

Chapter - 3 "Risk Assessment and Internal Control"

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

Step-1 - Audit Engagement - Terms of Audit Engagement agreed upon with the client.
(SA-210)

Step-2 - Preliminary Engagement Activities - ^{To be performed} before planning activities
(SA-300)

Step-3 - Planning Activities - Establish Audit strategy - that sets the STD of Audit
(SA-300)
- Develop an Overall Audit Plan that includes detailed description of NTE of Audit Procedures to be performed (RAP + FAP)

Step-4 - Performing RAP - to identify and Assess ROMM
(SA-315)

Step-5 - Performing FAP - that includes ToC/Compliance Procedures and Substantive Procedures
(SA-330) (Response)

Tests of details (ToD)
and
S.A.P.

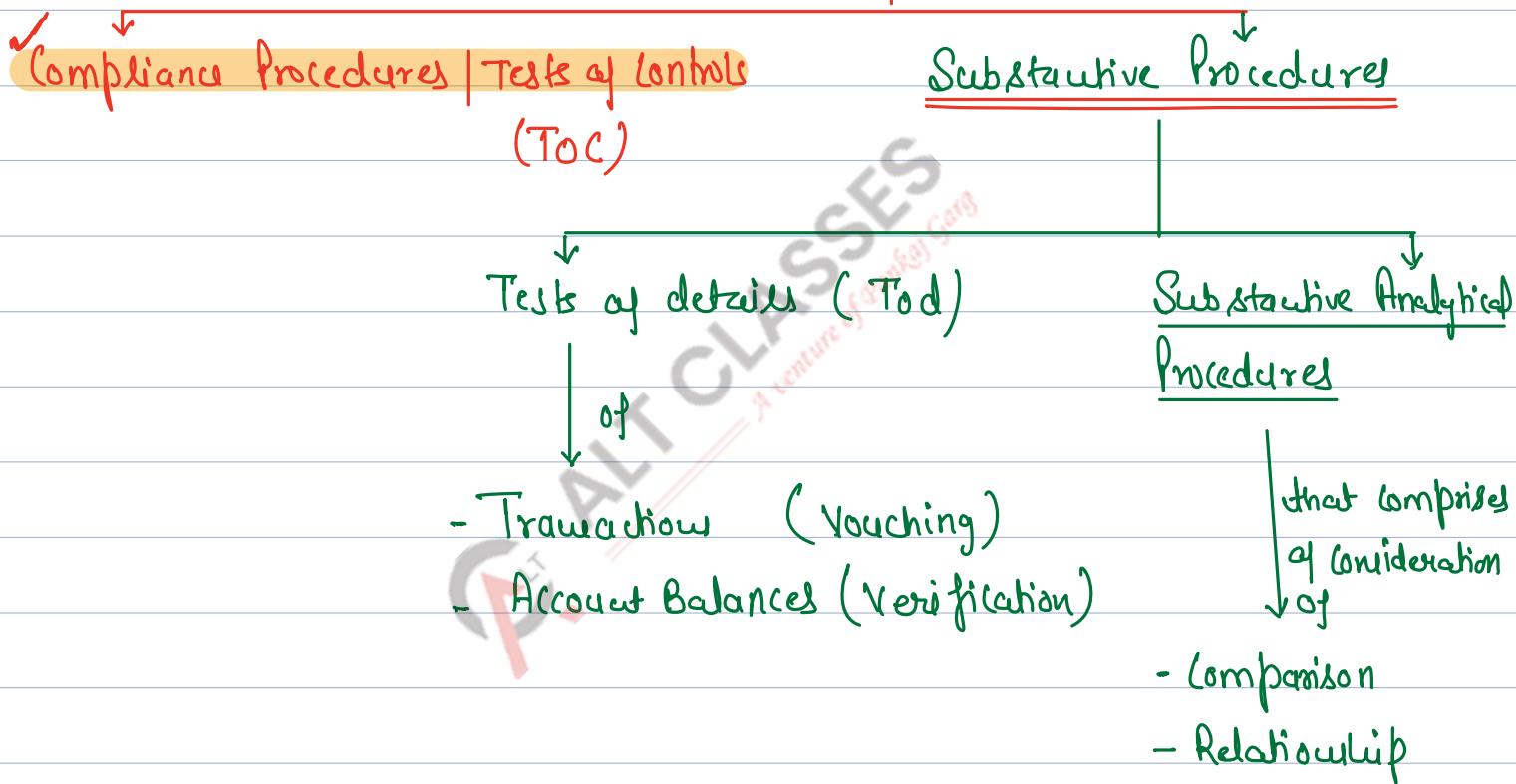
To Collect Sufficient Appropriate Audit Evidences as to whether F.S. are free from material misstatements, whether caused due to error or fraud.

