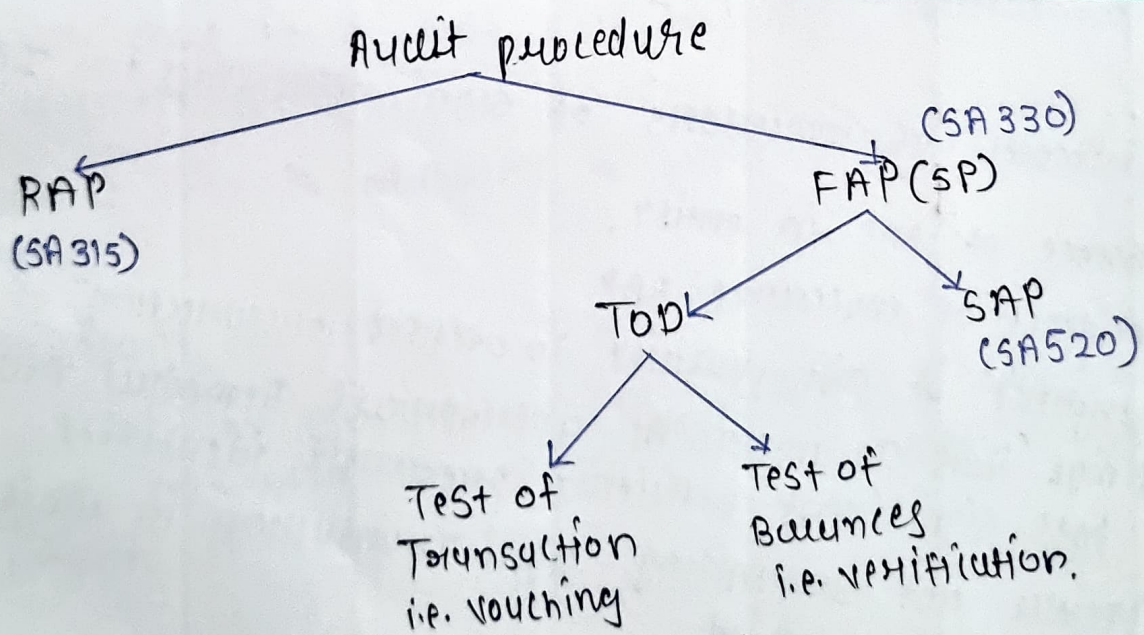


5.] Example of ^{multiple} factors that Auditor may considered before determining whether a deficiency or a combination is a significant deficiency
SA 315 (SA)
→ Refer Module - 1 Pg. 2A.45

Chapter - 10

Risk Assessment and

Internal Control



• what is included in RAP:-

It shall include the following,

Inquiries of management and others within the entity

Examples

- Interview audit personnel
- employee involved in unusual transaction
- in-house legal counsel
- marketing and sales personnel
- Risk mgt. function
- Info. system personnel.

Analytical procedure

A.P. performed AS RAP inc. Both F.I and INFI

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 TCW
- entity's premise & plant facility.

• understanding The Entity and it's Environment:-

The Auditor shall obtain understanding of the following:-

R: Relevant industry, regulatory and other external factors 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 continuous process:-

→ such understanding establish a frame of references within which auditor plans and perform the audit and exercise P.T for Example when.
RAMDAS.

(R) : AROMM of f.s.

(A) : consider APP.NESS of selection and application of A.P

- ①: determine materiality (SA 320)
- ②: developing expectation when use A.P. (SA 520)
- ③: Evaluate whether A.E obtained SAE
- ④: identify areas where specialist consideration required.

Audit Risk

• Introduction To Audit Risk:-

- meaning :- it means that auditor provide inappr. 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 $\begin{cases} \text{IR} \\ \text{DR} \end{cases}$
- **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)

- IR is an susceptibility of an assertion about a C&B to MS that is material $\rightarrow I_{Aggt.}$

Before consideration of any related controls as described in SA 200.

- IR factors are considered in determining or designing

TOL S.P.

- only client can influence

component of ROMMS.

Control Risk (CR)

- CR is the risk that M.S. that could occur in an assertion about C&B

- that M.S. is material $\rightarrow I_{Aggt.}$
- will not PDC fraud or error on timely basis by Entity's I.C.

