

National Financial Reporting Authority



## National Financial Reporting Authority (NFRA) publishes second 'Audit Practice Toolkit' to enhance audit quality in India

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The National Financial Reporting Authority (NFRA) commenced in November 2025 issuing Audit Practice Toolkits with a focus on supporting the small and medium practitioners engaged in the audits.

The initiative is part of NFRA's systemic drive to continue to support the overall quality of auditing practices in India. This is in continuation of NFRA's recent initiatives to conduct outreach programs for audit firms and audit practitioners, especially focusing on small and medium practitioners.

Now, NFRA has issued an Audit Practice Toolkit titled 'Risk & Response Memorandum: ROMM (Risk of Material Misstatement) Assessment at Assertion Level for Revenue'. This Audit Practice Toolkit deals with a critical phase of audit i.e., assessment of ROMM for various material financial statement line items. Shri Nitin Gupta, Chairperson, NFRA said this sample document is adaptable to different type and sizes of audit engagements.

Therefore, this is expected to be a practical guide to many Small & Medium-size practitioners who can use it by suitably amending the contents based on facts and circumstances of their audit engagements.

During the rest of the financial year, NFRA plans to issue sample Audit Practice Toolkits in a few other significant audit areas.

The toolkits are available on NFRA website at the link - <https://nfra.gov.in/stakeholder-outreach-and-engagement/>

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**Objective of the document:**

This document prepared by NFRA Staff is intended purely towards promotion of awareness of auditing and accounting standards and audit quality as part of NFRA’s education, training, seminar and advocacy initiatives, especially in support of the outreach activities being conducted, and in response to the feedback being received through such engagements.

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## A. Background- Professional Standards' Requirements

Risk assessment lays the foundation for overall audit approach. SA 315, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment* (SA 315) is intended to assist auditors in identifying and assessing the risks of material misstatement in a consistent and robust manner.

### Brief introduction to the risk assessment process

SA 315 require auditors to identify and assess risks of material misstatement, whether due to fraud or error, through understanding of (a) the entity and its environment; (b) the applicable financial reporting framework; and (c) the entity's system of internal controls. The execution of the iterative actions in the context of identifying and assessing risks of material misstatement are interdependent concepts, which are important to establishing a sound basis and foundation for an audit. The quality of auditor's risk identification and assessment process, therefore, has a pervasive effect on all aspects of the audit.

The risk assessment framework under SA 315 **highlights the dynamic and iterative nature** of the process for identifying and assessing risks. The preliminary risk assessments, and planned responses to those assessments, may need to change when new information is obtained.

### Risks of material misstatement

Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the **risk of material misstatement** and **detection risk**.

Risks of material misstatement may exist at two level viz. financial statement level (i.e., risks which are pervasive to the financial statements) and relevant assertion<sup>1</sup>-level for significant classes of transactions, account balances or disclosures. Initial identification and assessment of risks of material misstatement at the assertion level consists of following two components:

- *Inherent risk*: The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.
- *Control risk*: SA 200<sup>2</sup> defines Control risk as the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control. Further, as per Para 26(c) to SA 315, the auditor shall relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; As per para A130, the controls can be either directly or indirectly related

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<sup>1</sup> Representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur. SA 315.A123 further describes about assertions used by the auditor to consider the different types of potential misstatements.

<sup>2</sup> SA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing*

to an assertion. The more indirect the relationship, the less effective that control may be in preventing, or detecting and correcting, misstatements in that assertion.

The auditor may assess the ROMM separately for Inherent risk and Control risk or on combined basis.

Detection risk is the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

**ROMM at Assertion Level**

The table below depicts different types of assertions based on reading of paragraph 25(b) and A121 – A125 of SA 315.

Assertions	Material Misstatement Categories		
	Transactions/Events during the audit period	Account balances at the period end	Presentation and Disclosure
Occurrence	√	-	√
Completeness	√	√	√
Accuracy	√	-	-
Cut-off	√	-	-
Classification	√	-	-
Existence	-	√	-
Rights and obligations	-	√	-
Valuation and allocation	-	√	-
Classification and understandability	-	-	√
Accuracy and valuation	-	-	√

According to para A124 of SA 315, the auditor may use the assertions described above or may express them differently, provided all aspects described above have been covered. *The auditor may choose to combine the assertions about transactions and events with the assertions about account balances.*

**Risks that Require Special Audit Consideration****Significant risk (Para 27 & 28 of SA 315)**

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

- (a) Whether the risk is a risk of fraud;
- (b) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;
- (c) The complexity of transactions;
- (d) Whether the risk involves significant transactions with related parties;
- (e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- (f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual. (Ref: Para. A131-A135)

**Risks for which Substantive Procedures alone do not provide Sufficient Appropriate Audit Evidence (Para 30 of SA 315)**

Above type of risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention.

