CHAPTER -1

NATURE, OBJECTIVE AND SCOPE OF AUDIT

Handwritten notes 📝

---Dolly Gorai--

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Chapter-1

Nature, Objective and Scope of Audit :-

ORIGIN of Auditing :-

- The word "audit" originates from latin word "audire" meaning "to hear".
- In medieval times, auditors used to hear the accounts read out to them to check that employees were not careless and negligent.
- Coming to more recent history, the first Auditor General of India was appointed in British India in 1860 having both accounting and auditing functions. later on, office of Auditor General was given statutory recognition.
- Presently, Comptroller and Auditor General of India is an Independent Constitutional authority responsible for auditing government receipts and expenditures.
- The Institute of Chartered Accountants of India was established as a statutory body under an act of parliament in 1949 for regulating the profession of chartered Accounting in the country.

Date
Page

Definition :-

Audit is an Independent Examination of financial Information of an Entity whether profit oriented or not irrespective of its size or legal form. when such an examination is Conducted with a view to express an opinion thereon

Types of Independence (As per FAC)

① Independence of mind.
The opinion of Auditor is not Subordinate to the wishes of the person.
Auditor should be having
(a) Integrity
(b) Objectivity
(c) professional Skepticism.

② Independence in Appearance
Auditor should avoid all those situations and circumstances on the basis of which, third party will conclude that

Advantages of Independent Audit

Audit is advantages for wide range of users, If it is Conducted Independently :-

① Shareholders :- Shareholders Cannot participate into day to day affairs of Company but they need an Independent mechanism to examine the FS prepared by management so the interest is safe guarded by audit as they will get qualitative and reliable information.

(a) Integrity
(b) objectivity
(c) professional skeptism
is compromised.

(2) Government :- In determining Tax liabilities

(3) Lenders :- Bank / FI can make credit decisions on the basis of Audited FS (whether to give loan or not)

(4) Employees :- There will be moral check as employees will be having fear that their fraud can be discovered.

(5) Management :- will get to know about the functioning of Internal control and their deficiencies.

Objectives of Audit (SA-200)

① To obtain Reasonable assurance that whether financial statement are free from material mis-statement whether due to fraud or error in order to form opinion on financial statements.

② To report the opinion in accordance with SAs.

Reasonable assurance	Financial statement.
① Reasonable assurance is a high level of assurance but not complete assurance	① It is a structured representation ② of historical financial Information
② Reasonable assurance is different from Absolute Assurance	③ Including the related notes ④ intended to Communicate
③ Absolute Assurance is a Complete guarantee that FS are free from material mis-statement	(a) Entity's Economic resources and obligations. at a point in time (b) Changes there in over a period of time.
	⑤ In accordance with the FRF

It is the difference between
(a) what is reported in the FS
(b) what should have been reported in accordance with FRF

Difference between PFI and HFI

Point of Difference	HFI	PFI
Meaning	(1) HFI means information. (2) Expressed in financial terms (3) In relation to a particular entity (4) derived primarily from entity's Accounting system. (5) about (a) Economic events accured in past time period (P&L) (b) Economic Condition at point of time in past (BS)	(1) PFI means financial Information (2) based on assumptions about (a) Events that may occur in future (b) possible actions by entity (3) It can be in the form of: (a) projection. (b) forecast (c) Both.
Assurance	Reasonable Assurance (Audit) Limited Assurance (Review)	moderate assurance.
opinion	Practitioner will form an opinion.	As evidence is future oriented opinion cannot be formed
Evidence	past-rooted	future oriented.
objective	practitioner will ensure that HFI is prepared as per the framework.	practitioner will examine that assumptions are reasonable and properly disclosed.

Inherent limitations

Nature of Financial Reporting

① Management forms Judgement while preparing the FS
Judgements involve Subjectivity due to which uncertainities arise.
Hence, Auditor cannot absolute assurance that whether FS are free from m-m.

② Management is responsible to (a) prepare FS (b) design proper internal controls for improving reliability of financial information.

③ But Internal control have its own limitations (eg. Collusion) due to which financial information is not that reliable

Eg. An entity forms a system where "goods receiving section" examine goods on delivery and authorised person signs on purchase Bill. But, if Accountant and that Authorised person collude, then they can override the controls and FI will not be reliable.

Nature of Audit Procedure

① There are practical and legal limitations due to which Auditor cannot obtain absolute assurance

(a) Sampling :- Auditor does not check each and every transaction and makes use of samples. This is practical limitation

(b) Management will not provide evidence Auditor cannot force management or employees to provide evidence as auditor does not have legal powers. This is legal limitation

(c) Fraud :- management may consist of dishonest people who commits fraud. They will use sophisticated tools and organised schemes to conceal it they will use fabricated documents which is difficult for Auditor to detect

(d) RTP :- Management commits transactions with RPs of which Auditor is unaware ⇒

of Audit

Not an Investigation

As Audit is not an official. Investigation Auditor cannot obtain Absolute Assurance.

Decrease in Relevance of Information over time

① The relevance of information over time.
In recurring Audits Auditors may have relied on evidence collected in 2nd year and may not have obtained fresh evidence in 3rd year.
(even if something new has happned)

Future Events.

Future events affects the Entity adversly and affect Entity's ability to continue its business.

eg: change in market conditions new business models etc.

The Transaction are in paper only and auditor cannot detect as he is unaware of RP relationships.