- Inverse Relationship B/W

CR



efficiency of I.C.



- only client can influence

eg.
collusion among employees.

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 $\rightarrow I_{Aggt.}$ with other MS.

- DR consists 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 Assessed

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 of
effectiveness
of that indirect
control.

Extent

more persuasive
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. / Repres. fo.
> Inq. (+) observ.

SP

{ AP designed To detect MMS @ }
AL

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 predictable over time.

• Nature and Extent of S.P.:-

Nature

depending on circumstances
Auditor determine that

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

↑ the Assessment of Risk

↑ persuasive A.E. required.

likelihood of MMS due to particular characteristic of CABD

whether RAP takes into account relevant control. that require auditor to obtain AE about operating effectiveness of relevant control.

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.
- Where reliance on control, Auditor obtain more persuasive AE
- in TOC, required higher level of Assurance about operating effectiveness of control.

NOTE → some misc. point recd from book (M₂ pg. 1B.42)

SA-320

Materiality In Planning & Performing Audit

Materiality :- Misstatement that inc. omission considered to be material if they if 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 હોય MMS indicate કરે છે.

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

→ concept of materiality Applies on

```
graph LR; A[concept of materiality Applies on] --> B[forming opinion]; A --> C[planning]; A --> D[performing]; A --> E[evaluation];
```

SA 320 deals with it

→ The Auditor's make judgement about size of M.S. that will considered material. it provide basis for,

① NTE of → RAP (i)
→ FAP (ii)

② Identifying ROMM and Assessing it

→ concept of materiality.

Exploined in
AFRF

NOT Explain

Refer SA 320.

→ they generally Explain that,

- meaning (SA 320)

- Nature/size/Both affect the judgement of materiality.

- common financial needs of users

To be consider about judgement on materiality.

- possible effect of M.S. on specific individual users is not considered.

→ the auditor should consider

Statutory Requirement

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

Any Item of
P&L

> 1% of RFO or 100,000

whichever is **higher**

disclosed separately

S.H. Holding
> 5% of total.

disclosed in Notes to Account as No. of shares

size
Number of
UNC. MS
circumstances
of their occurrence.

To Evaluate
effect of
M.S. on F.S.

- Determination of materiality by Auditor Based on Assumption

Use 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 APT.

④ make study of F.S. with reasonable diligence.

⑤ 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 CABD

→ To reduce to an APT. ly low level the probability that Aggt. of

undetected

and

unconnected

→ misstatement

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

• Factors Affecting identification of Benchmark (B.M.):

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 its **Life cycle**.

E : **Element** of FS i.e. A, L, I, E.

N : **Nature** of Entity.

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

• Factors Affecting Materiality for Particular CABD:-

LE/R/AFRF Affect
user's Expectation

↓
Regarding measurement
and disclosure

↓
(eg.) RPT, Remn of mgt/TCW etc.

Key disclosure
Related to
industry in
which entity
operates.

↓
(eg.) R&D cost for
Pharmy. 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:-

