack of understanding the purpose
- Collusion
- Judgement by mgmt
- limitations in case of small entities : ~~segregation of duties~~
  However, owner-manager effective oversight. ✓
  ↓ can override

Components of IC

- Control Env.
- IS
- RAP [Entity]
- Control Activities
- monitoring

COMPONENTS ☆

Ⓐ Control Environment — evaluate whether :
☆
- mgmt created culture of honesty & ethical behaviour
- this provides appropriate foundation for other components of IC

includes :
→ governance & mgmt function
→ attitude, awareness & action of TCWG/mgmt
→ sets tone of the organisation

☆ Existence of Satisfactory Control Env.

- helps reduce Risk of Fraud
- not an absolute deterrent

Deficiency in Control Env = Undermined effectiveness of IC
ये also influences NTE of FAP

Control Env अपने आप mm PDC नहीं करता
but other control components को influence करता है

Elements

- [Communication] & [Enforcement] of Integrity & Ethical values
  - behavioural standards through policy docs & COC
  - mgmt action to eliminate temptations that promote illegal acts.
- Commitment to competence
- Participation by TCWG
  - Independence from mgmt
  - experience
  - involvement etc...
- Mgmt philosophy & operating style
  - approach to Risks & attitude towards FR etc...
- Organisational Structure (+) lines of reporting
- Assignment of Authority & Responsibility
- HR policies & practices
  - Recruitment
  - Training
  - promotion
  - compensation etc...

Ⓑ Risk Assessment Process [Entity की] : how mgmt determines risks.
☆ Obtain understanding क्या Entity के पास process है for ?
→ Identifying Business Risks relevant to FR
→ Estimating significance
→ assessing likelihood of occurence
→ deciding about actions to address risk

Risk किन circumstance में arise या change होता है ?
- Change in reg./op env.
- Recruitment of new ß
- New technology
- new business model etc....

Ⓒ Info. System :
☆ Obtain an understanding of
① — Class of transaction — entity op में — जो significant to FS है
② — procedures — ↳ initiate, process, record, correct, t/f to General ledger, report in FS
③ — related a/c records, supporting info & specific a/c in FS used for ②
④ — How IS captures events & conditions significant to FS
⑤ — FR process used to prepare FS
⑥ — Controls surrounding journal entries

Ⓓ Control Activities — P&P that ensure mgmt. directives are carried out.
☆
→ Authorisation
→ performance reviews [actual performance with budgets]
→ Info processing [controls over arithmetic accuracy, program change]
→ physical controls [physical security of assets]
→ SOD. [diff. ß recording transaction & custody of assets]

Ⓔ Monitoring of Controls :
☆ Obtain understanding of major activities entity uses to monitor IC over FR
- process to assess effectiveness of IC performance
  ↳ on timely basis — remedial actions
  consider controls operating as intended (+) modified for change
- through [→ ongoing activities [regular supervision] / → separate evaluations] combination
- use info from commⁿ from external parties
  Eg: → customer complaints / → regulator comments } indicating problems & highlight areas of improvement.

Are all Controls Relevant to Audit ?

↓

Entities IC (+) obj. relate to
- FR ✓
- operations ✗
- Compliance ✗
  ↓
  relevant if relate to data auditor uses in AP

} not all are relevant to auditor's RAP
↓
Not relevant : need not be considered

If regulation require auditor to report on compliance of IC :
Review of IC broader & more detailed.

☆ Factors :
☆ ✓ Materiality
☆ ✓ Significance of related risk
- ✓ Size of the entity
- ✓ Nature of Entity's business (+) org (+) ownership
- ✓ Diversity (+) complexity of operations
- legal & regulatory requirements
- Circumstances & component of IC
- ✓ Nature & complexity of system in IC
- how a specific control PDC mm

Controls over completeness & accuracy of Info

Relevant if auditor intends to make use of info in FAP.

IC over safeguarding of assets

may include controls relating to FR ✓ & operations → generally not relevant to audit.
auditor's consideration is limited to those relevant to reliability of FR

Nature & extent of understanding of relevant controls

Step 1: Evaluate Design : capable of effective P-D-C of mm
Step 2: Check implementation : control exists & entity is using it
Step 3: Test Op. Effect.

