

**Meaning of Audit (ICAI Module Pg. No.: 1.5) :**

Meaning of Audit	- It is an independent <sup>1</sup> examination of financial information <sup>2</sup>
	- of any entity, whether profit oriented or not, and irrespective of its size or legal form <sup>3</sup>
	- when such an examination is conducted with a view to expressing an opinion <sup>4</sup> thereon.

**Important Notes to above Meaning:**

1. 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.

2. Financial Information includes Financial Statement (FS) as well, Financial Information can be part of FS or more than FS.

FS includes –

- Balance Sheet/ Statement of Assets and Liabilities
- Profit and Loss Account/ Income and Expenditure Account
- Cash Flow Statement
- Statement of Changes in Equity (Only in case of Ind AS FS)
- Notes to Accounts

3. It can be profit oriented company or NGO, it can be sole proprietor or partnership firm or LLP or Company or any form of organisation.

4. Types of Opinion:

(i) Unmodified Opinion:

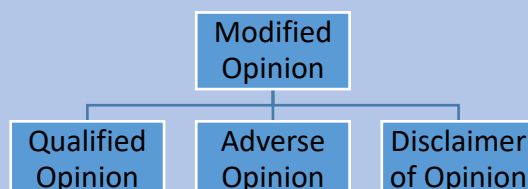
The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

(ii) Modified Opinion:

If the auditor:

- (a) concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement<sup>5</sup>; or
- (b) is unable to obtain sufficient appropriate<sup>6</sup> audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Sub-types of Modified Opinion:



5. Misstatement refers to a difference between the amount, classification, presentation, or disclosure of a reported financial statement 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.

6. Sufficient refers to Quantity of Audit Evidences while Appropriateness refers to Quality of Audit Evidences. 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.

**Objectives of Audit (ICAI Module Pg. No.: 1.8) :**

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

Objectives of Auditor	(a) To obtain reasonable assurance <sup>7</sup>
	- about whether the financial statements 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 financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework <sup>8</sup> ; and
	(b) To report on the financial statements, - and communicate as required by the SAs, in accordance with the auditor's findings <sup>9</sup> .

**Important Notes to above Objectives:**

7. Difference between Reasonable Assurance and Absolute Assurance

Reasonable Assurance	Absolute Assurance
It is a high-level of assurance but it is not complete assurance.	It is a complete assurance or a guarantee that financial statements are free from material misstatements.

8. 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.  
For Eg. – Schedule III of the Companies Act, 2013 which prescribes the format of FS for companies.
9. The auditor's opinion is communicated and reported in written report which is known as audit report.
10. Generally, auditor is appointed by the owners of the organization. In case of companies, the auditor is appointed by the shareholders in Annual General Meeting (AGM), however if it is Government Company then Comptroller and Auditor General (CAG) appoints the auditor. In case of firm/ LLP, partners appoint the auditor.
11. Audit report is submitted to the person, who appoints the auditor. So, in case of Companies, it is submitted to shareholders, in case of firm/ LLP, it is submitted to partners.

**Scope of Audit – What it includes (ICAI Module Pg. No.: 1.10) :**

Scope of Audit	❖ <u>What includes:</u> <ul style="list-style-type: none"> <li>To cover all aspects of the entity relevant to the financial statements being audited.</li> </ul>
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	<ul style="list-style-type: none"> <li>To reasonably satisfy about the information contained in underlying accounting records and other <i>source</i> data is reliable and sufficient basis for preparation of financial statements. For that auditor may study and assess accounting systems and internal controls and by carrying out appropriate tests, enquiries and procedures.</li> <li>To decide whether relevant information is properly disclosed in the financial statements considering statutory requirements. It is done by ensuring that financial statements properly summarize transactions and events recorded therein and by considering the judgments made by management in preparation of financial statements.</li> </ul>
	<p>❖ What it does not include (ICAI Module Pg. No.: 1.12) :</p> <ul style="list-style-type: none"> <li>Auditor is not expected to perform duties which fall outside domain of his competence.</li> <li>An auditor is not an expert in authentication of documents. The genuineness of documents cannot be authenticated by him because he is not an expert in this field.</li> </ul>

**Important Notes to above Scope:**

12. An audit is not an official investigation into alleged wrong doing. Auditor does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out an official investigation. (Theoretical Question 4, ICAI Module Pg. no. 1.39)

13. Difference between Audit and Investigation

Audit	Investigation
To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.	A critical examination of the accounts with a special purpose.
The scope of audit is general and broad.	The scope of investigation is specific and narrow.