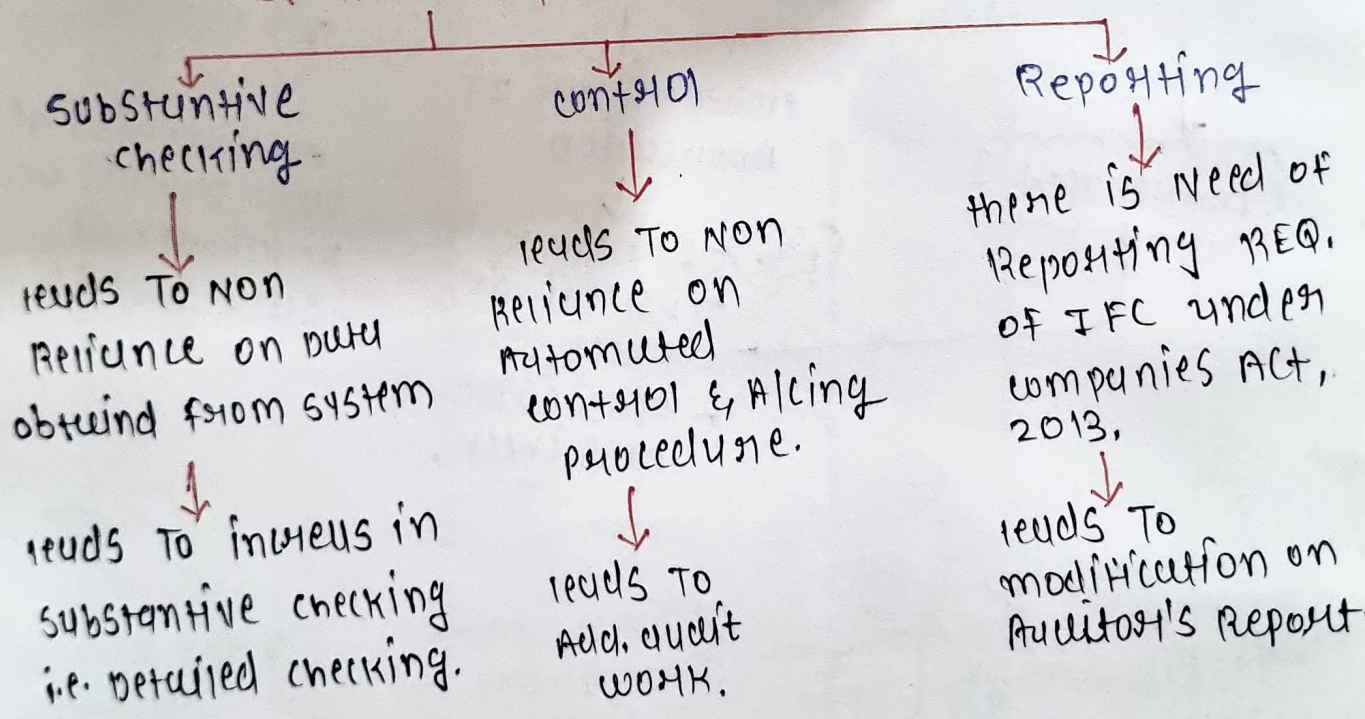
- ATME refers to business environment where the processing, operation, accounting and even the decision making are carried out by computer system.
- also known as (IS, IT)

Following are the points that Auditor should keep in mind to understand ATME:-

- Info. system being used
- Their purpose.
- Inhouse vs packaged
- location of IT system (local vs global)

- Outsourced Activities
- Key person (CFO, CISO, Administration)
- Risk Arise from use of IT system:-
 - unauthorised Access To data,
 - change in data (direct)
 - Excessive Access To data (super user)
 - inappropriate seq. of duties.
 - loss of data.

Above risk should be mitigated, if not it has impact on,



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.

embedded into IT Application

Eg.

- Edit check
- user limit check
- Reasonable-ness check,

I.T. dependent Control.

