

Chapter - 4 "Materiality, Risk Assessment and Internal Control"

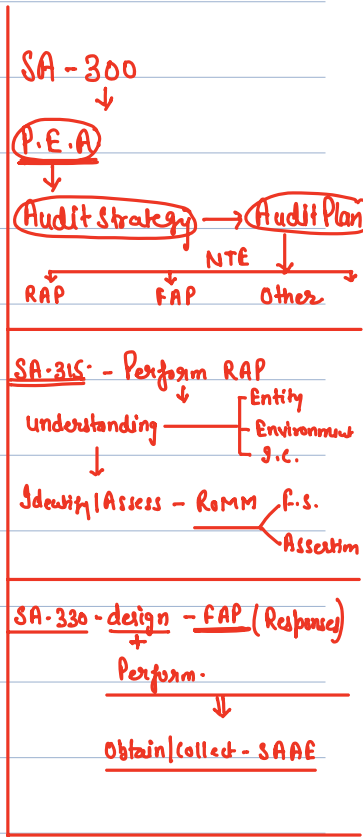
- Topics Covered:
- (1) Audit Risk
 - (2) Risk Based Audit Approach
 - (3) Internal Control System - Nature, Scope, Objective and Structure.
 - (4) Components of Internal Control System
 - (5) Internal Control assessment and Evaluation
 - (6) SA-265

(7) SA-330 "Responses to Assessed Risk":

- SA 330 requires the auditor to design and perform audit procedures which are appropriate to assessed ROMM; for the purpose of collection of sufficient appropriate audit evidences.
- Such responses are classified in two categories:
 - (a) Tests of Controls - ToC (compliance procedures); and
 - (b) Substantive Procedures (ToD + SAP)

Compliance Procedures / Tests of Controls:

- ⊖ Procedures designed and performed to evaluate the operating effectiveness of controls, in preventing, or detecting and correcting the material misstatements in the financial statements.
- ✓ SA 330 requires that auditor shall design and perform ToC to obtain SAAE regarding operating effectiveness of controls when:
 - (a) Auditor expects that the 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 evidences about:
 - ✓ (a) operating effectiveness of controls;
 - (b) How controls were applied at relevant times during the audit;



- (c) Consistency with which they are applied;
- (d) By whom and by what means they were applied.

Most Efficient - Inquiry
(but provides least Evidence)

★ Observation; Inspection; Reperformance

Most effective - Reperformance
(but time consuming)

Matters to be considered in determining extent of TOC:

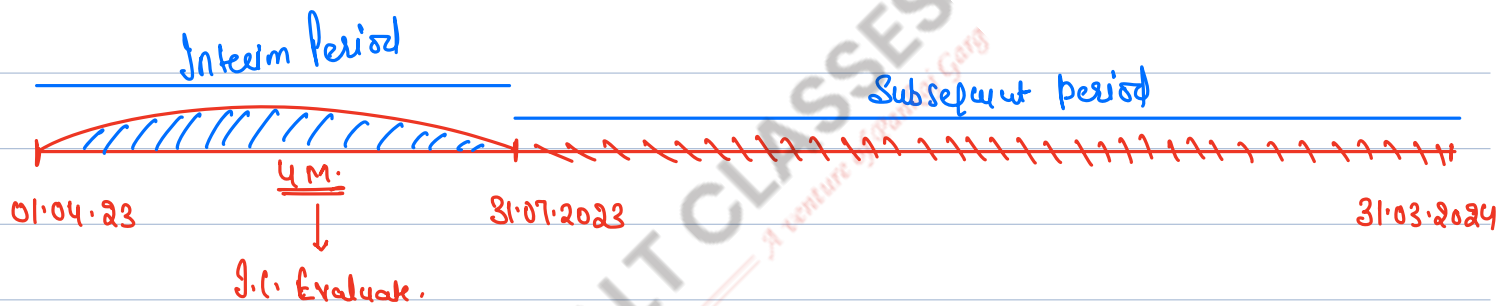
— From Book (Learning) —

Best (Effective + Efficient)

Inquiry along with
Inspection

Special Consideration w.r.t. TOC:

(i) Using Audit Evidence obtained during Interim Period:



✓ Auditor should obtain audit evidences as to significant changes subsequent to interim period.

- Determine the additional procedures to be performed and additional evidences to be collected for the remaining period.

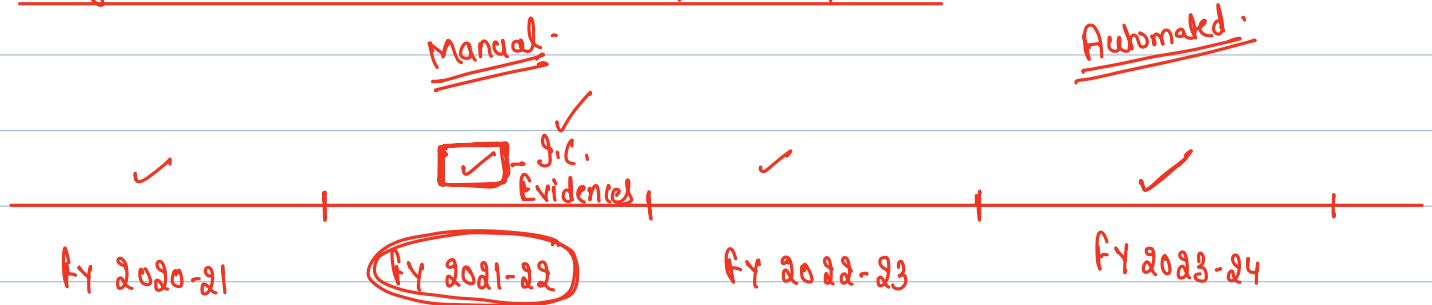
- While determining additional evidences to be obtained about controls, that were operated subsequent to interim period depends on following factors:

- Significance of assessed RoMM;
- Specific controls that were tested during interim period; and significant changes to them since their testing;
- Length of the remaining subsequent period;
- Control Environment;
- Extent to which auditor intends to reduce extent of sub. procedures based on reliance of controls.

(f) Degree to which audit evidence as to operating effectiveness of controls was obtained.

Imp:

(a) Using audit evidence obtained during prior period:



(i) Establish continuing relevance of evidences obtained during audit of prior periods by determining significant changes subsequent to prior period.

(ii) If no significant change occurs, perform TOC once in three years; with review of such controls every year.

(iii) If significant changes occurs, auditor should perform TOC in Current period.

(iv) Factors warranting re-testing of controls:

(a) Deficient Control Environment;

(b) " Monitoring of controls;

(c) " General IT controls;

(d) Significant manual elements in relevant controls;

(e) Personnel changes that significantly affect the application of Control;

(f) changing circumstances that indicate need for change in control.

⑧ Frameworks of Internal Controls:

(i) COSO Framework

(ii) COBIT "

(iii) Criteria of Control (CoCo)

(iv) Turnbull Report

(v) Sarbanes Oxley Act

From Book