Where routine business transactions are subject to highly automated processing with little or no manual intervention, it may not be possible to perform only substantive procedures in relation to the risk. In such cases audit evidence may be available only in electronic form, and its sufficiency and appropriateness usually depend on the effectiveness of controls over its accuracy and completeness (Ref: Para. A140). This may also be the case in case of transactions of large volume say Revenue, Payroll, etc.

**Fraud Risk****(Refer. Para 16 and 25 to 27 of SA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*)**

Para 16 of SA 240 requires the auditor to perform certain procedures as part of his/her risk assessment procedures under SA 315 for use in identifying the risks of material misstatement due to fraud. Para 25 of SA 240 requires the auditor to identify and assess the ROMM due to fraud at financial statement level and at assertion level. Para 26 casts a responsibility on the auditor to presume fraud risk in case of Revenue, unless auditor is able to rebut that presumption. Further, para 47 of SA 240 mandates the auditor to document the reasons for the rebuttal.

Para 27 of SA 240 prescribes that the fraud risk, if any, has to be treated as significant risk.

The Auditor uses various approaches to assess the fraud risk including an approach based on concept of 'Fraud Triangle'.

#### **Revision of Risk Assessment**

#### **(Ref. Para. 31 & A142 of SA 315)**

During the course of the audit based on the findings of audit procedures, the auditor's assessment of ROMM at assertion level may change. In such event, the auditor shall revise the assessment and modify the further planned audit procedures.

**B. Risk of Material Misstatement (ROMM) for Revenue – Audit of Dhanvantri Limited by Audit Firm CA. Ram Lakhan & Associates**

*(Notes: This sample ROMM Work Paper for an important financial statement line item (FSLI) i.e., Revenue has been developed for education and training purposes. This ROMM assessment is at assertions level only. It is designed for audit of Standalone Financial Statements (SFS) as well as Consolidated Financial Statements (CFS). In case an audit firm is engaged for an audit of SFS only, contents of this sample document need appropriate changes.)*

**I. Review and Signoff by Engagement Team**

	<b>Name &amp; Designation</b>	<b>Signature</b>	<b>Date</b>
<b>Prepared by</b>	CA. Bharat, Engagement Supervisor		5 <sup>th</sup> November 20XX
<b>Reviewed by</b>	CA. Laxman, Engagement Manager CA. Sushrut, Information System Audit Expert		10 <sup>th</sup> November 20XX
<b>Approved by</b>	CA. Ram, Engagement Partner		15 <sup>th</sup> November 20XX
<b>Reviewed by</b>	CA. Charaka, Engagement Quality Control Reviewer		16 <sup>th</sup> November 20XX

## II. Observations from Detailed Analysis of Financial Performance of Dhanvantri Limited

This ROMM work paper is for a key source of revenue of Dhanvantri Limited i.e., sale of pharmaceutical products. Separate ROMM work papers will be prepared for other sources revenue of Dhanvantri Limited. Further this ROMM work paper is for audit of Standalone Financial Statements of Dhanvantri Limited. Our firm is also auditors of Consolidated Financial Statements of Dhanvantri Limited and separate ROMM work papers will be prepared for each material component, whose financial information is included in the Consolidated Financial Statements, in co-ordination with the component auditors of those material components. In case of non-material components, we will be applying other audit procedures such as analytical review etc., as considered appropriate under individual facts and circumstances.

### Financial Reporting Framework Applicable

Dhanvantri Limited is a listed company, therefore, required to follow Indian Accounting Standards prescribed under Companies (Indian Accounting Standards) Rules 2015. Accordingly, the requirements of Ind AS 115, *Revenue from Contracts with Customers* are applicable for accounting for Revenue of Dhanvantri Limited. We have performed details review of the nature and type of revenue transactions of Dhanvantri Limited and note that Ind AS 115 application does not pose significant risk from accounting point of view except for Ind AS 115 prescriptions relating to variable consideration in para 50 -59. The variable consideration prescriptions affect the timing and amount of recognition of revenue due to various discount and promotional schemes of Dhanvantri Limited introduced from time to time. However, our discussion with Sales and Marketing Head revealed that the Dhanvantri Limited has not introduced any new incentive or promotional schemes during the year under audit.