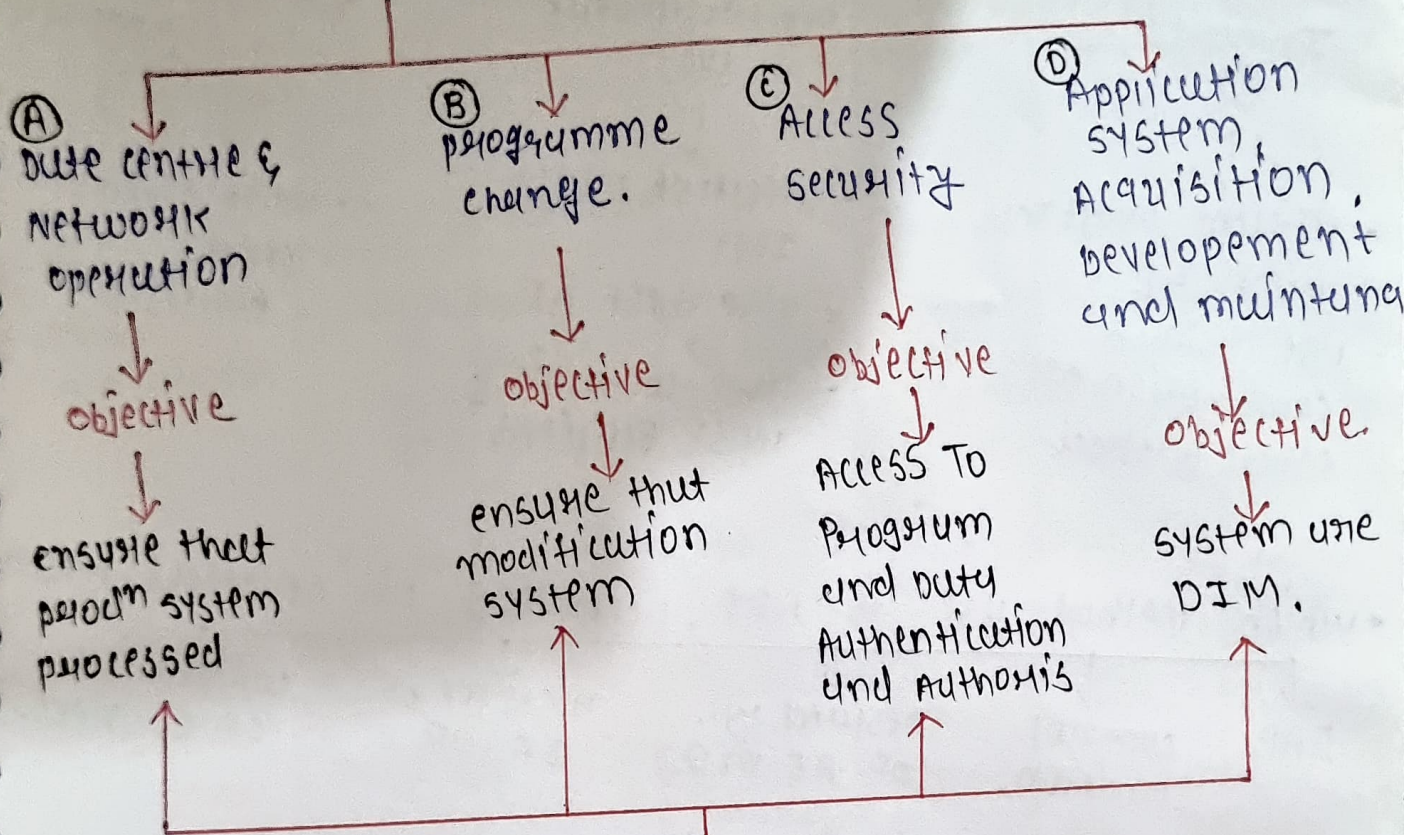
Basically manual control

use some form of Data, Info, Report

produced from I.T. system

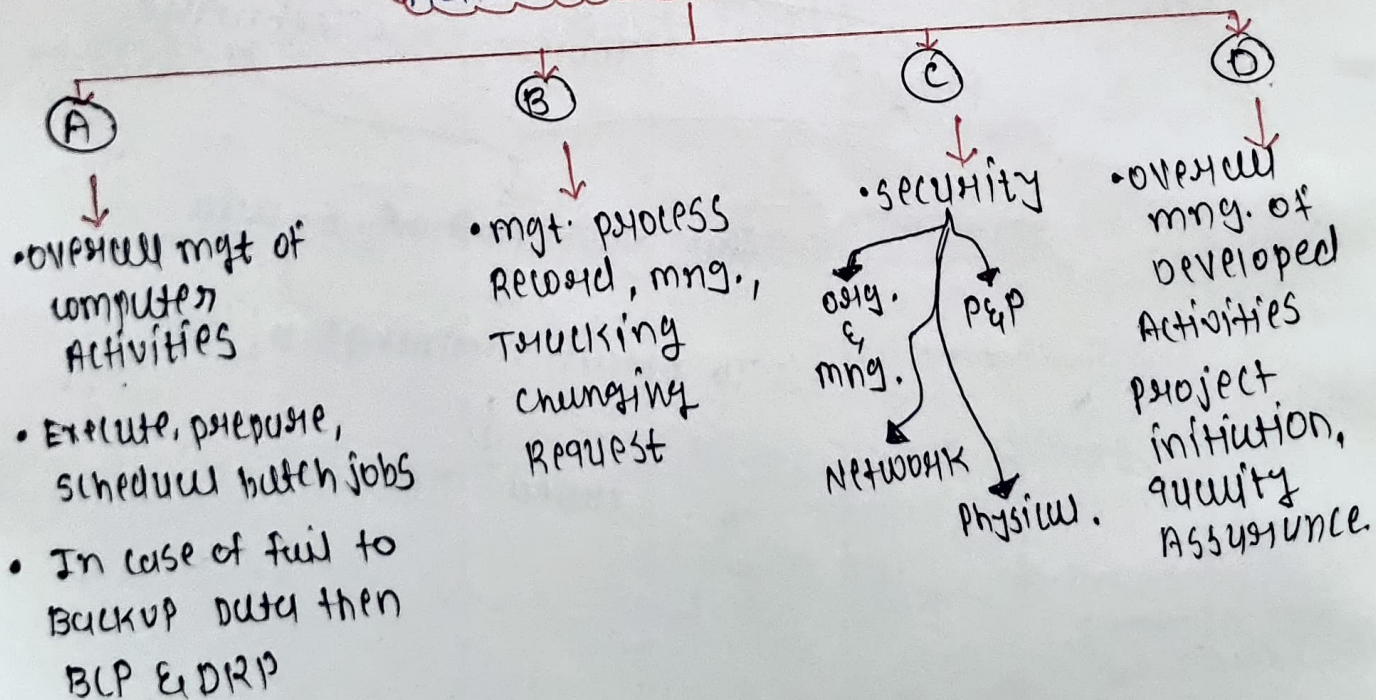
effectiveness of Data depends on Reliability of Data source.

