5.] Example of ~~factor~~ matter that Auditor may considered before determining whether a deficiency or a combination is a significant deficiency

SQ Sept'24(iii) (5M)

→ Refer Module-1 Pg. 1A.45

Chapter-10

Risk Assessment and Internal Control

Audit procedure

- RAP (SA 315)
- FAP (SP) (SA 330)
  - TOD
    - Test of Transaction i.e. vouching
    - Test of Balances i.e. verification.
  - SAP (SA520)

• What is included in RAP:-

It shall include the following,

Inquiries of management and other within the entity

Examples

• Internal audit personnel
• employee involved in unusual transaction
• in-house legal councel
• marketing and sales personnel
• Risk mgt. function
• Info. system personnel.

Analytical procedure

A.P. performed as RAP inc. Both F.I and NFI

Example

Relationship b/w sales and volume of goods sold,

it Helps to identify unusual transaction or Event

Observation and inspection.

Examples

• Entity's operation
• Docs. (Business plan and strategy) & I.C. manuals.
• Report prep
  - By mgt
  - By TCWG
• entity's premise & plant facility.

• Understanding The Entity and it's Environment:-

The Auditor shall obtain understanding of the following:-

R : Relevent industry, Regulatory and other External factor inc. AFRF. Example of matter auditor shall considered,

• Accounting principles, and industry specific practices.
• Regulatory framework or Regulated industry
• legislation and Regulation that affect entity.
• government policies directly affecting the conduct of Entity.

O : entity's objective and strategies and those related Business risk that may result in ROMMS. for Eg.

- industry development.
- New product or services
- Expansion of Business.

M : The measurement and review of Entity's financial performance. following may be used By Auditor,

- Key performance indicator, key ratios, Trends, operating statistics.
- period-on-period financial results Analysis.
- credit Rating agency Report.
- Budget, forecast or other level performance Report.

A : The Entity's selection and application of Accounting policies inc. changes thereto.

N : The Nature of Entity including,

- it's operations
- it's ownership and governance.
- Types of investment that Entity is making or plan to make,
- How entity is financed and way of structure.

understanding an Entity is continuos process:-

→ such understanding establish a frame of references within which auditor plans and perform the audit and Exercise P.J for $\underbrace{\text{Example}}_{\text{RAMDAS.}}$ when.

R : AROMM of f.S.

A : consider Appt. ness of selection and application of A.P

(M) :- Determine materiality (SA 320)

(D) : Developing Expectation when use A.P. (SA 520)

(A) : Evaluate whether A.E obtained SAAE

(S) : identify areas where sp. audit consideration Required.

Audit Risk

• Introduction To Audit RISK :-

- meaning :- it means that auditor provide inappt. audit opinion when the F.S. materially misstated.
- it means that Auditor provide unmodified opinion when F.S. are materially misstated.
- Audit Risk (AR) is function of ROMM, DR
- What is Not included in A.R
  • Auditor's Business Risk such as
    - loss from litigation
    - adverse publicity
    - other Event arising in connection with Audit of F.S.
  • A.R. Not include the Risk that auditor provide modified opinion when in fact F.S Not materially misstated.

$$A.R = IR \times CR \times DR$$

Inherent Risk (IR) ⟷ Control Risk (CR)

component of ROMMS.

Detection Risk (DR)

Inherent Risk (IR)

- IR is an susceptibility of an assertion about a CABD to MS that is material – I / Aggt.

Before consideration of any related controls as described in SA200.

- IR factors are considered in determining or designing

TOC | S.P.

- only client can influence

Control Risk (CR)

- CR is the risk that M.S. that could occure in an assertion about CABD
  - that M.S is material – I / Aggt
  - will not PDC fraud or error on timely basis by entity's I.C.
  - Inverse relationship b/w CR and efficiency of I.C.

CR ↓ → efficiency of I.C. ↑

CR ↑ → efficiency of I.C. ↓

- only client can influence

eg. collusion among employee.

Detection Risk (DR)

- SA 200
- DR is the risk that procedure performed by auditor
  - To ↓ risk to an acceptably low level.
  - will not detect a MS that exist & that could be material – I / A with other MS.
- DR comprise of
  - Sampling Risk
  - Non Sampling Risk
  - Auditor can influence DR
  - it can be reduced by increasing area of checking, testing larger samples and includes more expert in ET

SA-330

Auditor's Responses To Assesed Risks

Test of Control (TOC)

Nature

To design & perform Toc auditor shall

- perform O.A.P (+) inquiry
- Determine controls Tested depend on any other Indirect control
  - if yes
  - obtain A.E support op. effectiveness of that Indirect control.

Extent

- More persuassive A.E Needed
  - ↑ Extent of Testing.
- Matter considered.
  - → freq. of performance of control by entity.
  - → EROD from control.
  - → Avl. of R&R AE
  - → Extent to which AE obtained from Test of other control Related to Assertion.

Timing

- some controls checked only at a specific point of time such as P.V. performed by mgt
- for other controls there are No time constraints.