कैसे ? ☆ RAP to obtain AE about design & implementation of IC
- Inquiry (alone not sufficient)
- observation
- Inspecting docs
- Tracing transactions through IS

☆☆☆ Benefits of Evaluation of IC to Auditor

ß को पता चलेगा :
- क्या error/fraud मिलेंगे op. में ?
- क्या adequate IC है - in use & operating as planned ?
- क्या effective Internal audit dept है ?
- क्या IC asset safeguard कर रहे हैं ?
- क्या mgmt adequately transactions की correct recording कर रहा है ?
- कितनी reliable हैं reports & certificates ?
- circumstance में appropriate AP या audit technique कौनसी होगी ?
- किस area के control weak हैं और कहाँ के excessive हैं ?
- worthwhile suggestions to improve IC.

Formulate Audit Programme after understanding IC

w/o understanding
- unnecessary heavy
- object of audit lost in mass of entries & vouchers

पता करो system actually operation में है या नहीं

with review:
- → enough time to fully understand IC & implications - be more objective
- → can bring to mgmt notice - weakness in IC (+) suggest improvements
- → In test checking - helps decide appropriate AP in different areas

IC considered weak - do AP otherwise not required.
(+) extend to cover large no. of transactions
(+) perform additional tests.

} Extent & Nature of audit programme subs. influenced by IC

info required: important features of business
co's procedures, manuals, flow-charts
↓
if not available:
contact right officers & 'yees to get info.

Methods of Evaluation of IC

Read co. manuals, study org. charts, make suitable enquiries. . . .

Narrative record

- complete exhaustive description
- actual testing & observation necessary
- recommended where no formal IC system
- more suited to small business

Disadvantages:
- to comprehend system in op.
- to identify weakness / gaps
- to incorporate changes [manpower]

} difficult

Checklist

- series of instructions / Questions
- ET follows / answers - Y / N / N.A.

Eg:
- ⇒ Are tenders invited before placing orders?
- ⇒ Is the purchase order from standardized?
- ⇒ Are purchase orders forms pre-numbered?
- ⇒ Are inventory control accounts maintained by appropriate persons?

- Principal studies this & ascertain existence / efficiency of IC

Internal Control Questionnaire

- set of questions
- thorough view of IC
- Yes: satisfactory
  No: weakness [Explanation / details]
  N.A.: not relevant to business
- issued to client & filled by 'yees of client
- inconsistency noticed: matter discussed by ET and client's 'yees for clear picture
- oversight of procedure is less likely to occur
- disclose controls defects orderly

} +ve

Eg:

Purchases
- (i) Are purchases centralised in the Purchase Department?
- (ii)
  - (a) Are purchases made only from approved suppliers?
  - (b) Is a list of approved suppliers maintained for this purpose?
  - (c) Does the master list contain more than one source of supply for all important materials?
- (iii) Are the purchase orders based on valid purchase requisitions duly signed by authorised persons in this behalf?
- (iv) Are purchases based on competitive quotations from two or more suppliers?
- (v) Are purchase orders pre-numbered?
- (vi) Are purchase orders signed only by employees authorized in this behalf?
- (vii) Are all materials received only in the Receiving Department?
- (viii) Are persons connected with receipt of materials and the keeping of receiving records denied authority to issue purchase orders or to approve invoices?
- (ix) Are materials inspected and counted, weighed or measured in the Receiving Department?
- (x) Are receipt of materials evidenced by pre-numbered Goods Received Note?

Creditors
- (i)
  - (a) Are suppliers' invoices routed direct to the Accounts Department?
  - (b) Are they entered in a Bill register before submitting them to other departments for check and/or approval?
  - (c) Are advance and partial payments entered on invoices before they are submitted to other departments?
- (ii) Does the system ensure that all invoices are duly processed?
- (iii) In respect of raw material and supplies, are reconciliations made of quantities and/or values received as shown by purchase invoices with receipt into stock records?
- (iv) Does the Accounts Department match the invoices of supplies with Goods Received Notes and purchase orders?
- (v) Do all invoices bear evidence of being checked for prices, freight, terms etc.?
- (vi) Are all advance payments duly authorized by persons competent to authorize such payments?
- (vii) Are duplicate invoices marked immediately on receipt to avoid payment against them?
- (viii) Are all supplier's statements compared with ledger accounts?
- (ix) Is there any follow-up action to investigate difference, if any, between the suppliers' statements and the ledger accounts?
- (x) Is a list of unpaid creditors prepared and reconciled periodically?