**Inherent Limitations of Audit (ICAI Module Pg. No.:1.14) :**

There are some inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error. These fundamental limitations (Inherent Limitations of Audit) arise due to the following factors: -

Inherent Limitations	<p>(i) <u>Nature of Financial Reporting:</u></p> <ul style="list-style-type: none"> <li>FS involves many judgements by management which are subjective or have a degree of uncertainty which leads to misstatement<sup>5</sup> in FS.</li> <li>Also management design Internal Controls to avoid misstatements in FS, however their implementation has their own limitation which leads to misstatement<sup>5</sup> in FS.</li> </ul>
	<p>(ii) <u>Nature of Audit Procedures:</u> (Theoretical Question 5, ICAI Module Pg. No.. 1.39)</p>

	<p>There are practical and legal limitations on ability of auditor to obtain audit evidence. For example:</p> <ul style="list-style-type: none"> <li>• Auditor forms his opinion only by testing samples. (Practical Limitation)</li> <li>• Management may not provide complete information as requested by auditor. Even for that auditor cannot force to management, it can only be reported. (Legal Limitation)</li> <li>• Management or part of management may be involved in fraud, 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.</li> <li>• It is quite possible that entity may have entered into some transactions with related parties which involve some wrong doing.</li> </ul>
	<p>(iii) <u>Not in nature of investigation:</u></p> <p>As already discussed, 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.</p>
	<p>(iv) <u>Timeliness of financial reporting and decrease in relevance of information over time</u></p>
	<p>(v) <u>Future events:</u></p> <p>Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business. Hence, going concern assumption is tricky part in FS.</p>

**Assurance Engagement (ICAI Module Pg. No.:1.22) :**

Assurance Engagement	<p><u>Meaning:</u></p> <p>An engagement in which a practitioner<sup>(i)</sup> (i.e. Practicing CA) expresses a conclusion designed to enhance the degree of confidence of the intended users<sup>(i)</sup> (Eg. Shareholders in case of companies) other than the responsible party<sup>(i)</sup> (Eg. BOD/ Management in case of companies) about the outcome (i.e. Opinion) of the evaluation or measurement of a subject matter<sup>(iii)</sup> (Eg. FS) against criteria<sup>(iii)</sup> (Eg. Law, Standards etc.).</p> <p>- It means that the practitioner gives an opinion about specific information due to which users of information are able to make confident decisions knowing well that chance of information being incorrect is diminished.</p>
	<p><u>Elements of an Assurance Engagement (ICAI Module Pg. No.:1.23) :</u></p> <p>(i) <u>A three party relationship involving a practitioner, a responsible party, and intended users: (Theoretical Question 3, ICAI Module Pg. No.. 1.39)</u></p> <ul style="list-style-type: none"> <li>• A <b>practitioner</b> is a person who provides the assurance. The term practitioner is broader than auditor. (i.e. Practicing CA)</li> </ul>

	<ul style="list-style-type: none"> <li>• A <b>responsible party</b> is the party responsible for preparation of subject matter. Eg. BOD/ Management in case of companies.</li> <li>• <b>Intended users</b> are the persons for whom an assurance report is prepared. These persons may use the report in making decisions. Eg. Shareholders in case of companies.</li> </ul> <p>(ii) <u>An appropriate subject matter:</u> It refers to the information to be examined by the practitioner. For Eg. FS.</p> <p>(iii) <u>Suitable criteria:</u> These refer to benchmarks used to evaluate the subject matter like standards, guidance, laws, rules and regulations.</p> <p>(iv) <u>Sufficient Appropriate Evidence:</u> 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.</p> <p>(v) <u>A written assurance report in appropriate form:</u> A written report is provided containing conclusion that conveys the assurance about the subject matter.</p>
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CA in Practice = Auditor = Practitioner = Professional Accountants

**Types of Assurance Engagement along with Engagement Standards:** [\(Theoretical Question 2, ICAI Module Pg. No.. 1.39\)](#)

Types of Assurance Engagement	<p>(i) <u>Audit:</u></p> <ul style="list-style-type: none"> <li>• Reasonable Assurance Engagement of Historical Financial Information.</li> <li>• Standards on Auditing (SAs) are applicable.</li> <li>• Eg. Mandatory yearly audit to be conducted of all companies as per the Companies Act, 2013.</li> </ul>
	<p>(ii) <u>Review:</u></p> <ul style="list-style-type: none"> <li>• Limited Assurance Engagement of Historical Financial Information.</li> <li>• Standards on Review Engagements (SREs) are applicable.</li> <li>• Eg. Mandatory Quarterly Review of Listed Companies.</li> </ul>
	<p>(iii) <u>Assurance Engagements dealing with matters other than historical financial information:</u></p> <ul style="list-style-type: none"> <li>• Examination of prospective financial information (like forecast) or assurance regarding operations of controls</li> <li>• It provides Moderate Level of Assurance. <sup>16 &amp; 17</sup></li> <li>• Standards on Assurance Engagements (SAEs) are applicable.</li> </ul>

**Important Notes to above Types:**

14. Difference between Reasonable Assurance Engagements and Limited Assurance Engagements (ICAI Module Pg. No.:1.25) :

Reasonable assurance engagement	Limited assurance engagement
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Reasonable assurance engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement.
It draws reasonable conclusions on the basis of sufficient appropriate evidence.	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
Example of reasonable assurance engagement is an audit engagement.	Example of limited assurance engagement is review engagement.

