

CH1

7-1 / CH1 / SA200 ✓

nature objective and scope of audit

origin of audit

- > Exist in ancient times also
- > found in Kautilya's arthashastra in 4th century BC.
- > concepts of periodical checking and verification existed even in those days.
- > "audit" originated from "audire" to hear
- > in ancient times auditors used to hear accounts read out, to know efficiency of employee's work
- > First auditor general was appointed in British government in 1860 having both accounting and auditing functions.
- > presently comptroller and auditor general is independent constitutional authority responsible for auditing government receipt and expenditure.

What is audit

-> Audit is independent examination of Financial Information

↓

Judgement of a person is not

subordinate to others views

-> Entity may be profit oriented or not, it is irrespective for the purpose of audit.

Even a non-profit organization should get its accounts audited

It's Irrespective of profit oriented, size, legal structure.

-> auditing is done to express opinion on the Financial Information.

Auditor in view to satisfy himself that the financial statements are not misleading, checks whether:

- > Accounts are drawn up with reference to entries in books of accounts
- > Entry should be supported by sufficient evidence.
 - Ex: sales entry need sale invoice
 - purchase entry need purchase invoice
- > Information in FS should be clear and unambiguous.
- > none of entries in books were omitted
- > FS are properly classified, described and disclosed in conformity with accounting standards.
- > FS shows true picture of operational results & Assets and liabilities.

SA 200 / overall objectives of independent auditor and conduct of an audit in accordance with standards of auditing "objectives of auditor:

- > To obtain reasonable assurance auditor can't give absolute assurance.
 - 100% assurance - Reasonable assurance
 - highly level assurance - not 100% assurance
- > Reasonable assurance that financial statements are free from material misstatements.
- > Audit is conducted by auditor with professional competence and skills in accordance with SA's.
- > Audit procedures are applied in accordance with SA's
- > To express an opinion on financial statements that they are prepared according to ~~financial statements~~ financial reporting framework

→ To Report on Financial statements
→ To communicate as required by the law

Applicable Financial reporting frame work

- Frame work adopted by entity in preparation of financial statements

Scope of audit - Range

→ Purpose of audit is to enhance degree of confidence of users in the financial statements

Users of Financial statements

- Share holders
- employees
- customers
- Govt
- Regulatory authorities
- Banks, etc.

→ Enhancing degree of confidence is achieved by the expression of an opinion of auditor.

1. coverage of all aspects of entity

Should cover all aspects, the effect of which is on financial statements.

2. Reliability and sufficiency of financial info.

auditor shall be reasonably satisfiably with financial information that the given info was reliable and sufficient for preparation of financial statements.

Check of Reliability and sufficiency of info:

→ IT accounting system of entity was proper
→ IT internal structure of entity was proper

→ auditor makes some tests and enquiries

3. proper disclosure of Financial info.

Auditor should make sure that auditor's proper disclosure of financial info as required by law was made

→ Auditor evaluates whether applied accounting policies are appropriate - conforming them consistently.

→ understand that financial statements are prepared on basis of historical financial information.

Aspects out of scope of audit:

→ Auditor is not expected to perform out of his competence.

example:

Physical condition of certain assets on civil structure

→ genuineness of document can't be authenticated by auditor as he is not expert in authentication

→ audit is not an official investigation of company's affairs. He doesn't have any legal powers of search or recording statements of witnesses on oath.

Audit is distinct from investigation.

<u>Investigation</u>	<u>Audit</u>
Investigation is critical examination of accounts for special purpose. Example: If fraud is suspected and it is specifically called upon to check accounts whether fraud really exists, it takes character of investigation. → scope of investigation is narrow and specific	Objective of audit is to obtain reasonable assurance about whether financial statements are free from material misstatement. <u>normal</u> → scope of audit is general and broad.

Inherent limitations of audit:

1. Nature of financial reporting.
Financial statements → In accordance with sec III
↓
Financial Reporting Frameworks
↓
Preparation
↓
Management
↓
Accounting estimates
↓
Provision of litigation
↓
Provision of tax
- It may be uncertain and subjective
So, auditor may not be able to obtain absolute assurance.

→ Auditor assumes management acknowledges their responsibility and internal controls are proper and financial statements are as per FAT. There can be possibility that internal controls are not working properly.
Nature of audit procedures.

→ Management may not provide complete information requested by auditor
→ And no way by which auditor can force management to provide required information.
→ Management may be dishonest and itself involved in fraud, engaged in concealing facts.
Fraud by designing sophisticated and carefully organized schemes
→ Management may produce fabricated documents before auditor to lead him to believe the audit evidence is valid.