(i) Types of Responses: SA 330 requires the Auditor to design and perform procedures that are appropriate to assessed Risk



for the purpose of collection of sufficient appropriate Audit Evidences.

Responses / Procedures are classified in two categories



(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 assertion level.
- Auditor shall design and perform TOC so as to obtain SAAE as to 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, audit shall perform other audit procedures in combination with inquiry to obtain audit evidences about operating effectiveness of controls, including:

(a) How controls were applied at relevant times during the audit. (e.g. Manual controls / Automated controls / Outsourcing)

(b) Consistency with which they are applied.

(c) By whom and by what means they were applied.

Note: 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 time at which it is made.

- Matters to be considered in determining [Extent of TOC]:

~~(a)~~ Frequency of performance of controls (e.g. Inventory controls - Physical veri.)

~~(b)~~ Length of time

~~(c)~~ Expected rate of deviation

~~(d)~~ Relevance and reliability of audit evidences to be obtained

~~(e)~~ Extent to which audit evidences is obtained from tests of other controls related to same assertion.

Imp Factors to be considered while using audit evidence^{obtained} in previous audit:

- (i) Effectiveness of Other elements of control - e.g. Control Environment, monitoring, Entity Risk Assessment Process.
- (ii) " " General I.T. controls.
- (iii) " " Controls and its application by the Entity.
- (iv) Risk arises from characteristics of controls.
- (v) ROMM and Extent of Reliance on Controls.
- (vi) Personnel changes that significantly affect the application of controls.
- (vii) Lack of a change in a particular controls required due to changed Circumstances.

Effectiveness ↓ - Other Elements - General I.T. controls - Controls & its application.	Risk ↓ Characteristics - ROMM	Changes ↓ Personnel. Lack of changes
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Imp Specific Inquiries by auditor when deviations from controls are detected:

When deviations 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 TOC are necessary; and
- (c) Potential risk of misstatement need to be addressed during substantive procedures.

e.g. Authorisation of R.P. dxw. → Audit Committee ✓ (control designed)

R.P. dxw. → approved/authorised by Director (finance) - Control implement.

whether ROMM - accounting of R.P. dxw. - Exist.

(iii) Designing and performing Substantive Procedures:

- Irrespective of assessed ROMM, auditor shall design and perform substantive procedures for each class of transaction, account balance and disclosure.

- Substantive procedures includes —

- Tests of details of transactions; and
(Tod) Balances
- Substantive Analytical Procedures.
(SAP)

- Auditor is required to determine whether:

(a) Performing Only SAP will be sufficient to reduce audit risk to an acceptable low level

(b) Performing Only Tod are appropriate

Note: A combination of SAP and Tod is generally considered more responsive to assessed risk.

- SAP are more applicable to large volume of transactions that tend to be predictable over time.

(Note: Details of SAP - will be covered in SA-520)

Extent of

- Substantive Procedure depends upon the results of testing of controls. In case of Unsatisfactory controls, auditor is required to increase the extent of substantive procedures.

- Extent of Substantive Procedure is generally considered in terms of sample size.