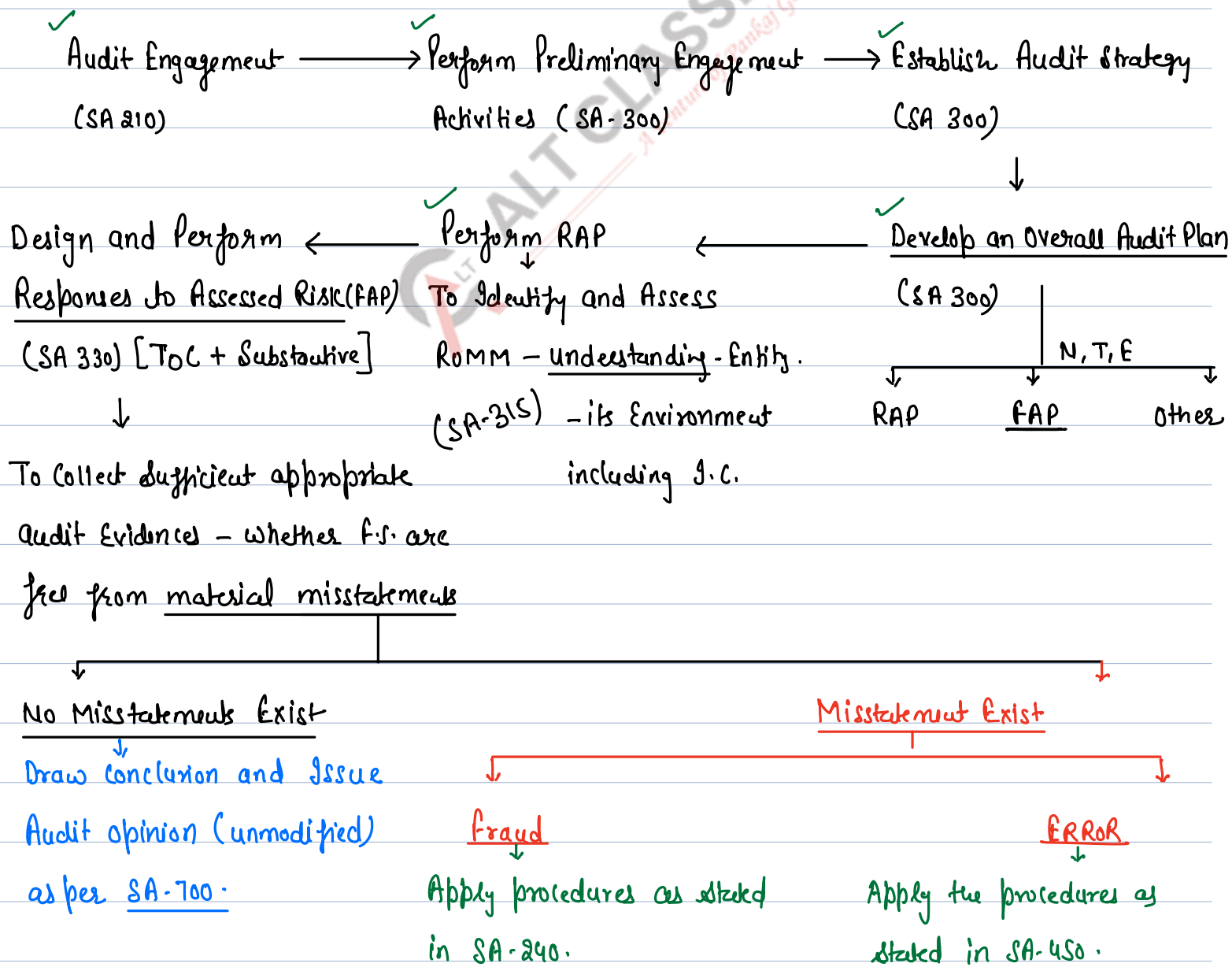


Chapter - 3 " Risk Assessment and Internal Control "

- Topics Covered:
- (1) Audit Risk (SA 315)
 - (2) Materiality in planning and performing an audit (SA 320)
 - (3) Identifying and Assessing ROMM (SA 315)
 - (4) Internal Control (SA 315)
 - (5) Risks that require special consideration
 - (6) Evaluation and Testing of Internal Control System
 - (7) Automated Environment

(8) Auditor's Responses to Assessed Risks (SA 330):



(i) Types of Responses: SA 330 requires the auditor to design and perform audit procedures which are appropriate to assessed risks



for the purpose of collection of sufficient appropriate audit evidences.