→ Auditor is not expert in authentication of documents.
→ Company involved in related party transactions which are only paper transactions and may not have actually occurred.

3. Audit is not an investigation
Audit is not an investigation official.

4. Future events
Audit is done assuming going concern concept. Some future events may occur which can adversely affect going concern of entity, ability of entity to continue in near future.

5. Timeliness of financial reporting and decrease in relevance of info over time

→ Relevance of information decreases over time
→ And auditor can'tre through each and every method

Audit engagement

- In context of auditing, it's a formal agreement
- To decide terms and conditions before entering into agreement is important
- Formal agreement called engagement letter purpose of external audit is to enhance the degree of confidence of intended users of financial statements.

Benefits of audit:

- B → Banks, ~~companies~~, lenders rely on audited financial statements for making credit decisions
- I → Information, Audited accounts provides high quality information and confidence to Govt determining tax liability
- S → Safe guards the interest of share holders as any adverse occurrence of co.
- C → Auditor reviews the existence and operation of controls and points out deficiency
- A → nothing
- M → Auditors act as relational check on employees

It's audit mandatory

- Even non corporate entities compulsorily required to get their accounts ~~checked~~ audited under tax laws.
- In India every person is required to get accounts audited if turnover crossed certain threshold limit under Income tax law.
- Schools may be required to get audit. Past purpose of obtaining grant or assistance from govt.
- Audit is not always mandatory
- Many entities get voluntarily because of its benefits

Who appoints auditor?

- Govt co → By CAG
- Non Govt co → By members
- Firms → By partners

Non govt co.

First auditor appointed by Board of directors in 30 days → If not then by members
→ subsequent auditors → by members in AGM for 6 yrs holds fill

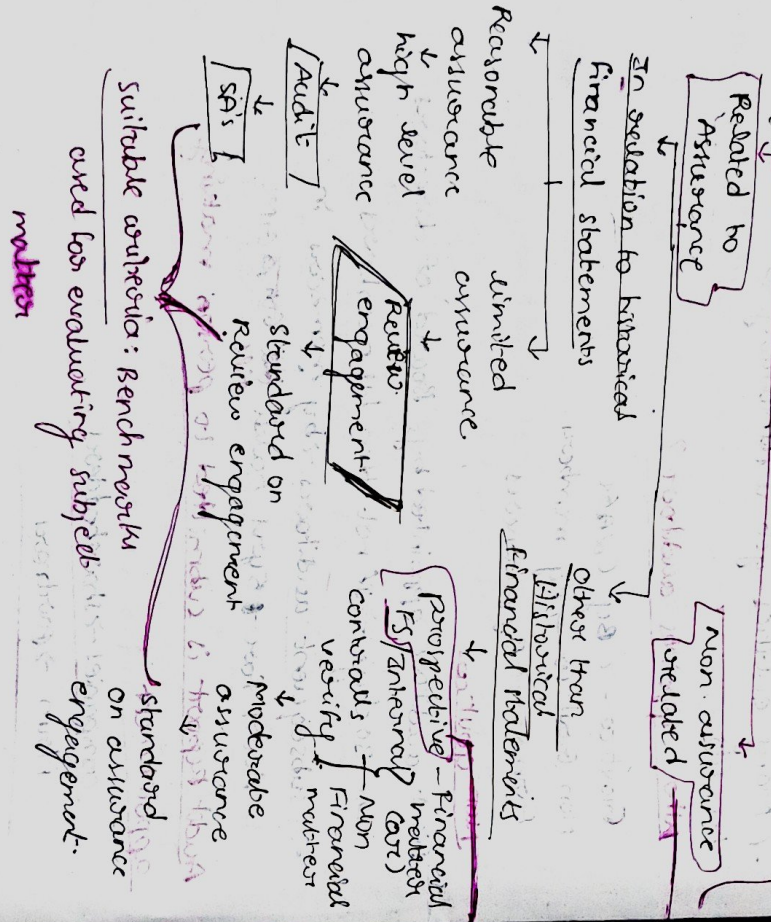
Audit Report is submitted to person making appointment

