

NATURE OBJECTIVE AND SCOPE OF AUDIT

Meaning and Nature of Audit

- An audit is an Independent Examination of Financial information of Any Entity
- Whether Profit Oriented or not Irrespective of its size or legal form
- When Such Examination is Conducted with view to express an Opinion Thereon

Purpose of Audit

- The Purpose of External Audit engagement is to enhance the degree of confidence of Indented user of FS
- This engagement is also known as Reasonable Assurance Engagement
- It is done by independent Auditor to express an opinion on whether the FS present T&F view of Entity's affairs.

Auditor's Task that FS would not mislead anybody & it should satisfy himself that

- A/c's have been drawn up with reference to the Entries In BOA
- Entries in BOA are adequately supported by SAAE
- None of the entries in the BOA has been Omitted in the process of Compilation
- Nothing which is not in BOA has found place in the FS
- Information Conveyed by the FS is clear and Unambiguous
- FS amounts are properly Classified, Described and Disclosed in conformity with AS
- Statement of A/c present T&F picture of the Operational Results of Assets and Liabilities

Overall Objectives of the Auditor as per SA 200

- To obtain **Reasonable Assurance** About Whether the FS as whole are free from MMs; and
- To **Report** On the FS and Communicate as required by the SA's In accordance with the Auditor's Findings

Summary

- Obtaining **Reasonable Assurance** about Whether the FS as whole are free from MMs due to fraud or Error.
- Gaining a Reasonable Assurance leads to formation of Opinion Whether FS are **Prepared in all Material Aspects** in accordance with AFRFW
- To **Report** on the FS & **Reporting of Opinion** as per the Auditor's Findings
- **Communication** of Reporting
- Reporting and Communication in accordance with SA

SCOPE OF AUDIT: WHAT IT INCLUDES

- Coverage to all aspects of entity relevant to the FS being audited
- Reliability and Sufficiency of Financial Info.
- Proper disclosure of Financial Info.
- Expression of Opinion on Financial Info

SCOPE OF AUDIT: WHAT WON'T INCLUDES

- Responsibility of Preparation and Presentation of FS
- Duties outside scope of Competence of Auditor
- Expertise in authentication of Documents
- Investigation

Inherent Limitations of Audit

The Auditor is not expected to, and Cannot, Reduce Audit Risk to Zero & therefore can't obtain absolute assurance that the FS free from MMs Due to fraud or Error

Most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

1. The Nature of Financial Reporting
2. The Nature of Audit procedures
3. Audit is not investigation
4. Timeliness of financial reporting and decrease in relevance of information over time
5. Future Events

The Nature of Audit procedures

- Preparation of FS involves making **many judgments by Mgmt.**
- These judgments may involve **subjective decisions or a degree of uncertainty**. Therefore, auditor may not be able to obtain absolute assurance

The Nature of Financial Reporting

- There are **practical and legal limitations on ability of auditor to obtain audit evidence**. For example, an auditor does not test all transactions and balances.
- Management **may not provide complete information as requested by auditor**. There is no way by which auditor can force management to provide complete information as may be requested by auditor
- The **management may consist of dishonest and unscrupulous people** and may be, itself, involved in fraud. It may be engaged in concealing **fraud by designing sophisticated and carefully organized schemes** which may be hard to detect by the auditor.
- An **auditor is not an expert in authentication of documents**. Therefore, he may be led to accept invalid audit evidence on the basis of unauthentic documents

Audit is not investigation - Audit is not an official investigation. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors

Timeliness of Financial Reporting and the Balance between Benefit and Cost: The relevance of information decreases over time and auditor cannot verify each and every matter. Therefore, a balance has to be struck between reliability of information and cost of obtaining it

Future events: Future events or conditions may affect an entity adversely. **The business may cease to exist in future** due to change in market conditions, emergence of new business models or products or due to onset of some adverse events.

Advantages of Audit of Financial Statement

- It **protects the financial interests of people not involved in managing the entity**
- It **deters employees** from committing theft or fraud
- Audited FS are useful for **calculating taxes, securing loans**, and determining the value of a business in a sale
- They can also **resolve disputes** related to wages, bonuses, or property damage
- Audits find and suggest solutions for losses caused by **inadequate Internal Controls**.
- Audits check if records are maintained properly and help clients correct any deficiencies
- Audits review organizational controls, **highlighting weaknesses** or shortcomings
- Audited accounts simplify **settling financial matters** when a partner joins or leaves
- The **government may require audited statements** before granting assistance

Audit Mandatory or Voluntary

Audit required under law: The organisations which require audit under law are the following: e.g., companies governed by the Companies Act; banking companies

Voluntary category are the audits of the accounts of proprietary entities, partnership firms, Hindu undivided families, etc. In respect of such accounts, there is no basic legal requirement of audit.