### Revenue profile of Dhanvantri Limited for the year under audit

*(For information about Dhanvantri Limited's Sales, Distribution and Marketing department organisational structure, sales policy, process and controls, refer documents attached to ROMM Work Paper)*

₹ Crores

Particulars	31.03.20X(Y-2)	31.03.20X(Y-1)	Current Year Ending 31.03.20XY	
	(Previous Year 2)	(Previous Year 1)	Actuals (9 Months)	Forecast (12 Months)
	Actuals			
<b>A. Revenue from contracts with customers</b>	<b>205,000</b>	<b>204,000</b>	<b>158,000</b>	<b>225,000</b>
Provision for sales return	(500)	(500)	(200)	(300)
Rebates, discounts, price reduction and others	(3,500)	(4,000)	(2,800)	(4,700)
<b>Revenue as per contracted price, net of returns</b>	<b>201,000</b>	<b>199,500</b>	<b>155,000</b>	<b>220,000</b>

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RISK & RESPONSE MEMORANDUM: ROMM ASSESSMENT AT ASSERTION LEVEL FOR REVENUE - A SAMPLE DOCUMENT

Particulars	31.03.20X(Y-2) (Previous Year 2)	31.03.20X(Y-1) (Previous Year 1)	Current Year Ending 31.03.20XY	
			Actuals (9 Months)	Forecast (12 Months)
	<b>Actuals</b>			
<b>Disaggregated revenue by type</b>				<b>220,000</b>
<i>Sale of products</i>	<i>197,000</i>	<i>195,000</i>	<i>151,000</i>	<i>215,000</i>
<i>Sale of services</i>	<i>4,000</i>	<i>4,500</i>	<i>4,000</i>	<i>5,000</i>
<b>B. Other operating revenue</b>	<b>4,500</b>	<b>4,800</b>	<b>4,300</b>	<b>4,000</b>

Our discussion with Sales and Marketing Head during the year revealed that the pharmaceutical industry across the globe witnessed a successful year, driven by demographic shifts and evolving patient needs. Back home in India, the pharmaceutical industry continues to see strong growth of 7-10%. Dhanvantri Limited impressive revenue growth (forecast) of 9.75% is line with the industry trend. The key drivers in India are growing population, demographic and lifestyle changes, and increased access to modern medicines. These factors are further aided by Government of India incentive schemes such as Ayushman Medical Insurance scheme.

#### Review of published information

We have reviewed in detail the following information and data of Dhanvantri Limited and do not find any information that may have material impact on our ROMM for Revenue from Sale of Products.

- 1) Annual Reports for the year audit and previous year.
- 2) Quarterly financial results submitted to stock exchange i.e., Bombay Stock Exchange (BSE).
- 3) Earnings call transcripts and press releases on the website of Dhanvantri Limited.

Our Engagement Team also had discussions with Sales, Distribution and Marketing Team of Dhanvantri Limited.

### III ROMM Work Paper for Revenue (Sale of Products) of Dhanvantri Limited

#### Assessment of Risk of Material Misstatement for Revenue- Risk and Response Summary

Objective
This workpaper has been prepared to document the evaluation of (a) risk of material misstatement (ROMM/ RMM) for the identified account captions and disclosures including the relevant risk factors that were considered to assess the level of inherent risk, (b) the assertions at which the risk exists (c) evaluation of whether a risk of fraud exists (d) the process level controls identified to address the relevant risks and the planned control reliance approach (e) planned audit response with respect to the identified risks

#### Overall summary of ROMM for Revenue from Sale of Products

ROMMs		Inherent Risk	Control Risk		Fraud Risk	Overall ROMM
Sl.#	ROMM Description		Manual Controls	IT Environment		
ROMM 1	Revenue is recognised for arrangements that do not meet the definition of a contract under the standard or do not exist. (Ind AS 115)	Medium (M)	Low (L)	NA	No	Low (L)
ROMM 2	Revenue is not accurately recorded because the transaction price is not appropriately determined as per Ind AS 115	Significant (S)	NA	Low (L)	Yes	Significant (S)
ROMM 3	For performance obligations satisfied at a point in time, an inaccurate amount is recorded for revenue.	Medium (M)	NA	NA	No	Low (L)
ROMM 4	For performance obligations satisfied at a point in time, revenue is not recognised in the correct accounting period.	Significant (S)	High (H)	Low (L)	Yes	Significant (S)

Based on above analysis, overall ROMM for Dhanvantri Limited Revenue from sale of products is ‘Significant’.

*(Note: However, this assessment is not a mathematical exercise. Engagement Teams have to exercise professional judgment and apply professional skepticism to estimate these risk bucket levels)*

These ROMM levels will be considered in determining the nature and extent of testing e.g., sample sizes for both test of controls and substantive tests.