Inventories
- (i) Are stocks stored in assigned areas?
- (ii) Are stocks insured comprehensively against different risks? If some risk is not insured, whether it is due to specific decision taken by a senior official?
- (iii) Is a record maintained for the insurance policies?
- (iv) Is the record reviewed periodically?
- (v) Is there an official who decides on the value for which stocks are to be insured?
- (vi) Is the adequacy of insurance cover reviewed periodically?
- (vii) Are perpetual stock records kept for raw materials, work-in-progress, finished goods and stores?
- (viii) Are stock records periodically reconciled with accounting records?
- (ix) Where there is a system of perpetual inventory count:
  - (a) Is there a periodical report of shortages/excess?
  - (b) If so, are these differences investigated?
  - (c) Are these differences adjusted in the stock records and in the financial accounts?
  - (d) Is written approval obtained from a responsible official to adjust these differences?
- (x) Are there norms for stock levels to be held?

Fixed Assets
- (i) Are budgets for capital expenditure approved?
- (ii) Is the authority to incur capital expenditure restricted to specified officials?
- (iii) Are purchases of capital expenditure subject to same controls as applicable to purchases of raw materials, stores etc.?
- (iv) Is there proper check to see that amounts expended do not exceed the amount authorized?
- (v) Are fixed assets verified periodically?
- (vi) Is there a written procedure for such verification?
- (vii) Are reports prepared on such verification?
- (viii) Do such reports indicate damaged/obsolete items of fixed assets?
- (ix) Are discrepancies disclosed by such reports investigated?
- (x) Are the records and financial accounts corrected with appropriate authority?

Flow-chart

- graphic presentation [diagram full of lines & symbols]
- most concise & comprehensive way
- real visual picture of whole activities of dept.
- narrative expl^n ↓
- bird's eye view of system
- flow of transactions / doc can be spotted

Eg:
- ⇒ at what point a document is raised internally or received from external sources;
- ⇒ the number of copies in which a document is raised or received;
- ⇒ the intermediate stages set sequentially through which the document and the activity pass;
- ⇒ distribution of the documents to various sections, department or operations;
- ⇒ checking authorisation and matching at relevant stages;
- ⇒ filing of the documents; and
- ⇒ final disposal by sending out or destruction.

Part - IV Automated Environment

Meaning

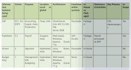
Business env. where - process / operations / accounting / decisions - carried using IS/IT
less manual
more system driven
more automated - more complex eg: ERP (SAP)

Key Features

- → Faster operations
- → Accuracy in data processing & computation
- → process large volume of data
- → Integration b/w operations
- → human errors ↓
- → provides latest info
- → connectivity & networking capability
- → better security & controls

Understanding Automated Environment SA-315

- → Information System used
- → their purpose → financial / non
- → Location → local vs. global
- → Architecture → Desktop based / cloud based
- → Version
- → Interface within systems
- → Inhouse vs. Packaged
- → Outsourced activities → IT support
- → key persons → CIO / CISO



Information Systems being used	Version	Purpose	Location- Local vs global	Architecture	Interfaces within systems	In-House vs. Packaged	Outsourced Activities	Key Persons	In-Scope
SAP	ECC 6.0, EHP5	Accounting, Supply chain, Production	Texas, USA	Client/Server, Unix AIX 5.3, MS-SQL Server 2008	Paymaster	Packaged		CIO, Administrators	Yes
PayMaster	5.3	Payroll	Gurgaon, India	Web-based, Windows, Apache, Oracle 11g	SAP, Accent	Packaged	Payroll processed at ADP		Yes
Accent	2	Appraisal	Hyderabad, India	Lotus Notes, Windows	Paymaster	In-house			No
Budget King	1	Management MIS Budgeting	Hyderabad, India	Web-based, Windows, Apache, Oracle 11g	None	In-house			No

Risks to IC imposed by IT SA-315

- → System inaccurately processing data / processing inaccurate data
- → Unauthorised access to data
- → Direct Data changes [backend changes]
- → Excessive access / Privileged access (super users)
- → Lack of adequate segregation of duties
- → Unauthorised changes / Failure to make necessary changes to System / Program
- → Loss of Data

Impact of IT Related Risks on Auditors

↓
if not mitigated: Impact on
- Substantive Testing
  - Can't rely on data
  - Test thoroughly for completeness & accuracy
  - detailed checking ↑
- Controls
  - Non-reliance on
    - Automated controls
    - Calculations
    - a/c procedures in apps.
  - Additional audit work
- Reporting
  - Modification of AR

Types of Controls

① General IT Controls
Policy & Procedures related to many applications
'Pervasive / Indirect'
↓
Includes:

② Application Controls
Automated (+) manual operate at business process level
Eg: Edit, validation, reasonable mandatory, user limit etc...