Engagement: it means a formal agreement between auditor and client under which auditor agrees to provide auditing services. It takes the shape of engagement letter.

External audit engagements:

- External audit engagements aim to boost the confidence of financial statement users.
- These engagements provide reasonable assurance.
- In India, companies must have their annual accounts audited by an external auditor
- Non-corporate entities can also opt for external audits due to their associated benefits

To whom audit report is submitted by an auditor

- The report is given to the person who appoints the auditor.
- In companies, this is the shareholders, and in firms, it's the partners

Meaning of Assurance Engagement

- Assurance engagement involves a practitioner providing a conclusion.
- The conclusion aims to increase the confidence of users (other than responsible party) in the evaluation or measurement of a subject matter against criteria.
- The practitioner offers an opinion on specific information.
- This helps information on which users make confident decisions with reduced risk of inaccuracies

Elements of an Assurance Engagement

1. Three Party relationship
 - a. A practitioner is a person who provides the Assurance**
 - b. A responsible party is the party responsible for preparation of subject matter**
 - c. Intended users are the persons for whom an assurance report is prepared.**
2. An appropriate subject matter
3. Suitable Criteria
4. Sufficient appropriate evidence
5. Written assurance report in appropriate form

Audit vs. Review

- Audit is a reasonable assurance engagement.
- It offers reasonable assurance.
- Review is a limited assurance engagement.
- It provides less assurance compared to an audit.
- Reviews involve fewer procedures and gather sufficient evidence for limited conclusions.
- Both audit and review pertain to financial statements based on historical financial data

Reasonable Assurance vs. Limited Assurance

Reasonable assurance engagement

- It Provides High Level Assurance
- It performs elaborate and extensive procedures to obtain SAAE
- It draws reasonable conclusions on the basis of SAAE
- E.g. Audit Engagement

Limited assurance engagement

- It Provides lower Level Assurance than Reasonable Assurance Engagement
- It performs fewer procedures compared to Reasonable Assurance Engagement
- It involves obtaining SAAE to draw limited conclusions
- E.g. Review Engagement.

Prospective vs. Historical financial Information

Prospective financial information” means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It can be in the form of a forecast or projection or combination of both

Historical financial information” means information expressed in financial terms in relation to a particular entity, derived primarily from that entity’s accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past

Standards on Auditing:

- Standards on Auditing apply to independent audits of financial statements.
- They specifically pertain to historical information
- These standards set high-quality benchmarks for auditors.
- Auditors must follow these standards during financial statement audits.
- Standards cover various auditing topics, including objectives, documentation, planning, risk assessment, sampling, evidence, and reporting.
- They encompass all key aspects of financial statement audits

Standards on Review engagements:

- Standards on review engagements apply to the review of financial statements.
- A review is a limited assurance engagement and offers less assurance than an audit.
- Reviews involve fewer procedures than audits.
- Despite being a limited assurance engagement, reviews still require obtaining sufficient appropriate evidence.
- An example of a review is when an auditor reviews interim financial information for an entity.

Standards on Assurance Engagements:

- Apply to assurance engagements dealing with subjects other than historical financial information.
- These engagements do not involve auditing or reviewing historical financial data.
- An example is an assurance engagement for examining prospective financial information.
- These standards cover various assurance tasks, including those related to non-financial matters like the design and operation of internal controls in an entity.

Standards on Quality Control:

- Standards on Quality Control (SQC) are guidelines for firms to maintain quality control in their audit, review, and assurance engagements.
- SQC 1 is one of these standards and requires auditors/practitioners to establish a quality control system.
- The system ensures compliance with professional standards, legal requirements, and the issuance of appropriate reports.
- The main goal is to have a quality control system in firms to ensure compliance with professional standards and legal requirements when providing services covered by engagement standards.

Why are Standards required?

- Standards ensure carrying out of audit against established benchmarks at par with global practices.
- Standards improve quality of financial reporting thereby helping users to make diligent decisions.
- Standards promote uniformity as audit of financial statements is carried out following these Standards.
- Standards equip professional accountants with professional knowledge and skill. 5. Standards ensure audit quality

Duties in relation to Standards

- Professional accountants have a responsibility to follow accounting standards in their work.
- They must adhere to these standards in most cases, but there can be situations where following a standard isn't effective for a specific job.
- In such cases, accountants should document the alternative procedures they used and explain why they departed from the standard unless it's obvious
- Their report should also highlight any departures from the standards.
- Just disclosing a departure in the report doesn't excuse the accountant from following the standards.