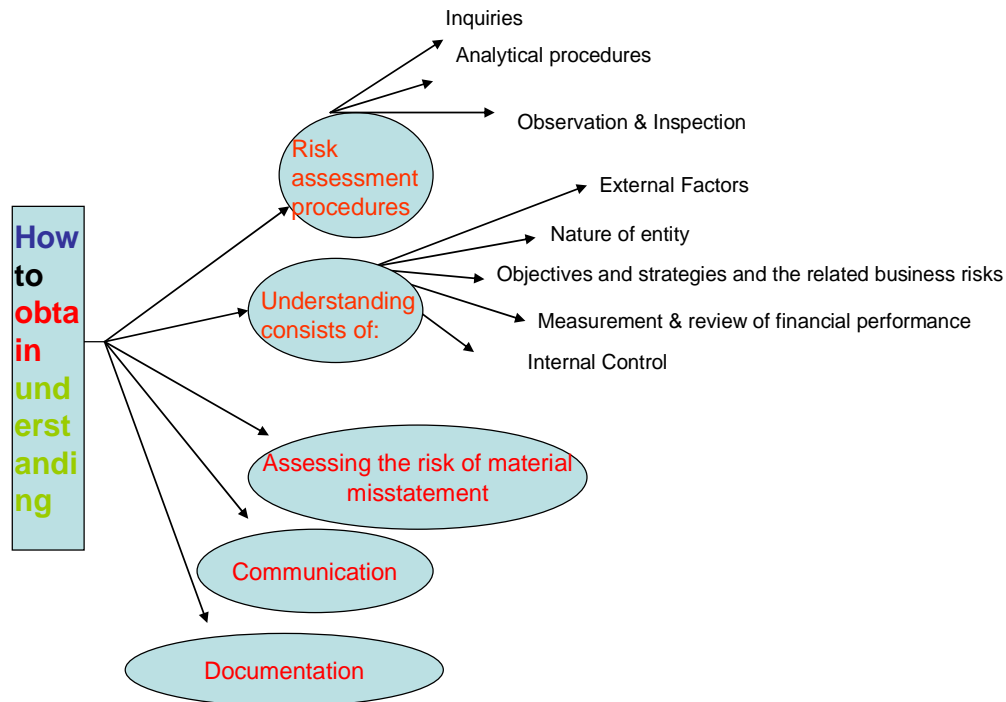


UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT



d) Measurement and Review of the Entity's Financial Performance

The auditor should obtain an understanding of the measurement and review of the entity's financial performance. Performance measures, internal and external, some times create pressures on the entity and motivate management to misstate the financial statements.

Internally generated information may highlight entity's position vis-à-vis, its competitors and reports from credit rating agencies and analysts may provide information useful to the auditors understanding of the entity and its environments.

Examples of matters an auditor may consider include the following:

- Key ratios and operating statistics
- Key performance indicators
- Employee performance measures and incentive compensation policies.
- Trends
- Use of forecasts, budgets and variance analysis
- Analyst reports and credit rating reports
- Competitor analysis
- Period –on-period financial performance (revenue growth, profitability leverage)

e) Internal Control

Understanding of Internal Control is used by the auditor to identify types of potential misstatements and to consider factors that affect the risks of material misstatements and design the nature, timing and extent of further audit procedures.

Definition of internal control

Internal controls is the process designed and effected by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. It follows that internal control is designed and implemented to address identified business risks that threaten the achievement of any of these objectives.

Components of internal control

- (a) The control environment
- (b) The entity's risk assessment process
- (c) The information system, including the related business processes relevant to financial reporting and communication.
- (d) Control activities
- (e) Monitoring of controls