

Chapter 1 - Nature, Objective and Scope of Audit

Meaning and Nature of Auditing

Meaning of Audit

An audit is an

- **Independent examination** of
- **financial information** of
- any **entity**,
 - whether profit oriented or not, and irrespective of its size or legal form,
- when such an examination is conducted with a view to expressing an **opinion** thereon

Analysis of the definition

- Audit is an independent examination of financial information.
 - Independence, here, implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.
- Audit applies to various entities, including non-profits (e.g., NGOs, trusts), regardless of size or legal form (e.g., sole proprietorships, partnerships, LLPs, private/public companies, societies, trusts).
- The purpose of the audit is to express an opinion on the FSs.
- Historical financial information - relates to information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods.
- Financial statements – A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework.

Objectives of Auditor

In conducting audit of FSs, objectives of auditor in accordance with **SA 200** "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing" are: -

- a) To obtain **reasonable assurance** about whether the **FSs** as a whole are **free** from **material misstatement**, whether due to **fraud** or **error**, thereby enabling the auditor to express an **opinion** on whether the FSs are **prepared**, in all **material** respects, in accordance with an **applicable financial reporting framework**; and
- b) To **report** on the FSs, and **communicate** as required by the SAs, in accordance with the auditor's findings.

Actual language used in audit report and industry

Whether the financial statements:

- Give a **true** and **fair** view (or present fairly in all material respects).
- Are prepared, in all material respects, in accordance with an applicable financial reporting framework.

True

Factually correct information which

- conforms with accounting standards and relevant legislation, and
- agrees with the underlying records.

Fair

Clear, impartial and unbiased information

- which reflects the commercial substance of the transactions of the entity.

For example - Security amount received from customers is your liability and not your income, if shown as income it is not clear, impartial and unbiased and therefore it is not fair.

Reasonable Assurance

A **high**, but **not absolute**, level of assurance.

Meaning of Assurance Engagement

What is Engagement?

Engagement means an arrangement to do something.

Assurance engagement

- An engagement in which a **practitioner** obtains sufficient appropriate **evidence** in order to express a **conclusion** designed to **enhance** the degree of **confidence** of the **intended users** other than the **responsible party** about the outcome of the evaluation or measurement of a **subject matter** against **criteria**.
- Giving assurance means offering an **opinion** about **specific information** so the **users** of that information are able to make **confident decisions** knowing that the **risk** of the information being **'incorrect'** is **reduced**.

Elements of an Assurance Engagement

Following elements comprise an assurance engagement: -

A three party relationship involving a practitioner, a responsible party, and intended users

- An assurance engagement involves above said three parties.
- A **practitioner** is a person who **provides assurance**.
- The term practitioner is broader than auditor.
- Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.
- A **responsible party** is the party **responsible** for **preparation** of **subject matter**.
- **Intended users** are the persons for **whom** an assurance **report** is **prepared**. These persons may use the report in making **decisions**.

An appropriate subject matter

- It refers to the information to be **examined** by the practitioner.
- In case of audit, financial information or we can say FS is the appropriate subject matter.
- Who is responsible for subject matter - Management / Those charged with governance is responsible for subject matter that is the financial information.

Suitable criteria

- These refer to **benchmarks** used to evaluate the subject matter like standards, guidance, laws, rules and regulations.
- In case of audit, accounting standards are the suitable criteria

Sufficient appropriate evidence

- The practitioner performs an assurance engagement to obtain sufficient appropriate evidence. It is on the basis of evidence that conclusions are arrived and an opinion is formed by auditor.
- "**Sufficient**" relates to **quantity** of evidence obtained by auditor.
- "**Appropriate**" relates to **quality** of evidence obtained by auditor.
- One evidence may be providing more comfort to auditor than the other evidence.
- The evidence providing more comfort is qualitative and, therefore, appropriate. Evidence should be both sufficient and appropriate.

A written assurance report in appropriate form

It is the **final outcome** of assurance engagement. It contains the **conclusion** that conveys the assurance about the subject matter.

Misstatement

A **difference** between

- the **a**mount, **c**lassification, **p**resentation, or **d**isclosure
 - of a **reported** FS item

- and the amount, classification, presentation, or disclosure
 - that is **required** for the item to be in accordance with the applicable financial reporting framework.