General I.T. control have control over following



To Meet F.R. objective.

Activities Included in



• Testing method of ATME:-

Inquiry
①

- efficient audit test
- least AE
- use within combination of other method.

Repetition
②

- effective audit test
- give best AE
- time consuming least efficient

Inquiry + inspection
③

- most effective and efficient

• Which method use is Apt, depending on several factors

RAP

control environ.

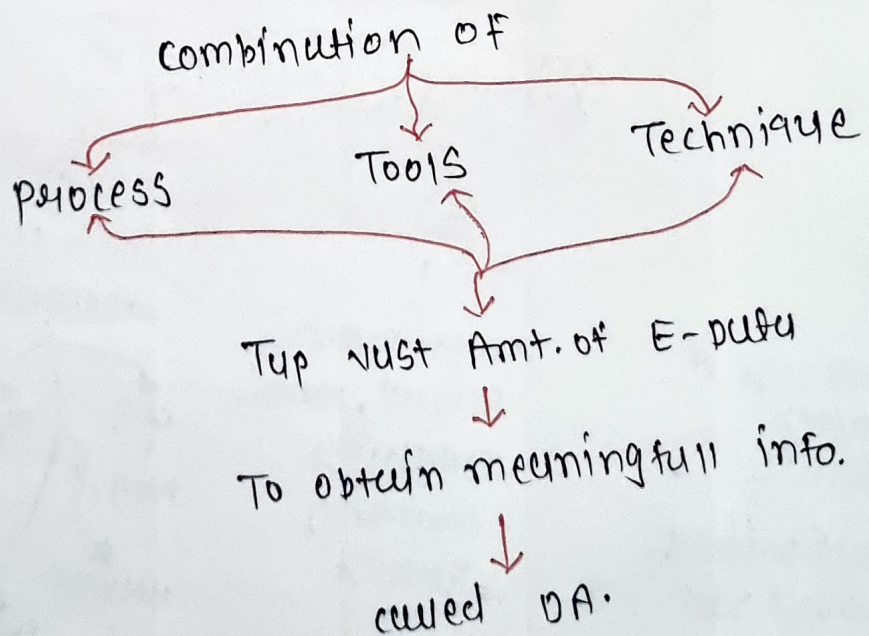
Desired int. of AE REQ.

History of ERROR

complexity of business.

• Data Analytics (DA) for audit:-

meaning :-



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

Recomp. of
Balances

check
completeness
of data &
popn. used
TOC/SAP

• Internal Financial Control [IFC] :-

meaning :- IFC refers to

↓
policies and procedure

↓
put in place to ensure,

↓
C.A.R.E (+) POC fraud.

• Assess and Report Audit finding :-

At conclusion of audit

certain finding / matter

need to assess & Report

↓
To SH / mgt / TCM

~~Any impact on~~

① Any weakness in I.T. control?