③ IT Dependent Controls
manual controls using data produced from IT Systems

interrelated: G-IT needed to support functioning of appl^n
both needed to ensure complete (+) accurate info through IT systems

① Data Center & Network operations →
- obj: Prod^n system meets FR obj.
- Activities: Batch jobs, Backups, BCP, DRP etc.....

② Programme change →
- obj: Modified system meets FR obj.
- Activities: Change mgmt, requests, making, testing....

③ Access Security →
- obj: authenticated & authorised access to meet FR obj...
- Activities: Appl^n, Data, OS, Network, Physical Security....

④ Application system →
- Acquisition
- Development
- Maintenance

(Business appl^n)
- obj: systems are developed & implemented to meet FR obj.
- Activities: Project initiation, analysis, design, Testing....

Testing methods

- Inquiry
- Observation
- Inspection
- Reperformance

Low AE ↓ High AE (Effectiveness)
Low ↑ High (Efficiency)

Professional judgement (+) Factors
— Risk assessment

Hence, Inquiry in combination with others
alone never sufficient
Reperformance - best AE but time consuming
Inquiry (+) Inspection = most effective (+) most efficient

More common methods

- → Obtain understanding of automated transaction
  walk-through of end to end
  Inquiry (+) Obs. (+) Inspection
- → Observe how user processes transaction
  different scenarios
- → Inspect configuration defined in app

- control Env.
- desired level of Evidence
- history of errors
- complexity of business
- assertions etc

Characteristics of manual & Automated Elements of IC

affects the manner in which transactions are initiated, recorded & reported :

→ manual system : approvals ✓ reviews ✓ reconciliations ✓ follow up ✓

Automated procedures : electronic records replace paper documents.

→ IT system - combo of automated (+) manual controls :
  - independent of IT
  - use info produced by IT
  - monitor effective functioning of IT

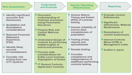
Manual vs. Automated Elements

more suitable : judgement & discretion required
- unusual transactions
- where errors difficult to predict
- circumstance that require response o/s scope of existing control.
- In monitoring effectiveness

less suitable :
- recurring transactions
- errors predicted can be P-D-C by automated controls
- control activities can be adequately designed & automated.

manual less reliable that automated : bypassed, ignored, overridden, prone to errors. ~~Consistency~~

Audit Approach



Risk Assessment	Understand and Evaluate	Test for Operating Effectiveness	Reporting
• Identify significant accounts and disclosures • Qualitative and Quantitative considerations • Relevant Financial Statement Assertions (FSA) • Identify likely sources of misstatement • Consider risk arising from use of IT systems	• Document understanding of business processes using Flowcharts/ Narratives • Prepare Risk and Control Matrices (RCM) • Understand design of controls by performing walkthroughs of end-to-end process • Process wide considerations for Entity Level Controls, Segregation of Duties • IT General Controls, Application Controls	• Assess Nature, Timing and Extent (NTE) of controls testing • Assess reliability of source data; completeness of population • Testing of key reports and spreadsheets • Sample testing • Consider competence and independence of staff/team performing controls testing.	• Evaluate Control Deficiencies • Significant deficiencies, Material Weaknesses • Remediation of control weaknesses • Internal Controls Memo (ICM) or Management Letter • Auditor's report

Data Analytics

Analytical process - info prepared from data using PTT known as CAATs. Eg: spreadsheets, IDEA, ACL.

Applications of Data Analytics :
⇒ Check completeness of data used in ToC/SP
⇒ Selection of Sample Eg: Random/Systematic
⇒ Recomputation of Balance Eg: Reconstructing Trial Balance
⇒ Reperformance of mathematical calcⁿ Eg: Depri, Int.
⇒ Analysis of Journal entry SA 240
⇒ Fraud Investigation
⇒ Evaluating impact of control deficiency

Digital Audit

Business Env → Digitization & Automation ↑

∴ use of digital technology by auditor → planning से opinion तक

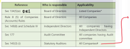
use of AI & Data Analytics to understand business process

Better audit ✓ attention to areas that require greater focus ✓

Better identify risks ✓

Internal Financial Controls

Policies & Procedures for -
→ Reliability of FR
→ Effectiveness (+) Efficiency of operations
→ Compliance with L&R
→ Asset safeguarding
→ Prevention & Detection of Frauds



