

Ch-1 Nature, Objective & Scope of Audit

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- ✓ Auditor is required to **consider reliability of info.** to be used as audit evidence.
- ✓ In cases of **doubt or indications of possible fraud**, SAs require auditor to **investigate further** & determine **modifications or additions to audit procedures** necessary to resolve the matter.
- ✓ Auditor **can't disregard past experience** of honesty & integrity of entity's mgt & TCWG.
- ✓ Nevertheless, a belief that mgt and TCWG are honest & have integrity **doesn't relieve auditor of need to maintain professional skepticism.**

What's an Engagement?

An arrangement to do something.

Auditing → Formal agreement b/w auditor & client under which auditor agrees to provide auditing services. It takes the shape of **engagement letter (SA 210)**.

Assurance Engagement

Engagement in which

- practitioner expresses a **conclusion** *kyu?*
- to **enhance degree of confidence** *kyu?*
- of **intended users other than responsible party** *kiska*
- **about outcome of evaluation or measurement of** *aise*
- a **subject matter against criteria.**

Practitioner **gives opinion** about specific info. due to which users are able to make **confident decisions** that chance of info. being incorrect is diminished.

Elements of an Assurance Engg.

Parties: 3 party relationship involving a **practitioner, a responsible party, & intended users**

1. Practitioner is a person who provides assurance. Term practitioner is **broader than auditor**. Audit is related to **historical info.** whereas practitioner may provide assurance **not necessarily related to historical financial info.**
2. Responsible party is the party responsible for **preparation of subject matter.**
3. Intended users are **persons for whom assurance report is prepared.** These persons may use report in making decisions.

Subject matter

It refers to **info. to be examined by practitioner.**

For eg, **financial info. contained in FS while conducting audit of FS.**

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Suitable criteria

Refer to **benchmarks** to evaluate subject matter like standards, guidance, laws, rules & regulations.

Sufficient appropriate evidence [SAE]

- ✓ Practitioner performs an assurance engagement to obtain SAAE.
- ✓ On basis of evidence **conclusions** are arrived & **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 other evidence.
- ✓ Evidence should be both sufficient & appropriate.

Written assurance report in appropriate form

Written report is provided **containing conclusion** that conveys assurance about subject matter.

Written assurance report is outcome of an assurance engg.

Examples of assurance engagements

Example of assurance engg.	Type of assurance engg.
Audit of FS	Reasonable assurance engg.
Review of FS	Limited assurance engg.
Examination of PFI	Provides assurance regarding reasonability of assumptions forming basis of projections.
Report on controls <u>operating</u> at organisation.	Provides assurance regarding <u>design</u> and <u>operation</u> of controls

Engagement & Quality Control Standards

Following Standards are collectively known as Engagement Standards: -

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

Purpose of these standards is to **establish high quality standards & guidance** in areas of FS audits and other types of assurance services.

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Standards on Auditing (SA)

- SA apply in context of an **audit of FS by an independent auditor.**
- SA apply in **audit of historical info.**
- High quality benchmarks.
- Examples: - SA 200, SA 230, SA 315, SA 500, SA 700

Standards on Review Engagements (SRE)

- SRE apply in context of **review of FS.**
- Review is a **limited assurance engagement & provides assurance lower than audit.**
- Review involves **fewer procedures** as compared to audit.
- It also involves obtaining **sufficient appropriate evidence.**
- Examples:
 - ✓ SRE 2400 (Revised) Engagements to Review Historical Financial Statements
 - ✓ SRE 2410 Review of Interim Financial Info. Performed by Independent Auditor of Entity

Note: Both SA & SRE apply to engagements involving **historical financial info.**

Audit Vs. Review

- ✓ Audit is a **reasonable assurance engg.**
- ✓ Review is a **limited assurance engg.** It provides **lower level of assurance than audit** i.e. Moderate assurance.
- ✓ Further, review involves **fewer procedures & gathers sufficient appropriate evidence** on basis of which **limited conclusions** can be drawn up.
- ✓ However **both "audit" and "review" are related to FS prepared on basis of historical financial info.**

Reasonable assurance engg.	Limited assurance engg.
High level of assurance.	Lower level of assurance than RA engg.
Elaborate & extensive procedures to obtain SAAE.	Fewer procedures as compared to RA engg.
Draws reasonable conclusions on basis of SAAE.	Obtaining SAAE to draw limited conclusions.
Eg. of reasonable assurance engg is audit engg.	Eg of limited assurance engg is review engg.

Standards on Assurance Engg. (SAE)

- Apply in assurance engg. dealing with **subject matters other than historical financial info.**
- Such assurance engg don't include "audit" or "review" of historical financial info.
- Examples:
 - ✓ SAE 3400 The Examination of Prospective Financial Information



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- ✓ SAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

Prospective financial info. means financial info. based on assumptions about events that may occur in future and possible actions by entity. Can be in form of a forecast or projection or combination of both.

- Practitioner obtains SAAE to effect that
 - ✓ mgt's assumptions on which PFI is based are not unreasonable,
 - ✓ PFI is properly prepared on basis of assumptions &
 - ✓ it's properly presented and all material assumptions adequately disclosed.
- PFI relates to future events. While evidence may be available to support assumptions on which PFI is based, such evidence is itself generally future- oriented.
- Auditor is not in a position to express opinion as to whether results shown in PFI will be achieved. Therefore, practitioner provides a report assuring that nothing has come to practitioner's attention to suggest that these assumptions don't provide a reasonable basis for projection.
- Hence, such type of assurance engg. provides only a "moderate" level of assurance.

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Standards on Related Services (SRS)

- Agreed Upon Procedures: Auditor to perform certain procedures concerning individual items of financial data, say, a/c payable, a/c receivable, etc.
- Compilation Engg: Practitioner may be called upon to assist mgt with preparation & presentation of historical financial info. without obtaining assurance on that info. Such type of compilation engg fall in the category of related services & practitioner issues a report clearly stating that it is not an assurance engg & no opinion is being expressed.
- Examples:
 - ✓ SRS 4400 Engagements to perform agreed-upon procedures regarding financial info.
 - ✓ SRS 4410 (Revised) Compilation engg.

Standards on Quality Control (SQCs)

- Establish standards & provide guidance regarding a firm's responsibilities for its system of quality control for conduct of engg.
- SQC 1 has been issued in this regard.
- Requires auditors/practitioners
 - ✓ to establish system of quality control
 - ✓ so that firm & its personnel comply with professional standards & regulatory & legal requirements &
 - ✓ reports issued are appropriate.

Note: SQCs are to be applied for all engg.