- Inq.(+) Insp./Reperfo.
  - > Inq.(+) Observ.

{AP Designed To Detect MMS (4)}
{AL

SP

TOD

Test of Transaction i.e. vouching

Test of Balances i.e. verification.

SAP → Refer SA 520.

- meaning of SAP
- To provide A.E. Ratio used
- Applicable to large volume of Transaction that Tends to be predictible over time.

- Nature and Extent of S.P:-

Nature

Depending on circumstances Auditor Determine that

only SAP (+) TOD (+) combination of Both.

Extent

To Design TOD, Extent of Testing is Based on sample size.

Objectives (SA 330)

obtain SAAE about AROMM through Designing & implem. Appt. Response To those RISK

↓

SA 330 states, that,

The Auditor shall design and implement overall Response to the assesed ROMM @ FS level.

the auditor shall {Design and perform FAP} whose NTE are based on and are Responsive to AROMM @ A.L.

(*) The auditor shall,

consider the Reason for Assessment @ A.L. for each CABD inc.

likelihood of MMS due To particular characteristic of CABD

whether RAP Takes into Account Relevent control. that Require auditor to obtain AE about operating Effectiveness of Relevent control.

↑ the Assessment of Risk

↑ Pursuassive A.E. Required.

When Auditor Shall design and perform TOC:-

- When auditor's Assessment of ROMM @ AL inc. an Expectation that control are operating effectively.
- SP Alone cannot provide SAAE @ AL.
- greater Reliance on control, Auditor obtain more pursuassive AE
- in TOC, Required Higher level of Assurance about operating effectiveness of control.

NOTE → some misc. point Read from book (M_1 pg. 13.42)

SA-320

Materiality In Planning & Performing Audit

Materiality :- Misstatement that inc. omission considered To be material if they I/Aggt. could Reasonably be Expected to influence Economic Decision of user Based on (i.e. Taken on) F.S.

→ materiality is not Always a matter of Relative size.
eg. નાના Amt. નો fraud પણ MMS indicate કરે છે.

- Materiality in planning and performing audit is Auditor's Responsibility and matter of APJ :-

→ concept of materiality Applies on → planning, performing (SA320 Deals with it), Evaluation, forming opinion

→ The Auditor's make Judgement About size of M.S. that will considered material. it provide bassis For,

① NTE of → RAP (i), FAP (ii)

② Identifying ROMM and Assesing it.

→ concept of materiality.

- Explained in AFRF → they generally Explain that,
  - meaning (SA 320)
  - Nature/size/Both affect the judgement of materiality.
  - common financial Needs of user To be considere about Judgement on materiality.
  - possible Effect of M.S. on specific individual user is not considered.
- Not Explain → Refer SA 320.

→ the auditor should consider → size / Nature of UNC. MS / circumstances of their occurance. → To Evaluate effect of M.S. on F.S.

Statutory Requirement

↓

Division I, SCH. III of Co. Act, 2013

- Any Item of P&L → > 1% of RFO (or) ₹1,00,000 → whichever is Higher → Disclosed separately
- S.H. Holding > 5% of total. → Disclosed in Notes To Account As No. of shares

• Determination of materiality by Auditor Based on Assumption

User of F.S.

① Have reasonable knowledge of Business, Economic Activities, and Accounting.

② understand that FS prepared, presented and Audited to level of materiality

③ ~~Take~~ Recognise uncertainties inherent in the measurement of amount Based on APJ.

⑤ make study of F.S. with reasonable diligence.

④ make reasonable Economic decision on the Basis of F.I.

P.M = Performance Materiality

meaning :- Amt. or Amts. set By Auditor at less than materiality for

F.S. as a whole (or) Particular (ABD)

To Reduces to an Appt.ly low level the probability that Aggt. of

undetected (and) uncorrected

misstatement

Exceeds the materiality for the F.S. as whole.

• Factors Affecting identification of Benchmark (BM) :-

Focus : Item on which the Attention of user's Tends To Focused on :-

V : Relative Volatility of B.M.
I : Industry & Economic Environment in which Entity operates
O : Ownership structure and way entity financed.
L : Where entity stand in it's Life cycle.
E : element of FS i.e. A, L, I, E.
N : Nature of Entity.

→ percentage Applied on choosen B.M. is matter of APJ.

• Factors Affecting Materiality for Particular CABD :-

L&R / AFRF Affect user's Expectation
↓
Regarding measurement and Disclosure
↓
eg. RPT, Remn of mgt / TCWG.

Key Disclosure Related to industry in which entity operates.
↓
eg. R&D cost for Pharma. co.

aspect that separately Disclosed in F.S.
↓
eg. Newly Acq. co.

• Revision In Materiality :-

→ As a Result of

Δ in circumstances

Δ in understanding & operation of Entity as a Result of FAP

Acquired New Information.

Further if,
• Actual F.R. Different than anticipated F.R.
• lower materiality Require than initially Determined
Determine whether it Result into Revision in PM and check that NTE of FAP Appt.