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**Summary of Inherent Risk Assessment (Also refer Audit Strategy Document for Preliminary Findings)**

Sl. No.	Accounts/ Disclosures	Amt	Assertions					Inherent risk Level		Fraud Risk?	Control risks & testing	Substantive Procedures	Estimation involved?
			(₹)	Complete- ness	Existence/ Occurrence	Accuracy/ Valuation	Cut off	Rights & Obligat ions	Factors /Note 1				
ROMM 1	Sale of products	xxx	-	Y	-	-	Y	Note 1.1	M	No	Refer Section 1a  Manual Control	Yes  (Refer Section 2)	No
	Provision for sales return	xxx	-	-	-	-	-						
	Estimate on revenue chargeback	xxx	-	-	-	-	-						
ROMM 2	Sale of products	xxx	-	-	Y	-	Y	Note 1.2	S	Yes  Note 2.1	Refer Section 1b  Auto- mated Control	Yes  (Refer Section 2)	Yes  (Refer Section 3)
	Provision for sales return	xxx	-	-	-	-	-						
	Estimate on revenue chargeback	xxx	-	-	-	-	-						
ROMM 3	Sale of products	xxx	-	-	Y	Y	-	Note 1.3	M	No	Yes	Yes (Refer Section 2)	No
ROMM 4	Sale of products Dossier revenue (in cases where it does not qualify as a separate performance obligation)	xxx	Y	Y	-	Y	-	Note 1.4	S	Yes  Note 2.2	Yes	Yes	No
Other ROMM, if any	Other accounts	xxx						Other factors specific to engagement					

**Note 1 - Factors considered assessing level of Inherent Risk****Note 1.1 ROMM 1**

The company has large volume of transactions across various geographies. However, given the non-complex nature of contract arrangement, the inherent risk is evaluated as Medium.

**Note 1.2 ROMM 2**

The Company has agreements with its customers whereby the Company provides adjustments/ discounts/ rebates to the transaction price based on various criteria (including sale volumes, channel wise sales etc). This involves assumptions and estimations which has a possibility of management bias and risk of fraud. Accordingly, the risk has been determined as Significant.

**Note 1.3 ROMM 3**

Given the volume of activity and the size of account balance, there is susceptibility to error and hence the risk evaluated is Medium.

**Note 1.4 ROMM 4**

There are pressures on the management to meet revenue targets; the management performs cut-off adjustments at the period end to prevent incorrect revenue recognition, and historically there is an increase in sales near the period end, and this may provide opportunities for the management to manipulate the revenue recognition. Therefore, a risk of fraud has been identified with respect to this ROMM. Accordingly, significant risk is identified w.r.t early recognition of revenue

**Note 2 Factors considered in assessing Fraud Risk****Note 2.1 ROMM 1**

This involves assumptions and estimations which includes a possibility of management bias; hence a risk of fraud has been identified.

**Note 2.2 ROMM 4**

There is a significant pressure on the senior management of the company to meet its revenue targets and accordingly, Engagement Team (ET) has evaluated overstatement of revenue near the period end as a fraud risk.

**1a. Identified Manual Controls (other than controls relating to estimates)**

(Refer Separate Work Papers on Flow Charts and Walkthroughs for identification of these manual controls)

Sr.no.	What could go wrong (WCGW)? (Refer Note 2)	Control Description (Manual)	How is the control performed and documented (control attributes)?	Level of Precision of the control	Frequency of Control	Risk associated with control	Planned Sample size	Control reliance / Control risk
ROMM 1	The revenue is not recorded based on the quantity despatched	The warehouse manager physically counts the goods at the time of loading / despatch and agrees it with the invoice before approving the dispatch document	1. Physical counting by Warehouse manager and 2. Approval by warehouse manager	As this is a transaction level control, and there is consistency of performance of control, hence the level of precision would be higher	Recurring	Low	To be decided based on Statistical Sample Tables (Refer AICPA Sampling Guide 2019)	Yes - Control reliance planned / Low control risk

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Sr.no.	What could go wrong (WCGW)? (Refer Note 2)	Control Description (Manual)	How is the control performed and documented (control attributes)?	Level of Precision of the control	Frequency of Control	Risk associated with control	Planned Sample size	Control reliance / Control risk
ROMM 4	Since the accounting of revenue occurs at the time of raising of invoice (through the system) the revenue may be recognised before the delivery of the goods to the customer (in the incorrect period).	Sales cut off working (containing the actual delivery date) is prepared by marketing team and reviewed by AGM Finance. Based on this sales cut-off working period end adjustment entries are passed based by the finance manager and approved by AGM Finance.	1. AGM Finance reviews the cut off working by agreeing it to the delivery details received from logistics provider 2. AGM Finance agrees the cut-off working with the period end entry and approves the same	Since the control operates at a transaction level; the precision is evaluated to be high	Monthly	High	3	Yes - Control reliance planned / Low control risk

**1b. Identified Automated Controls (other than controls relating to estimates)**

(Refer separate work papers of IS Audit Team for evaluation and assessment of Information Technology General Controls (ITGCs) and Application Controls)