- companies → shareholders
- Firm → partners

Qualities of auditor

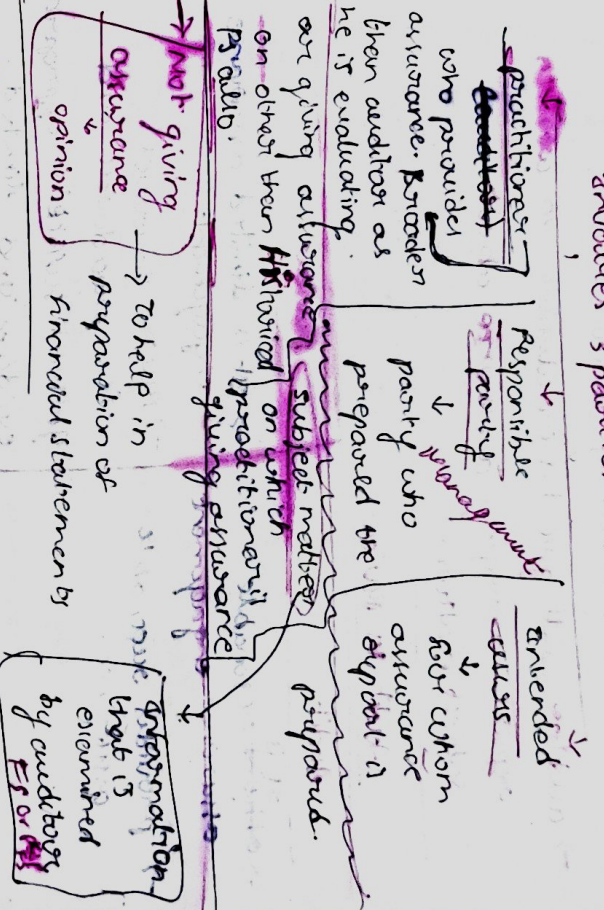
- > Should have thorough knowledge of accounting principles and techniques
- > He should have high degree of Integrity
- > ~~and~~ backed up with independence
- > Shall possess such qualities which a good business man posses
- > Auditor who holds ^{of others} must have basic human qualities. a part from professional education and training

Different type of engagement



Assurance engagement:

- > Engagement in which auditor gives his conclusion
- > which enhances the degree of confidence of intended users of FS
- > ~~involves 3 parties~~ Assurance engagement involves 3 parties



Example:

to go to bank for loan and presented the succeeding year Prudential financial statements prepared on basis of estimates. Bank can't rely upon Prudential financial statements and called for an audit. Here auditor gives a moderate assurance.

Sufficient appropriate evidence

A Sufficient related to quantity of evidence obtained by auditor

A Appropriate related to quality of evidence obtained by auditor

→ auditor will give his conclusions on overall report conveying assurance about financial subject matters.

Audit vs Review

Audit

→ ~~obtains~~ reasonable assurance engagement

→ provides sufficient assurance

Review

→ limited assurance engagement

→ Review involves few procedures and limited evidence and limited conclusions were drawn

Reasonable assurance is limited assurance

Reasonable assurance

→ provides high level of assurance

→ performs extensive, sufficient appropriate audit procedures

→ Example of Reasonable assurance is audit engagement.

Limited assurance

→ lower level assurance than reasonable assurance

→ limited procedures were performed

→ Example of limited assurance engagement is review engagement.

Historical financial statements

Information of an entity about events occurred, economic events in past

Prospective with financial statements

ES based on assumption about future events

→ Auditor gives assurance whether the assumptions are correct or not
→ He gives a moderate assurance

Non assurance engagement

standards on audited services

→ These standards apply in engagements to perform agreed upon procedures regarding financial information

Standards on quality controls

Established standards and provided guidance regarding firm responsibility for system of quality controls.

→ So that firm and its personnel comply with professional standards, legal requirements, and time or appropriate report

SQCI

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Why standards are important

- > It establishes benchmark at par with global practices
- > It improves quality of financial reporting
- > It promotes uniformity
- > It provides professional accountant with professional knowledge and skills.

International Accounting Standards

International Accounting Standards (IAS) are a set of accounting standards developed by the International Accounting Standards Board (IASB). These standards are designed to provide a common framework for the preparation and presentation of financial statements across different countries and jurisdictions.

Advantages of IAS

- 1. Global comparability: IAS provides a common framework for financial reporting, making it easier for investors and other stakeholders to compare financial statements across different countries and jurisdictions.
- 2. Improved quality: IAS is designed to provide a high level of transparency and reliability in financial reporting, which helps to reduce the risk of fraud and misstatement.
- 3. Cost reduction: IAS provides a common framework for financial reporting, which can help to reduce the cost of preparing financial statements for companies operating in multiple countries.
- 4. Increased transparency: IAS provides a common framework for financial reporting, which can help to increase the transparency of financial statements and make it easier for investors and other stakeholders to understand the financial performance of a company.