Misstatements can arise from error or fraud

- The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the FSs is **intentional** or **unintentional**.
- **'Fraud'** deals with **intentional** misrepresentation but, **'error'**, on the other hand, refers to **unintentional** mistakes in financial information.
- Few examples of misstatements could be: -
 - Charging of an item of capital expenditure to revenue or vice-versa
 - Difference in disclosure of a financial statement item vis-à-vis its requirement in applicable financial reporting framework
 - Selection or application of inappropriate accounting policies
 - Intentional booking of fake expenses in statement of profit and loss
 - Overstating of receivables in financial statements by not writing off irrecoverable debts
 - Overstating or understating inventories

When a misstatement will be considered as material

Misstatements, including omissions, are considered to be material

- if they, individually or in the aggregate,
- could reasonably be **expected** to **influence** the **economic decisions** of **users** taken on the basis of the FSs;

Meaning of Applicable financial reporting framework

Applicable financial reporting framework means a framework adopted in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

Types of Opinion

- **Clean** Opinion
- **Modified** Opinion
 - Qualified Opinion
 - Adverse
 - Disclaimer of Opinion

Nature of Matter Giving Rise to the Modification	Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but Not Pervasive	Material and Pervasive
Financial statements Are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Meaning of Pervasive

- The term pervasive is used to describe the **effect of misstatements** on the financial statement
- Whether the effect of material misstatement is pervasive or not it depends on **auditors judgement**.
- While deciding that the effect is pervasive or not auditor must keep the following things in mind
- Effect is pervasive when it is **not confined** to a specific element
- **Even** if it is **confined** to a specific element the effect can be considered as pervasive if it represent a **substantial proportion** of financial statements

- In relation to **disclosures**, The effect can be considered as pervasive if It is **fundamental** to **users** understanding of the financial statements.

Those charged with governance

The person(s) or organisation(s) with **responsibility** for

- overseeing the **strategic direction** of the entity and
- **obligations** related to the of the entity

Management

- The person(s) with **executive responsibility** for conduct of entity's operation

Pre- Conditions for an audit

In order to establish whether the preconditions for an audit are present, the auditor shall:

- Determine whether the financial reporting framework is **acceptable**; and
- Obtain the **agreement** of **management** that it **acknowledges** (मानती है) and **understands** (जानती है) its responsibility:
 - For the preparation of the **financial statements** in accordance with the applicable financial reporting framework;
 - For the **internal control** as management considers necessary; and
 - To provide the auditor with:
 - **Access** to all **information** such as records, documentation and other matters;
 - **Additional information** that the auditor may request from management for the purpose of the audit; and
 - **Unrestricted access** to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Internal Control

The Process **d**esigned, **i**mplemented and **m**aintained by

- Those charged with governance
- Management
- Other personnel

To Provide Reasonable Assurance with regard to

- Reliability of **financial reporting**
- Effectiveness & Efficiency of **operations**
- Safeguarding of **assets**
- Compliance with applicable **law & regulations**

Test Checking

- Application of Audit Procedures to less than 100% of the Transaction. It is also known as Sampling.
- Should be done in such a way that every item must have an equal chance of selection.

Judgement

The **application** of relevant

- **training, knowledge & experience**, (TKE)
- in making **informed decisions**
- about the courses of action that are appropriate in the circumstances of the audit engagement.

Professional judgement is **essential** to the proper conduct of an audit.

(Study this part while revising Chapter 1 For the first time after completion of syllabus)

Professional judgment is **necessary** in particular regarding **decisions** about:

- **Materiality** and **audit risk**.

- The **n**ature, **t**iming, and **e**xtent of audit **procedures** used to meet the requirements of the SAs and gather audit evidence.
- Evaluating whether **sufficient appropriate audit evidence** has been obtained, and whether more needs to be done to achieve the objectives of the SAs and thereby, the overall objectives of the auditor.
- The evaluation of **management's judgments** in applying the entity's applicable financial reporting framework.
- The drawing of **conclusions** based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

Other Points

- May differ from person to person
- Can also be formed after consultation

Framework to conduct audit

- Engagement / Appointment of the auditor
- Planning
- Materiality
- Risk assessment (Risk assessment procedures) ; and
- Response to the assessed risk (Further audit procedures)
 - ◆ Tests of controls, when required by the SAs or when the auditor has chosen to do so; and
 - ◆ Substantive procedures (Checking of Assertions), including
 - Tests of details and
 - Substantive analytical procedures.
- Audit Evidence
- Conclusions, Opinion and Reporting
- Audit Documentation.