S. No.	What could go wrong (WCGW)?	Control Description (Automated)	Relevant IT layers (Application /Database /Network and operating system)	Automated control category (Access control / Configuration control / Interface control / Other)	How is the control performed and documented (control attributes)?	Level of Precision of the control	Risk associated with control	Control reliance / Control risk
ROMM 1	Unauthorised creation / amendments could be made to sales orders	Access right to create and update sales order is restricted to authorised personnel.	Application layer (SAP)	Access control	Access right restriction	Automated control, High precision	Low	Yes - Control reliance planned / Low control risk
	Incomplete, inaccurate and unauthorised Customer Master creation & updation	Access for customer master creation & updation is restricted to authorised personnel.	Application layer (SAP)		Access right restriction	Automated control, High precision	Low	Yes - Control reliance planned / Low control risk
	Invoice could be raised without a sales order	The system is configured to permit invoice creation only against a valid sales order.	Application layer (SAP)		Configuration	Automated control, High precision	Low	Yes - Control reliance planned / Low control risk
	Accounting entries for invoices may not be passed appropriately	The system is configured to pass automated entries in the designated GL codes for recognition of revenue	Application layer (SAP)		Configuration	Automated control, High precision	Low	Yes - Control reliance planned / Low control risk

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S. No.	What could go wrong (WCGW)?	Control Description (Automated)	Relevant IT layers (Application /Database /Network and operating system)	Automated control category (Access control / Configuration control / Interface control / Other)	How is the control performed and documented (control attributes)?	Level of Precision of the control	Risk associated with control	Control reliance / Control risk
ROMM 2 and ROMM 3	Unauthorised or unapproved updation to price master, Inaccurate recording of sale proceeds.	Access for price master creation & updation is restricted to authorised personnel	Application layer (SAP)	Access control	Access right restriction	Automated control, High precision	Low	Yes - Control reliance planned / Low control risk
	The invoice price in the invoice may be incorrectly modified / edited	Invoice details relating to item code and price are automatically copied from the price master and cannot be edited by the user	Application layer (SAP)		Configuration	Automated control, High precision	Low	Yes - Control reliance planned / Low control risk

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2. Substantive Procedures (Summary of the approach for substantive procedures performed including nature, timing and extent)

S. No.	Substantive procedure reference no.	Description of the procedure performed	Test of details or substantive analytical procedure	Nature of procedure (Inquiry / Observation / Inspection/ Reperformance)	Timing of the procedure (Interim / Final)	Extent of planned procedure & Sampling approach	If Interim, what are the roll forward procedures ?	Expert/ Specialist involved? (If any, Refer Section 4 & 5)	If any Report is used in substantive test, describe how completeness & accuracy of information tested
ROMM 1 and ROMM 3	SP1	Obtain transaction level confirmation for revenue relating to the top two parties [comprising of 30% of population]	Test of details	Inspection (confirmation)	Final	Specific item testing	NA	NA	The sales reports have been reconciled with GL for completeness. Samples are selected from Sales register and agreed to underlying documentation for accuracy
	SP2	For balance population, test the invoices by agreeing the underlying documents such as shipping note/ delivery note, customer acknowledgement, customer PO/ contract	Test of details	Inspection	Final	Statistical sampling approach	NA	NA	Refer above

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S. No.	Substantive procedure reference no.	Description of the procedure performed	Test of details or substantive analytical procedure	Nature of procedure (Inquiry / Observation / Inspection/ Reperformance)	Timing of the procedure (Interim / Final)	Extent of planned procedure & Sampling approach	If Interim, what are the roll forward procedures ?	Expert/ Specialist involved? (If any, Refer Section 4 & 5)	If any Report is used in substantive test, describe how completeness & accuracy of information tested
ROMM 4	SP 3	For invoices raised close to the period end, examine underlying documentation such as shipping note/ delivery note, customer acknowledgement, customer contract to determine whether the invoices were recognised in the right period	Test of details	Inspection	Final	Statistical sampling	NA	NA	Refer above
	SP 4	For sales returns recorded post year-end date, evaluate whether it impacts revenue recognised during the year	Test of details	Inspection	Final	Statistical sampling	NA	NA	Agree the sales register to the trial balance as of April 202X

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S. No.	Substantive procedure reference no.	Description of the procedure performed	Test of details or substantive analytical procedure	Nature of procedure (Inquiry / Observation / Inspection/ Reperformance)	Timing of the procedure (Interim / Final)	Extent of planned procedure & Sampling approach	If Interim, what are the roll forward procedures ?	Expert/ Specialist involved? (If any, Refer Section 4 & 5)	If any Report is used in substantive test, describe how completeness & accuracy of information tested
	SP 5	For invoices raised subsequent to the period end, examine underlying documentation such as shipping note/ delivery note, customer acknowledgement, customer contract to determine whether dispatch had actually occurred after the period end, and there were no invoices pending to be recorded in the current year under audit	Test of details	Inspection	Final	Statistical sampling	NA	NA	Refer above