Responses are classified in two categories —

- (a) Compliance procedures (Tests of Controls - TOC)
- (b) Substantive " (Tests of details - TOd + Substantive Analytical Pro. - SAP)

✓ (ii) Designing and Performing TOC:

- Tests of Controls may be defined as audit procedures designed to evaluate operating effectiveness of controls in preventing or detecting and correcting material misstatements at the assertion level.
- Auditor shall design and perform TOC to obtain SAAE as to the operating effectiveness of controls when:
 - (a) he expects that controls are operating effectively; or
 - (b) substantive procedures alone cannot provide SAAE.
- In designing and performing TOC, auditor shall perform other audit procedures in combination with Inquiry to obtain audit evidence about operating effectiveness of controls, including:
 - (a) How the controls were applied at relevant times during the audit.
 - (b) Consistency with which they are applied.
 - (c) By whom and by what means they were applied.
- Inquiry alone is not sufficient to test operating effectiveness of controls. Inquiry combined with inspection or re-performance may provide more assurance than Inquiry combined with observation, as observation is pertinent only at the point in time at which it is made.

Matters to be considered in determining the extent of tests of controls:

- (a) Frequency of performance of controls
- (b) Length of time
- (c) Expected rate of Deviation
- (d) R/R - Audit Evidences
- (e) Extent to which A.E. obtained from Tests of other controls.

Imp:

Factors to be considered while using audit evidences obtained in previous audits:

- (a) Effectiveness of Other Elements of Control - C.E, Monitoring, E.R.P.
- (b) " " General I.T. controls
- (c) " " controls and its application by the entity.
- (d) Risk arises from characteristics of controls (Manual or automated)
- (e) ROMM and Extent of Reliance on controls.
- (f) Personnel changes that significantly affect the application of controls.
- (g) lack of a change in a particular controls required due to changed circumstances.

Specific Inquiries by auditor when deviations from controls are detected:

When deviation from controls upon which the auditor intends to rely are detected, auditor shall make specific inquiries to understand these matters, their potential consequences and determine whether

- | | | |
|--|------------------------------------|--|
| ↓ | ↓ | ↓ |
| (a) TOC performed provide appropriate basis for reliance on controls | (b) Additional TOCs are necessary. | (c) Potential risk of Misstatement need to be addressed using Sub. procedures. |

(iii) Substantive Procedures: Procedures designed to detect material misstatements at the assertion level are known as Substantive Procedures.

- Sub. Procedures Comprises of (a) Tests of details - TOC (of Drawings and Balances)
(b) Substantive Analytical Procedures (SAP) (Vouching) (Verification)

Examples: Tests of details of Transactions (Vouching)

(a) Payment of Electricity Bills - Vouching -

- (i) Electricity Bill - Amount Payable
- (ii) Receipts / Bank Statement - Paid
- (iii) Authorisation

Electricity Exp - 2022-23 - ? 12.00 lakh. } Assurance - Comparison
2021-22 - ? 11.50 lakh. } SAP.

Tests of details of Balances (Verification)

e.g. Trade Receivable. 50,00,500 (Existence, valuation)

(List of receivables)

A		<u>15,70,000</u>	<u>Request Letter</u>
B	Amount due	12,06,000	↓ <u>Confirmation</u>
C		10,01,000	(E.C.)
D		4,09,500	

Appropriateness / Reasonableness:

<u>Trade Receivable</u>	2022-23	2023-24	
Sales →	15%	16%	→ S.A.P.

✓ SAP - More applicable to large volume of transactions that can be predicted over time.

For Ex: Rental Income of a Bldg: No. of Apartments × Rental Rate p.m.
 × Occupancy Ratio × 12 Months.
 = 50 × 50,000 × 100% × 12 M
 = 300,00,000

Substantive Procedures: - LEARNING and Noting -