Risk Assessment and Risk Assessment Procedures

- Risk assessment is done to **assess** the risk of material misstatement. (ROMM)
- Risk of material misstatement is defined as 'the risk that the **financial statements** are **materially misstated prior to audit**
- Risk assessment procedures are
 - used to
 - obtain an **understanding** of the entity and its environment,
 - including its **internal control**
 - in order to
 - assess the risk of material misstatement and
 - determine the nature, extent and timing of further audit procedures.
- After RAP, the Auditor can assess the level of ROMM.
- Once the ROMM is assessed, we can decide NET of FAPs
 - Nature - (Compliance or Substantive)
 - Extent - (Sample size, Less work or more work)
 - Timing - (Interim period and some transaction at the year end OR all year end in detail)
- Risk assessment procedures **alone do not provide audit evidence** sufficient to support audit opinion.
- They are required in all financial statement audits.

Further Audit Procedures

Compliance Procedure or Test of control

- Auditor will test internal control to assure that his initial understanding of IC was right or not.
- We will evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements

Substantive Procedure

- Auditor will check transactions, account balance presentation and disclosure
 - Analytical Procedures
 - Test of Details (Vouching and Verification)

Assertions

- Assertions refer to **representations by management**, explicit or otherwise, that are embodied in the financial statements.
- By stating that the financial statements are in compliance with the relevant financial reporting framework, management is making certain assertions about the proper recognition, measurement, presentation, and disclosure of the various components of the financial statements and any accompanying disclosures.
- Auditor will check those claims (assertions).
- The assertions used by the auditor to identify potential errors or inaccuracies in financial statements can be divided into three categories and may take the following forms.

Transactions	Account balance	Presentation and Disclosure
O ccurrence	E xistence	O ccurrence and rights and obligations
C ompleteness	R ights and obligations	C ompleteness
A ccuracy or Measurement	C ompleteness	C lassification and understandability
C ut-off	V aluation and allocation	A ccuracy and valuation
C lassification		

Assertions related to transactions**Occurrence**

Transactions that are recognized in the financial records as having occurred, i.e., did it really happen? and such transactions and events **pertain** to the **entity**.

Completeness

All transactions and events that should have been recorded have been **recorded**.

Accuracy

Amounts and other data relating to recorded transactions and events have been recorded **appropriately**.

Cut-off

Transactions and events have been recorded in the correct **accounting period**.

Classification

Transactions and events have been recorded in the **proper accounts**.

Assertions related to Account Balance**Existence**

Assets, liabilities, and equity interests **exist**.

Rights and obligation

the entity **holds** or **controls** the **rights** to assets, and **liabilities** are the **obligations** of the entity.

Completeness

All assets, liabilities and equity interests that should have been **recorded** have been recorded.

Valuation and allocation

Assets, liabilities, and equity interests are included in the financial statements at **appropriate amounts** and any resulting **valuation** or **allocation** adjustments are appropriately recorded.

Assertions related to Presentation and Disclosure**Occurrence and rights and obligations**

Disclosed events, transactions, and other matters have occurred and **pertain** to the **entity**.

Completeness

All disclosures that should have been included in the financial statements have been **included**.

Classification and understandability

Financial information is **appropriately presented** and **described**, and disclosures are clearly expressed.

Accuracy and valuation

Financial and other information are disclosed **fairly** and at **appropriate amounts**.