3. Estimates (Summary of the approach for procedures performed in response to estimate identified)

ID	Estimate Description	Underlying Linked Accounts	Estimate elements	Describe the approach to test the Estimate	How is the control performed and documented (control attributes)?	Level of Precision of the control	Frequency of Control
1	Value of rights to return / Sales return provision - the dealers have the right to return the goods (pharma products) sold by the Company in case the inventory expires. This provision for sales returns is estimated on the basis of historical experience, market conditions and specific contractual terms.	Provision for sales return	<p>Provision for sales returns are estimated on the basis of historical experience, market conditions and specific contractual terms. The following elements make up the estimate -</p> <p>Data - Revenue amount, and actual sales return for prior years.</p> <p>Assumption - Sales return percentage (assumption is based on market conditions, historical trends etc,</p> <p>Method - Sales return percentage is applied to the actual sales for the year to determine the amount of sales return provision</p>	<p><b>Control testing</b> To test the control framework - "Review of sales return provision working on a periodic frequency (e.g., monthly basis) approved by VP-Finance</p> <p><b>Substantive testing</b> 1. Perform retrospective analysis with respect to provision for sales return recognised in the previous years 2. Evaluate the method, assumption &amp; data used in the estimation process - i.e., for assumption consider the past returns history, agree the amount of actual returns, actual revenue to the company's ledgers.</p>	Approval by VP-Finance	As there is consistency of performance of control, hence the level of precision would be higher	Quarterly

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RISK & RESPONSE MEMORANDUM: ROMM ASSESSMENT AT ASSERTION LEVEL FOR REVENUE - A SAMPLE DOCUMENT

ID	Estimate Description	Underlying Linked Accounts	Estimate elements	Describe the approach to test the Estimate	How is the control performed and documented (control attributes)?	Level of Precision of the control	Frequency of Control
2	Provision for chargeback	Estimate on revenue chargeback (including discounts, rebates, etc)	<p>a) Method - The Company creates provision for chargebacks based on the inventory lying with the distributors multiplied with the expected Weighted average charge back (WAC) rate.</p> <p>b) Data - Closing inventory with customers</p> <p>c) Assumption - Weighted average charge back rate</p>	<p><b>Control testing</b> To test the control framework - "Review of revenue charge back working on a periodic frequency (e.g., monthly basis) approved by VP-Finance</p> <p><b>Substantive testing</b> 1. Perform retrospective analysis with respect to provision for sales return recognised in the previous years. 2. Data &amp; assumption - from the detailed listing of revenue charge back provision as of the YE date, for a selected sample agree the closing inventory with the report received from the respective customer and evaluate the WAC rate by considering the historical trends, inventory pattern, etc.</p>	Approval by VP-Finance	As there is consistency of performance of control, hence the level of precision would be higher.	Quarterly

**4. Management's Expert (The management Experts involved for getting assistance by management)**

ID	Name of Management Experts	Area involved/ Process affected	Has the auditor also documented procedures performed to assess the competency, capability and objectivity of specialists/ experts engaged by the management.	Type of Specialist	Procedures performed by Management Expert	Procedures performed by Auditor
	Not applicable. Although accounting for revenue from sale of products of Dhanvantri Limited involves some estimations due to sales incentives, volume discounts and Sales Returns etc., Management Experts are not required/engaged in these estimation processes as these processes are not complex.					

**5. Auditors Expert / Specialists (Other than IT Team)**

The auditor involved the following Specialists/ Experts to provide assistance for the purpose of audit as agreed in the planning meeting with the auditor:

ID	Name of Management Experts	Area involved/ Process affected	Has the auditor also documented procedures performed to assess the competency, capability and objectivity of specialists/ experts engaged by the management.	Type of Specialist	Procedures performed by Auditor's Expert
	Not applicable. Although accounting for revenue from sale of products of Dhanvantri Limited involves some estimations due to sales incentives, volume discounts and Sales Returns etc., Audit Experts are not required/engaged in these estimation processes as these processes are not complex.				

**IV. Audit Firm’s Staff Guidance on ROMM**

**1. Risk Assessment Matrix**

Our firm uses 3 x 3 Risk Assessment Matrix and performs ROMM at assertion level separately for Inherent Risk and Control Risk as depicted below.