Reference	Who is responsible	Applicability
Sec 134(5)(e) DRS	Board of Directors	Listed Companies*
Rule 8 (5) of Companies (Accounts) Rules	Board of Directors	All Companies
Sec 149(8) and Schedule IV	Independent Directors	All companies having Independent Directors
Sec 177	Audit Committee	All companies having Audit committee
Sec 143(3) (i)	Statutory Auditors	All Companies#

→ Not applicable to Pvt Co → OPC or Small or T/o < 50cr & borrowing < 25 cr

Documenting the risk

- discussions among ET (+) significant decisions.
- key elements of understanding Entity/Env/IC, source of Info, RAP performed.
- identified RMM < FS level / assertion level
- Risks identified & related controls.

Assess & Report Audit Findings [Exceptions]

Deficiency in IC exists - unable to PDC mm on timely basis or control missing

Consideration while assessing findings -
⇒ Weakness identified in IT controls
⇒ Impact on overall audit
⇒ Reporting Deficiency to mgmt through mgmt letter/ IC memo
⇒ Communicate significant Deficiency to TCWG (writing) SA 260

Part V : SA-330 The Auditor's Responses to Assessed Risks

→ FS level
→ assertion level

Compliance Procedures [TOC] → Results unsatisfactory → Substantive Procedures [SP] ↑

Auditor design & perform TOC to obtain SAAE as to operating effectiveness of controls

→ when ?
- expectation : controls are operating effectively
- SP alone can't provide SAAE

meaning → AP designed to detect mm

SP → SAP (520) ; TOD → AB, C, D

Nature & Extent
a) only SAP sufficient
b) only TOD appropriate
c) combination most responsive

Responces [FAP]
- TOC
- SP
  - TOD
    - vouching [C : P&L]
    - verification [AB : B/S]
  - SAP

In designing FAP
- Consider
  - likelihood of mm [Inherent Risk]
  - risks taken into a/c controls [Control Risk]
- RMM high : obtain more persuasive AE

ToC includes
- Inspection of docs [AE that IC have operated]
- Inquiries & observation [when no audit trail]
- Reperformance of IC
- Testing of IC on specific computerised application

Nature → a) Perform inquiry + other AP ↓ obtain evidence about operating effectiveness of controls
  - → how applied at relevant times
  - → consistency
  - → by whom

→ b) Indirect controls : necessary to obtain AE supporting effective operation?

→ Inquiry alone not sufficient - combine with inspection/reperformance [observation at a point in time only]

Nature of IC = Type of AP

Eg: Doc → inspection

Extent
→ more persuasive AE = ↑ extent of TOC (+) degree of reliance
→ matters to be considered -
- Frequency of performance of control
- Length of time auditor is relying
- Expected rate of Deviation
- Relevance + Reliability of AE to be obtained
- Extent to which AE is obtained from other TOC

Timing
→ Particular time
→ throughout the period auditor intends to rely

Using AE obtained in previous audits → establish continuing relevance [significant changes in controls]

length of time period that may elapse before re-testing →
→ Effectiveness of Elements of IC : Control Env, RAP, monitoring etc...
→ Risks from characteristics [manual or automated]
→ Effectiveness of GITC
→ Nature & extent of deviations in previous audit
personnel changes ?
→ Changing circumstances - lack of Change.
→ RMM - extent of reliance

Evaluating operating effectiveness of controls
mm detected by SP indicate controls not operating effectively?
↓
strong indicator of existence of deficiency
} However absence of mm detected by SP ≠ controls effective ✓

Deviations from controls detected
Specific inquiries to understand these matters (+) consequences
& Determine:
① TOC performed provide appropriate basis for reliance on controls?
② Additional TOC necessary?
③ Potential RMM ⟶ SP ?

Testing of IC
whether & how far in operation?
actual testing of system in operation
Selective basis
all imp areas covered in 3 years.
TOC - effectiveness of
Design
Operation

Effective op. of IC का AE obtain करने में Auditor consider करता है
- how IC applied
- consistency
- by whom applied
|
Some **deviations** may occur
↓
Factors:
· changes in key [illegible]
· seasonal fluctuation of volume of transactions
· human error
↓
detected ✓
Auditors [make specific inquiries - 'timing of staff changes'
[ensure TOC covers period of change
↓
इस evaluation का conclusion : "Assessed Control Risk needs to be revised."
↓
Modify NTE of planned SP