Example on Assertion

		₹
Plant & Machinery (at Cost)		4,00,000
Less: Depreciation till the end of previous year	1,40,000	
For the year	<u>26,000</u>	<u>1,66,000</u>
		2,34,000

The assertions are as follows:

- the firm owns the plant and machinery;
- the historical cost of plant and machinery is ₹ 4 lacs;
- the plant and machinery physically exists;
- the asset is being utilised in the business of the company productively;
- total charge of depreciation on this asset is ₹ 1,66,000 to date on which ₹ 26,000 relates to the year in respect of which the accounts are drawn up; and
- the amount of depreciation has been calculated on a recognised basis and the calculation is correct.
- The above assertions are **implicit**

Explicit assertions are made when otherwise the reader will be left with an incomplete picture; it may even be misleading.

- Secured Loans ₹ 4,00,000
- The description does not give us a complete picture. We do not know:
 - the name of the lender, if it is relevant;
 - the nature of security provided; and
 - the rate at which interest is payable.
- Negative assertions are also encountered in the financial statements and the same may be expressed or implied. For example, if it is stated that there is **no contingent liability** it would be an expressed **negative assertion**;

On the other hand, if in the balance sheet there is no item as “building”, it would be an **implied negative assertion** that the entity did not own any building on the balance sheet date.

Audit evidence

Information used by the auditor in arriving at the **conclusions** on which the auditor's **opinion** is based. Audit evidence includes both information contained in the **accounting records** underlying the financial statements and **other information**.

Information contained in the accounting records

Accounting records include

- the records of initial accounting entries and supporting records such records of fund transfer
- Invoices;
- Contracts
- the ledgers, journal entries and other adjustments to the financial statements.
- records such as worksheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

Other information

Other information that authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the financial statements:

Other information which the auditor may use as audit evidence includes, for example

- **minutes** of the meetings,
- written **confirmations** from trade receivables and trade payables,
- **manuals** containing details of internal control etc.

Audit Risk

The risk that the auditor expresses an **inappropriate opinion** when the **FSs** are **materially misstated**. Audit risk can be divided into two part

- Risk of material misstatement.
 - Inherent risk
 - Control risk
- Detection Risk

What is not included in Audit Risk ?

- Risk that the auditor might **express** an **opinion** that the **FSs are materially misstated when they are not**.
- Audit risk is a technical term related to the process of auditing; it does **not** refer to the **auditor's business risks** such as loss from litigation, adverse publicity, or other events arising in connection with the audit of FSs.

Inherent Limitations of Audit - SA 200

- Limitations of Audit: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the objectives of an audit, is to enable an auditor to express an opinion on such FSs.
- The auditor is **not expected** to, and **cannot, reduce audit risk to zero** and **cannot** therefore **obtain absolute assurance** that the FSs are free from material misstatement due to fraud or error.
- This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being **persuasive rather than conclusive**.
- The process of auditing, however, is such that it suffers from certain limitations, i.e. the limitation which cannot be overcome irrespective of the nature and extent of audit procedures. The limitations of an audit arise from

Nature of financial reporting

- Preparation of FSs involves making many **judgments** by management.
 - These judgments may involve **subjective** decisions or a degree of **uncertainty**.
 - Therefore, the auditor may not be able to obtain absolute assurance that FSs are free from material misstatements due to frauds or errors.
- One of the premises for conducting an audit is that management acknowledges its responsibility of preparation of FSs in accordance with the applicable financial reporting framework and for devising suitable internal controls. However, such controls may not have operated to produce reliable financial information due to their own limitations.

Nature of Audit procedures

- There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example,
 - Auditor does **not test all transactions** and **balances**. He forms his opinion only by testing **samples**. It is an example of practical limitation on auditor's ability to obtain audit evidence.
 - 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. In case he is not provided with required information, he can only report. It is an example of legal limitation on an auditor's ability to obtain audit evidence.
- 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. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine.
- 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.
- It is quite possible that the entity may have entered into some transactions with **related parties**. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.

Not in nature of investigation

- An 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 decrease in relevance of information over time

- The relevance of information decreases over time and the 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.
- **Adverse events** may seriously affect the entity's ability to continue its business.
- 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.

Because of the limitations of an audit, there is an unavoidable risk that some material misstatements of the FSs may not be detected, even though the audit is properly planned and performed in accordance with SAs.

However, the inherent limitations of an audit are **not a justification** for the auditor to be satisfied with less-than-persuasive audit evidence.

Who Appoints an Auditor?