**15. Difference between Historical Financial Information and Prospective Financial Information**

<b>Historical Financial Information</b>	<b>Prospective Financial Information</b>
Financial information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods.	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
It is rooted in past events which have already occurred.	It is related to future events.

**16. In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence (ICAI Module Pg. No.:1.26)**

- 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.

**17. While 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. Therefore, 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. (ICAI Module Pg. No.:1.26)**

**Standards on Related Services (SRS) (ICAI Module Pg. No.:1.30) :**

SRS	<ul style="list-style-type: none"> <li>• These standards apply in engagements to perform agreed-upon procedures regarding financial information.</li> </ul>
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	<ul style="list-style-type: none"> <li>Agreed-upon procedure which can be some kind of preparation or to perform certain procedures on financial information, however it is not an assurance engagement.</li> <li>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 financial statement, say, a balance sheet or even a complete set of financial statements.</li> <li>Such type of compilation engagements fall in the category of related services and practitioner issues a report clearly stating that it is not an assurance engagement and no opinion is being expressed.</li> </ul>
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**Engagement Standards and Quality Control Standards:**

Engagement Standards (ICAI Module Pg. No.:1.28)	<ul style="list-style-type: none"> <li>Standards on Auditing (SAs) – Audit of Historical Financial Information</li> <li>Standards on Review Engagements (SREs) – Review of Historical Financial Information</li> <li>Standards on Assurance Engagements (SAEs) - Assurance Engagements dealing with matters other than historical financial information</li> <li>Standards on related services (SRSs) - Agreed-upon procedures regarding financial information</li> </ul>
Quality Control Standards (ICAI Module Pg. No.:1.31)	<ul style="list-style-type: none"> <li>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.</li> <li>Only 1 standard - SQC1 is issued in this regard which is part of Ch. 11.</li> <li>It requires auditors/practitioners to establish system of quality control so that firm and its personnel comply with professional standards and regulatory &amp; legal requirements and reports issued are appropriate.</li> </ul>

**Important Points to above Standards:**

18. Engagement standards are specific to the engagement like Audit, Review etc. while Quality Control Standards are applicable to firm providing engagement services. Hence, SQC 1 is applied to all services covered by Engagement Standards.

19. Why are Standards needed? (ICAI Module Pg. No.:1.31)

- 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.
- Standards ensure audit quality.

20. Standards are compulsory to be followed, however, if there is any situation where it is not possible to follow any part/ procedure of the standard, then practitioner is required to document how alternative procedures performed to achieve the purpose of required procedure. Also, reason for departure has also to be documented unless it is clear. Further, his report should draw attention to such departures. It is also to be noted that a mere disclosure in the report does not absolve a professional accountant from complying with applicable Standards. (ICAI Module Pg. No.:1.32)

**Other Important Points for MCQs/ Correct Incorrect:**

21. Preparation and presentation of financial statements of an entity is responsibility of management of entity.
22. Users of financial statements may be shareholders, employees, customers, government and regulatory authorities, bankers etc.
23. Engagement means a formal agreement between auditor and client under which auditor agrees to provide auditing services. It takes the shape of engagement letter.
24. The purpose of external audit engagements (i.e. Statutory Audit) is to enhance the degree of confidence of intended users of financial statements. Such engagements are also reasonable assurance engagements.
25. Audit is mandatory for all companies in India under the Companies Act, 2013, Income Tax Act, 1961 mandates Tax Audit to assessee falls under specified criteria, LLP Act, 2008 mandates Audit under the act to LLP falls under specified criteria. These are examples of Mandatory Audit as it is specified by Statute.
26. Many entities may get their accounts audited voluntarily because of benefits from the process of audit like to get loan, subsidy, grants etc.

**Summarized Points of MCQs, Correct Incorrect, Test Your Understanding and Theoretical Questions:**

- (1) Audit provides high quality financial information, acts as a moral check on employees and helps in safeguarding interests of shareholders. These are the advantages of Audit. 'It enhances risk of management bias' – It is not an advantage of the Audit.
- (2) In an assurance engagement the practitioner obtains sufficient appropriate evidence, there is some information to be examined by practitioner and a written assurance report in appropriate form is issued by practitioner. It relates to providing assurance matters other than historical financial information.
- (3) Engagement standards ensure uniformity by practitioners in course of performance of their duties. It neither ensure proper rights to practitioners in course of performance of their duties nor ensure preparation and presentation of financial statements in a standardized manner nor ensure savings in resources of clients.
- (4) Limited assurance engagement does not involves obtaining sufficient appropriate evidence to draw reasonable conclusions, but to draw limited conclusion which is lower level of assurance than



reasonable assurance. And review of interim financial information of a company is an example of limited assurance engagement.

- (5)** Standards on auditing mainly with mandatory responsibilities of auditors.
- (6)** 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. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.
- (7)** As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
- (8)** As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements 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.
- (9)** Choosing of appropriate accounting policies is responsibility of management as preparation and presentation of FS is the responsibility of Management. The role of auditor lies in evaluating selection and consistent application of accounting policies by management.