Likelihood (Probability) ↑		Severity (Magnitude) →		
		Low	Medium	High
	High	Medium	High	High
	Medium	Low	Medium	High
	Low	Low	Low	Medium

Further, a combined ROMM is arrived using the following approach, subject to engagement team’s professional judgment, which would form the basis, along with assurance provided by analytical procedures, in deciding the nature and extent (Sample Size) of Test of Details (a type of substantive test).

Inherent Risk	Control Risk	Risk of Material Misstatement
High	High	High
High	Medium	High
High	Low	Medium
Medium	High	High
Medium	Medium	Medium
Medium	Low	Low
Low	High	Medium
Low	Medium	Low
Low	Low	Low

Note: The above exercise is not a mathematical exercise but needs the application of professional judgment and professional skepticism by the Engagement Team.

Additionally, the audit firm evaluates the classification of ROMM in Revenue as ‘Significant Risk’ or ‘Fraud Risk’ based on the criteria given in SA 315 or SA 240. Refer specific paragraphs below on these two critical audit areas.

Our firm’s methodology generally requires following confidence levels (quantitative terms) against each of the above risk bucket levels and those confidence levels will be used in determining nature & extent of testing (sample size determination using statistical audit sampling tables)

Risk Bucket Level	Significant	High	Medium	Low
Confidence Level	90-95%	80-90%	70%	30-50%

## 2. Evaluation of entity’s Internal Control System including Information Technology (IT) System

Entity’ internal control systems are significant components in achieving the management assertions regarding transactions and account balances that form part of the financial statements. Evaluation of internal control systems including IT platforms is an important part of our firm’s audit process. This aspect assumes added criticality in the audit assignments where we are required to express opinion on the design and operating effectiveness of company’s internal financial controls with reference to financial statements u/s 143(3)(i) of CA 2013.

Our firm’s audit methodology in this area is guided by prescriptions in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting<sup>3</sup>.

A few important aspects to note are given below.

As per para 14.5 Guidance Note on Audit of Internal Financial Controls Over Financial Reporting "The auditor's overall assessment of control risk for a particular assertion involves combining judgements about the prescribed controls, the deviations from prescribed controls, and the degree of assurance provided by the sample and other tests of controls". Further, if the controls are expected to be operating effectively, then control risk is considered to be Low.

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<sup>3</sup> Issued by the Institute of Chartered Accountants of India for the purpose of issuing audit report of adequacy and operating effectiveness of company’s internal financial controls with reference to financial statements u/s 143(3)(i) of CA 2013

**Risks associated with control**

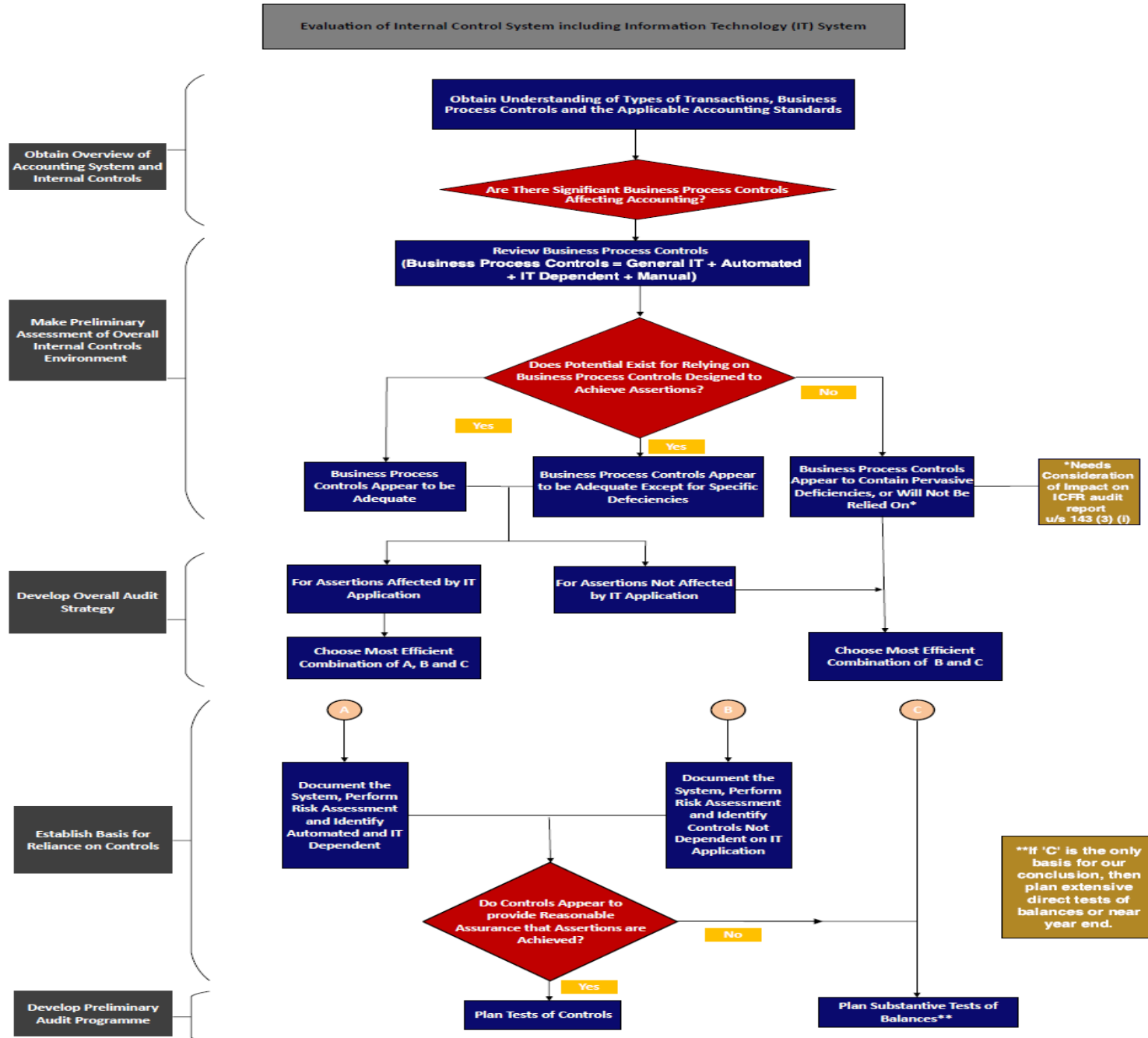
As per Para 113 to Guidance Note on Audit of Internal Financial Controls Over Financial Reporting - Factors that affect the risk associated with a control include:

- ❖ The nature and materiality of misstatements that the control is intended to prevent or detect;
- ❖ The inherent risk associated with the related account(s) and assertion(s);
- ❖ Whether there have been changes in the volume or nature of transactions that might adversely affect control design or operating effectiveness;
- ❖ Whether the account has a history of errors;
- ❖ The effectiveness of entity-level controls, especially controls that monitor other controls;
- ❖ The nature of the control and the frequency with which it operates;
- ❖ The competence of the personnel who perform the control or monitor its performance and whether there have been changes in key personnel who perform the control or monitor its performance; (Refer IG 6)
- ❖ The degree to which the control relies on the effectiveness of other controls (e.g., the control environment or information technology general controls); (Refer IG 7 and IG 8)
- ❖ Whether the control relies on performance by an individual or is automated (i.e., an automated control would generally be expected to be lower risk if relevant information technology general controls are effective)

**Level of Precision or Control Risk**

As per para 19.10 Guidance Note on Audit of Internal Financial Controls Over Financial Reporting gives factors that auditors might consider when judging level of precision of control like consistency of performance, predictability of expectations, level of aggregation, purpose of control etc.

Overview of our firm's overall approach for evaluation of internal control systems is given below.



**3. Fraud risk assessment**

Our firm uses an approach that is based on concept of ‘Fraud Triangle’ depicted below.



Pressures/Incentives	Opportunities	Rationalisation
<ul style="list-style-type: none"> <li>• High degree of market competition or market saturation</li> <li>• Vulnerability to rapid changes</li> <li>• Significant decline in customer demand and increasing business failures</li> <li>• Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.</li> <li>• Recurring negative cash flows from operations or inability to generate cash flows</li> <li>• New accounting, statutory, or regulatory requirements.</li> </ul>	<ul style="list-style-type: none"> <li>• A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms</li> <li>• Significant related-party transactions not in the ordinary course of business</li> <li>• Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.</li> <li>• Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult “substance over form” questions.</li> <li>• Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions</li> </ul>	<ul style="list-style-type: none"> <li>• Known history of violations of securities laws or other laws and regulations</li> <li>• Excessive interest by Management in dictating the entity’s inventory, price or earnings trend.</li> <li>• Management failing to remedy known significant deficiencies in internal control on a timely basis</li> <li>• An interest by management in employing inappropriate means to manipulate reported earnings</li> <li>• The owner-manager makes no distinction between personal and business transactions.</li> <li>• Frictional relationship between management and the current / predecessor auditor</li> </ul>

**4. Audit Sampling approaches**

Our firm generally uses the statistical sampling tables for selection of sample sizes prescribed in the globally used technical material issued by the AICPA . The reason being it is more aligned with the risk-based audit approach required under SAs and Audit Quality Control Standards and also it gives sample sizes for substantive tests and not just test of controls. In some cases of less complex audits, our firm uses the sample sizes given in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting referred earlier.