Auditors are appointed by the entity's owners, members in AGMs for companies, or by government authorities as per law. In India, the CAG appoints auditors for government companies, while partners appoint auditors for firms.

Sometimes, auditors may also be appointed by government authorities under specific laws or regulations, such as tax laws.

To Whom Report is submitted by an Auditor?

The result of an audit is a written report with the auditor's opinion, submitted to the **appointing party**: shareholders for companies, and partners for firms.

Different Type of Assurance Engagements

1. Audit
2. Review
3. Other Assurance Engagements.

Meaning of Review; Audit Vs. Review

- A review engagement is an example of a limited assurance engagement. Entities not legally bound may opt for financial reviews. Reviews provide assurance, cost less, cause less disruption.
- Both "audit" and "review" are related to FSs prepared on the basis of historical financial information. The differences are as follows

Reasonable assurance	Limited assurance
Thorough Procedures - Test of Controls, Substantive Procedures - MORE DEPTH	Less detailed procedures - Enquiries, Analytical Procedure. - LESS DEPTH
High Level Assurance	Moderate or lower assurance
Subject matters confirm with Suitable criteria in all material aspects. (Reasonable Conclusions)	Subject matter is plausible in the circumstance. The language signifies that level of assurance is moderate or lower. (Limited Conclusions)
Positively worded opinion.	Negatively worded opinion.
More regulations / standards.	Less.
In our opinion, the FSs give a true and fair view of (or present fairly, in all material respects) the financial position of X Company as at 31st March, 20XX, and of its financial performance and its cash flows for the year then ended in accordance with Applicable Financial Reporting Framework	Nothing has come to our attention that causes us to believe that the FSs of Y Company as of 31st March, 20XX are not prepared, in all material respects, in accordance with an applicable financial reporting framework.
Example - Audit	Example - Review engagements

Other assurance engagements

Assurance can also be related to matters other than historical financial information. Such an assurance may relate to prospective financial information. It may relate to providing assurance on internal controls in an entity.

Assurance on Prospective 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.
- In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that
 - **management's assumptions** on which the prospective financial information is based are not unreasonable,

- the prospective financial information is **properly prepared** on the basis of the assumptions and
- it is **properly presented** and **all material** assumptions are **adequately disclosed**.
- Evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future- oriented. The auditor is, therefore, not in a position to express an opinion as to whether the results shown in the prospective financial information will be achieved.
- In such assurance engagements, practitioner provides a report assuring that nothing has come to practitioner's attention to suggest that these assumptions do not provide a reasonable basis for the projection.
- Hence, such type of assurance engagement provides only a "**moderate**" level of assurance.

Quality Control and Engagement Standards

Why are Standards needed?

- 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 FSs is carried out following these Standards.
- Standards equip professional accountants with professional **knowledge** and skill.
- Standards ensure audit **quality**.

Standards on Quality Control

- **SQC 1 - "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements"**
- Standards on Quality Control (SQC) have been issued to establish standards and provide guidance regarding a **firm's responsibilities** for its system of quality control for the conduct of audit and review of historical financial information and for other assurance and related service engagements.
- SQC 1 has been issued in this regard. It requires auditors/practitioners to establish system of quality control so that firm and its personnel **comply** with professional **standards** and **regulatory** & legal **requirements** and reports issued are appropriate.

Engagement Standards

The following Standards issued under authority of ICAI Council are collectively known as Engagement Standards: -

1. Standards on auditing (SAs) which apply in **audit** of **historical financial information**.
2. Standards on review engagements (SREs) which apply in **review** of **historical financial information**.
3. Standards on Assurance engagements (SAEs) which apply in assurance engagements **other than audits** and **review** of historical financial information.
4. Standards on Related Services (SRSs) which apply in agreed upon procedures to **information, compilation engagements** and other related service engagements.

The purpose of issue of these standards is to establish high quality standards and guidance in the areas of FS audits and in other types of assurance services.