• materiality and Audit Risk are considered throughout the audit in particular when,

• I&A ROMM

• Determine NTE OF FAP

• Evaluating the effect of UNC. M.S on F.S. and form opinion in A.R.

AUTOMATED ENVIRONMENT

• Key Features of ATME:-

- Enable faster business operation
- Ability to process large volume of Transaction.
- Better security and control.
- less prone To Human Error
- provide latest information.

• meaning:-

- ATME Refers To Business Environment where the processing, operation, Accounting and Even the Decision making are carried out by computer system.
- also known AS (IS, IT)

Following Are the points that Auditor should keep in mind To understand ATME:-

- Info. system being used
- Their purpose.
- Inhouse v/s packaged
- location of IT system (local v/s Global)

- outsourced Activities
- Key person (CIO, CISO, Administrator)

• Risk Arise from use of IT system :-

- unauthorised Access To data.
- change in data (Direct)
- Excessiv Access To data (super user)
- inappropriate seg. of Duties.
- loss of data.

Above Risk should be mitigated, if not
It Has Impact on,

Substantive checking
↓
leads To Non Reliance on data obtaind from system
↓
leads To increas in substantive checking i.e. Detailed checking.

control
↓
leads To Non Reliance on Automated control & Alcing procedure.
↓
leads To Add. audit work.

Reporting
↓
there is Need of Reporting REQ. of IFC under companies Act, 2013.
↓
leads To modification on Auditor's Report.

Types of control

General IT control

Related to P&P

- Relate to many Application
- Support the effective of function

Interrelated.

Application control

Include

- Auto. control
- manual control

operate at a Business process lvl.

embeded into IT Application

Eg.
- Edit check
- user limit check
- Reasonable -ness check.

I.T. Dependent control.

Basically manual control

use some form of Data, Info., Report

produced from I.T. system

effectiveness of data depends on Reliability of data source.

General I.T. control Have control over following

Ⓐ Data centre & Network operation
→ objective
→ ensure that prodn system processed

Ⓑ programme change.
→ objective
→ ensure that modification system

Ⓒ Access security
→ objective
→ Access To Program and Duty Authentication and Authoris

Ⓓ Application system, Acquisition, Developement and maintena
→ objective.
→ System are DIM.

→ To Meet F.R. objective.

Activities Included in

Ⓐ
- overall mgt of computer Activities
- Execute, prepare, schedual batch jobs
- In case of fail to Backup data then BCP & DRP

Ⓑ
- mgt. process Record, mng., Tracking changing Request

Ⓒ
- security
  - org. & mng.
  - P&P
  - Network
  - Physical.

Ⓓ
- overall mng. of Developed Activities
  project initiation, quality Assurance.

• Testing method of ATME:-

Inquiry ①
- efficient audit Test
- least AE
- use within combination of other method.

Reperformance ②
- effective audit Test
- give best AE
- Time consuming least Efficient

Inquiry + inspection ③
- most effective and efficient

• Which method use is APJ, depending on several factor
- RAP
- control environ.
- Desired lvl. of AE REQ.
- History of ERROR
- complexity of Business.

• Data Analytics (DA) for audit:-

meaning:- combination of

Process, Tools, Technique

↓

Tap vast Amt. of E-Data

↓

To obtain meaningfull info.

↓

called DA.

DA used in

Testing of E-Records

Testing of data Residing in IT system using Audit Tools

To perform following

- Fraud investigation
- Evaluating Impact of control deficiency
- selection of audit sample
- Recompu. of Balances
- check completness of data & popu^n. used TOC/SAP

• Internal Financial control [IFC] :-

meaning :- IFC Refers To

↓

policies and procedure

↓

put in place To Ensure,

↓

C.A.R.E (+) PDC fraud.

• Assess and Report Audit Finding :-

At conclusion of audit

↓

certain Finding / matter → ① Any weakness in I.T. control?

↓

need To assess & Report

↓

To SH / mgt / TCWG

② Impact on audit

③ Report Def. → mgt. / TCWG

IC memo, mgt. letter

④ auditor communicate Def. (writting)

- Responsibilities Regarding IFC under Co.Act, 2013:

Sec. 134(5)(e)
- listed co.
- state in DRS that IFC
  - follow
  - adequate
  - Effective

Sec. 143(3)(i)
- Auditor Report shall state that IFC
  - adequate
  - Effective
- Not apply to
  - OPC
  - SC
  - T/O < 50Cr.
  - Borrowing < 25Cr (CY) During F.Y.

Sec. 177(4)(vii)
- Audit comittee Act in Acco. with Term of BOD inc. evaluation of,
  - IFC
  - RMS

Sec. 149(8)
- SCH IV
- code for Ind. DIR.
- function of Ind. DIR is satisfy
- Integrity of IFC & FI & RMS is Defensible.

SA330 :- Using AE obtained in previouse audit :-

Auditor shall considered

- Effectiveness of
  - general I.T. control
  - element of IC
  - control & it's Application by Entity.
- Risk from
  - characteristic of control
- ROMM & extent of Reliance on IC