↓
② Impact on audit

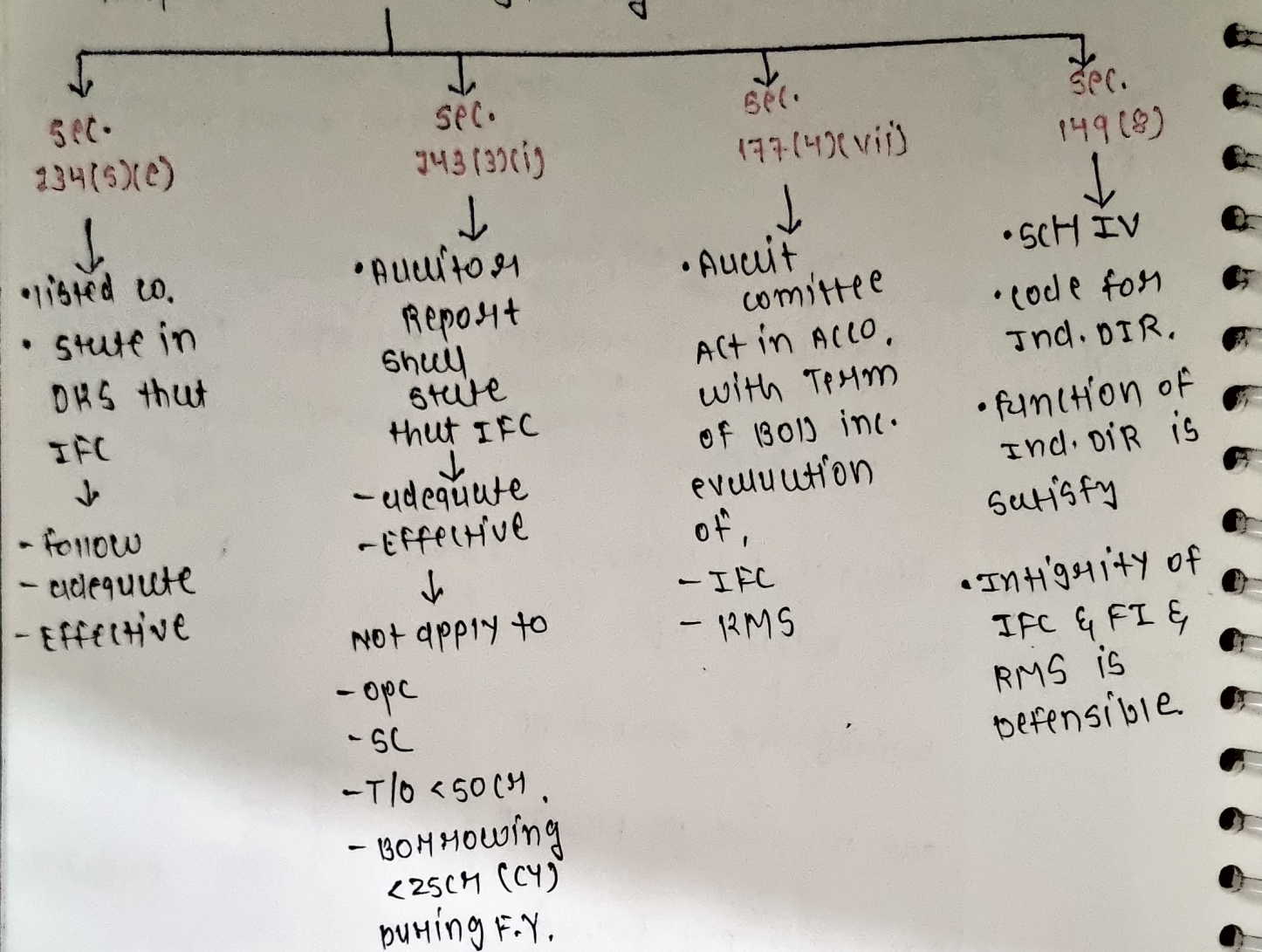
③ Report def. → mgt. / TCM

IC
memo,

mgt.
letter

④ auditor
communicate
def. (whitting)

Responsibilities Regarding IFC Under Co. Act, 2013:



SA 330 :- Using AE obtained in previous audit:-

Auditor shall considered