Standards on Auditing

- Standards on Auditing apply in the context of an audit of FSs by an independent auditor. It is important to remember that Standards on Auditing apply in **audit** of **historical information**. They can also be termed as performance benchmarks for the auditors.
- The main purpose is to bring as much **uniformity** as possible in work performed by auditors.
- Standards on Auditing cover a broad range of topics including the auditor's objectives, documentation, audit planning, risk assessment, sampling, evidence, and the formation and reporting of opinions on financial statements (FSs), encompassing all key areas of FS audit.
- Some examples of Standards on Auditing are: -
 - SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing
 - SA 230 Audit Documentation

- SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
- SA 500 Audit Evidence
- Revised SA 700 Forming an Opinion and Reporting on Financial Statements

Numbering of Standards

Standard on Quality Control (SQC)	01-99
Standard on Auditing (SA)	100-999
Standard on Review Engagement (SRE)	2000-2699
Standard on Assurance Engagement (SAE)	3000-3699
Related Services (SRS)	4000-4699

Classification of SAs

Introductory matters	100-199
General Principles and Responsibilities	200-299
Risk Assessment and Response to Assessed Risk	300-499
Audit Evidence	500-599
Using work of Others	600-699
Audit conclusions and Reporting	700-799
Specialised Areas	800-899

List of Standards

General Principles and Responsibilities		
1	SA 200	Overall objectives of the Independent Auditor and the conduct of the Audit in Accordance with Standard on Auditing
2	SA 210	Agreeing the Terms of Audit Engagements
3	SA 220	Quality Control for an Audit of financial statements
4	SA 230	Audit Documentation
5	SA 240	The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.
6	SA 250	Consideration of Laws and Regulations in an Audit of Financial Statements
7	SA 260	Communication with those Charged with Governance
8	SA 265	Communicating Deficiencies in Internal control to those Charged with Governance and Management
9	SA 299	Joint Audit of financial statements
Risk Assessment and Responses to Assessed Risks		
10	SA 300	Planning an Audit of Financial Statements
11	SA 315	Identifying and Assessing the Risk of material Misstatements through understating the Entity and Its Environment
12	SA 320	Materiality in Planning and Performing an Audit
13	SA 330	Response to Assessed Risks
14	SA 402	Audit consideration Relating to an Entity using a Service Organisation
15	SA 450	Evaluation of Misstatements Identified during the Audit
Audit Evidence		

16	SA 500	Audit Evidence
17	SA 501	Audit Evidence-Specific Consideration for selected Items
18	SA 505	External Confirmations
19	SA 510	Initial Audit Engagement - Opening balances
20	SA 520	Analytical Procedures
21	SA 530	Audit Sampling
22	SA 540	Auditing Accounting Estimates, Including fair value Accounting Estimates and Related Disclosures
23	SA 550	Related Parties
24	SA 560	Subsequent Events
25	SA 570	Going Concern
26	SA 580 (Written Representation
Using Work of Others		
27	SA 600	Using the work of Other Auditors
28	SA 610	Using the Work of Internal Auditors
29	SA 620	Using the Work of an Auditor's Expert
Audit Conclusions and Reporting		
30	SA 700	Forming an Opinion and Reporting on Financial Statements
31	SA 701	Communicating key Audit Matters in the independent Auditor's Report
32	SA 705	Modifications to the opinion in the independent Auditor's Report
33	SA 706	Emphasis of Matter Paragraphs and other Matter Paragraphs in the Independent Auditor's Report
34	SA 710	Comparative Information -Corresponding Figures and Comparative Financial Statements
35	SA 720	The Auditor's responsibilities relating to Other Information
Standards on Quality Control		
36	SQC 1	"Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements"

Standards on Review Engagements

- Standards on review engagements apply in the context of **review of FSs**.
- Review is a **limited assurance engagement** and it provides assurance which is lower than that provided by audit. It is due to the fact that review involves fewer procedures as compared to audit.
- Since a review also provides assurance to users, it also involves obtaining sufficient appropriate evidence. For example, when an auditor performs review of interim financial information of an entity.
- Examples of Standards on Review engagements are:
 - **SRE 2400** (Revised) Engagements to Review Historical FSs
 - **SRE 2410** Review of Interim Financial Information Performed by the Independent Auditor of the Entity
- It is to be noted that both Standards on auditing and Standards on review engagements apply to engagements involving historical financial information.

Standards on Assurance Engagements

- Standards on Assurance Engagements apply to **non-historical financial information** and include various assurance services beyond audits or reviews of historical data, such as examining prospective financial information or assessing non-financial aspects like internal controls.
- Examples of Standards on Assurance Engagements are:
 - **SAE 3400** The Examination of Prospective Financial Information
 - **SAE 3420** Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

Standards on Related Services

- Standards on Related Services govern
 - engagements for agreed-upon **procedures** on **financial information** and
 - **compilation** engagements where **no assurance** is **provided**.
- They outline the practitioner's duties in such services, which can include **specific financial data** checks or **assisting** in the **preparation** of financial statements without expressing an opinion.
- For example, an engagement to perform agreed-upon procedures may require the auditor to perform certain procedures concerning individual items of financial data, say, accounts payable, accounts receivable, purchases from related parties and sales and profits of a segment of an entity, or a FS, say, a balance sheet or even a complete set of FSs.
- An engagement in which practitioner may be called upon to **assist management** with the **preparation** and **presentation** of historical **financial information** without obtaining assurance on that information.
- Examples of Standards on related services are:
 - **SRS 4400** Engagements to perform agreed-upon procedures regarding financial information
 - **SRS 4410** Compilation engagements

Duties in relation to Engagement and Quality Control Standards

- It is the duty of professional accountants to see that
 - Standards are followed in engagements undertaken by them. Ordinarily, these are to be followed by professional accountants.
- However, a situation may arise when a specific procedure as required in Standards would be ineffective in a particular engagement. In such a case, he is required to
 - **document** how alternative procedures performed achieve the purpose of required procedure
 - **reason** for **departure** has also to be documented unless it is clear.
 - his **report** should draw attention to such departures.
- Disclosure in a report does not exempt accountants from complying to relevant Standards.

Scope of Audit-What It Includes

Scope refers to the coverage of something.

Scope of Audit

The following points are included in scope of audit of FSs: -

Coverage of all aspects of entity

Audit of FSs should be organized adequately to cover **all aspects** of the entity relevant to the FSs being audited.

Reliability and sufficiency of financial information

- Auditors must ensure the **reliability** of accounting **records** and **source data** (e.g., bills, vouchers, documents) as a sufficient foundation for the FSs.
- Auditors **assess** the **reliability** and **sufficiency** of **financial information** through analysis of accounting systems, internal controls, and execution of relevant tests, inquiries, and procedures.

Proper disclosure of financial information

- The auditor must ensure FSs **adequately disclose** relevant information and **comply** with **statutory requirements**, verifying that they accurately summarize recorded transactions and considering management's judgments in their preparation.
- The auditor evaluates **management's judgments** in FS preparation, including the selection and consistent application of accounting policies, such as depreciation methods for fixed assets and inventory valuation, ensuring proper choice and period-to-period consistency.
- FSs are based on historical financial information, which includes financial data on past economic events and conditions from an entity's accounting system, like past purchases and sales transactions.

Scope of audit-What it does not include

- Auditors are not required to assess matters beyond their expertise, such as the physical condition of complex machinery or the suitability and lifespan of buildings, which are better evaluated by qualified engineers.
- Auditors are **not** document authentication **experts** and **cannot verify** the **genuineness** of documents.
- An audit is **not** a **formal inquiry** into misconduct and does not grant the auditor legal authority for searches or sworn witness statements necessary for official investigations.
- Audit differs from **investigation**; the latter is a **detailed examination** for a **specific purpose**, such as fraud detection. Audit has a broad scope, while investigation is focused and narrow.

Benefits of Audit-Why Audit is Needed

- Audited accounts provide **high quality information**. It gives **confidence** to **users** that information on which they are relying is qualitative and it is the outcome of an exercise carried out by following Auditing Standards recognized globally.
- In case of companies, shareholders may or may not be involved in daily affairs of the company. The FSs are prepared by management consisting of directors. As shareholders are owners of the company, they need an **independent mechanism** so that financial information is **qualitative** and **reliable**. Hence, their interest is **safeguarded** by an audit.
- An audit acts as a **moral check** on **employees** from committing frauds for the fear of being discovered by audit.
- Audited FSs are helpful to **government** authorities for determining tax liabilities.
- Audited FSs can be relied upon by **lenders**, bankers for making their credit decisions i.e. whether to lend or not to lend to a particular entity.
- An audit may also **detect fraud** or **error** or both.
- An audit **reviews** the **existence** and **operations** of various **controls** operating in any entity. Hence, it is useful at pointing out deficiencies.

Audit- Mandatory Or Voluntary?

- Audit may not be legally mandatory for all entities; however, companies and certain non-corporate entities are required by law to undergo audits, such as when turnovers exceed thresholds specified by tax laws, like in India under income tax law.
- Entities like schools may need audits to qualify for government grants or assistance.
- Audit isn't always compulsory; many organizations opt for voluntary audits due to the benefits and internal governance that favor the auditing process.

Qualities of Auditor

- **Tact, caution**, firmness, good temper, integrity, discretion, industrious, judgement, patience, clear headedness and reliability are some of qualities which an auditor should have. In short, all those personal qualities that go to make a good businessman contribute to the making of a good auditor.
- He must have the highest degree of **integrity** backed by adequate independence.
- The auditor, who holds a position of **trust**, must have the basic human qualities apart from the technical requirement of professional training and education.

- **Knowledge** of an **expert**. He is called upon constantly to critically review FSs and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert. An exhaustive knowledge of accounting in all its branches is the sine qua non of the practice of auditing. He must know **thoroughly all accounting principles** and **techniques**.

Person conducting an audit should take care to ensure that financial statements would not mislead anybody

In doing so, he has to see that FSs would not mislead anybody by ensuring that: -

- the **accounts** have been drawn up with **reference** to **entries** in the books of account;
- the **entries** in the books of account are adequately **supported** by **sufficient** and **appropriate evidence**;
- **none** of the **entries** in the books of account has been **omitted** in the process of compilation;
- the **information** conveyed by the statements is **clear** and **unambiguous**;
- the FS **amounts** are properly **classified, described** and **disclosed** in conformity with **accounting standards**;
- and
- the statement of accounts presents a **true** and **fair** picture of the operational results and of the assets and liabilities.

Auditing provides assurance. Its basic nature lies in providing assurance to users - providing confidence to users of FSs. Such an assurance lends credibility to FSs. Audited FSs provide confidence to users that financial information reflected in FSs can be relied upon.

Relationship of Auditing with other Subjects

- Auditing is interdisciplinary in nature, utilizing accountancy, law, behavioural science, statistics, economics, and financial management. For effective FS audits, an auditor needs a strong grasp of accounting principles, business, and tax laws.
- Auditors engage with various individuals for information and inquiries, requiring understanding of human behavior. They also employ statistical methods for sample selection, as auditing every transaction is impractical.
- Economics knowledge aids auditors in understanding the economic context of a business. Familiarity with financial management, including funds flow, working capital, and ratio analysis, is crucial for effective audit procedures and overall financial market understanding.

Auditing and Accounting

Auditing reviews the FSs which are nothing but a result of the overall accounting process.

Auditing and Law

An auditor should have a good knowledge of business laws affecting the entity.

Auditing and Economics

Auditor is expected to be familiar with the overall economic environment of the client

Auditing and Behavioural Science

Knowledge of human behaviour is essential for an auditor to effectively discharge his duties.

Auditing and Statistics & Mathematics

Auditor is also expected to have the knowledge of statistical sampling for meaningful conclusions and mathematics for verification of inventories.

Auditing and Data Processing

EDP auditing in itself is developing as a discipline in itself.

Auditing and Financial Management

Auditor is expected to have knowledge about various financial techniques such as working capital management, funds flow, ratio analysis, capital budgeting etc.

Auditing and Production

Good auditor is one who understands the client and his business functions such as production, cost system, marketing etc.

Origin of Auditing

The origin of auditing can be traced back to ancient times, with references found in Kautilya's Arthshastra (4th century BC) in India. The word "audit" comes from the Latin "audire" meaning "to hear," and the Industrial Revolution in Europe led to increased demand for auditors. In India, the Auditor General was appointed in 1860, and the Institute of Chartered Accountants of India (ICAI) was established in 1949 to regulate the profession.

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