Types of Assurance

Audit	Review.
It is a Reasonable Assurance Engagement	It is a limited assurance engagement
Auditor will perform extensive and detailed procedure.	In comparison to Audit practitioner will perform fewer procedures
Auditor will draw Reasonable Conclusion.	Practitioner will draw limited Conclusions.
Standards: Standards on Auditing (SAs)	Standards on Review engagement (SRE)
Here, practitioner will examine Historical financial Information.	Here, practitioner will examine Historical financial Information.
	eg. Examination of Summary Financial statements

Engagements:

Assurance.

It is a moderate Assurance Engagement

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Practitioner examines prospective financial ~~Statement~~ information.

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Standards: Standards on Assurance Engagements (SAE)

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eg: Examination of projected financial statements.

Related Service.

Here, practitioner will assist management in compiling the financial statements.

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Here, practitioner will not obtain any assurance.

↓

Standards on Related Services (SRs)

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eg: Client has outsourced payroll management to a CA

~~AS~~ Types of Standards

Standards on Auditing	Standard on Review Engagement
① SAs apply in audit of financial statements by Independent Auditor.	① SRE applies on Review of financial information
② SAs apply in audit of HFI	② SRE applies on HFI
	③ SRE applies on limited Assurance engagement
③ Areas of SA:	④ Here, practitioner shall obtain SAA Evidence.
200 Series :- Responsibilities of Auditor	
300 & 400 Series :- Risk Assessment	
500 Series :- Audit Evidence.	
~~600 Series Joint Auditors~~	
700 Series :- Audit Opinion	⑤ Examples :-
600 Series :- Using work of others.	① SRE 2400 :- Review of Historical FS
④ Examples of SA :-	② SRE 2410 :- Review of Interim financial Information.
(a) SA 230 :- Audit documentation	
(b) SA 299 :- Joint Auditors	
(c) SA 500 :- Audit Evidence	

Standard on Assurance engagement.

1. SAE applies on assurance engagement which deals other than HFI
2. SAE applies on PFI
3. Here, practitioner will obtain Moderate assurance.
4. Examples:-

   1. SAE 3400:- Examination of PFI
   2. SAE 3420:- assurance Engagement on ~~performance~~ proforma financial Information.

Standard on related service

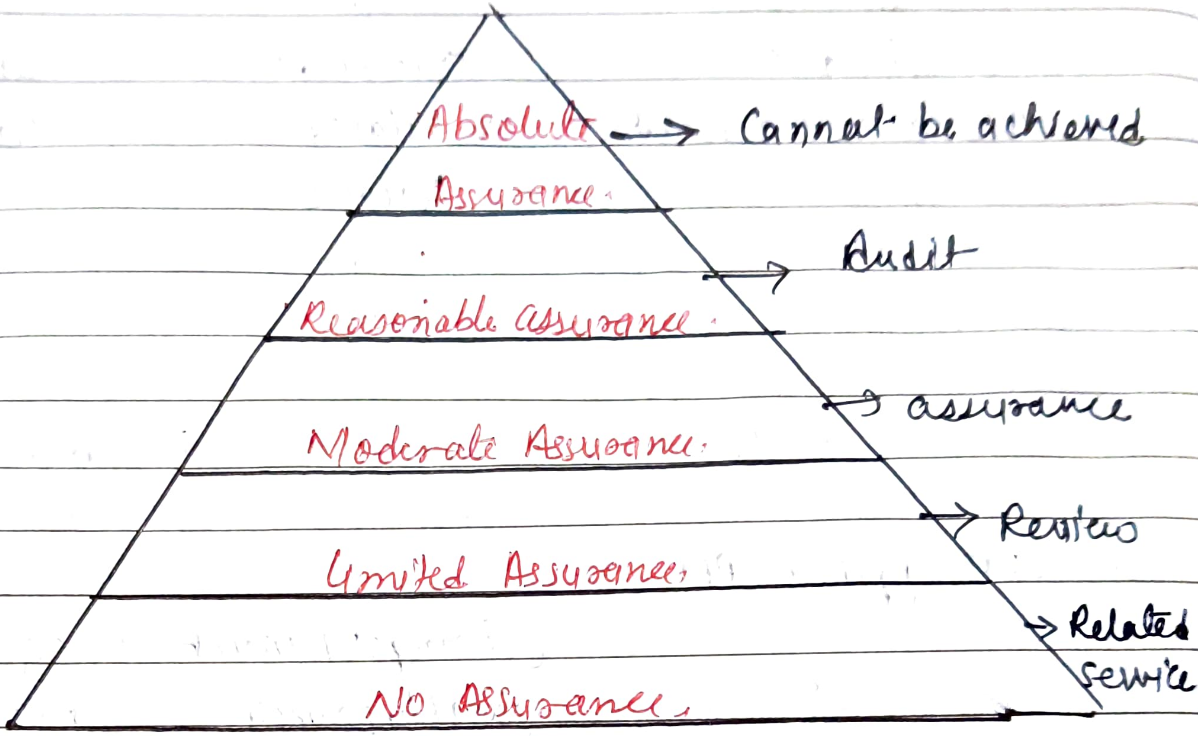
1. SRS applies on engagement to perform agreed upon procedures
2. Example:- Account payable, payroll management.
3. Here, practitioner assist the management in preparation and presentation of HFI
4. These are no Assurance engagement
5. also known as Compilation engagement
6. Examples.

   a. 4400 :- To perform agreed upon procedures
   b. 4410 :- Compilation engagement

Standard on Quality Control

1. This Standard applies on all engagement (Audit, review, assurance, related services)
2. SQC-1 is to ensure practitioner should establish proper system of quality Control in the firm

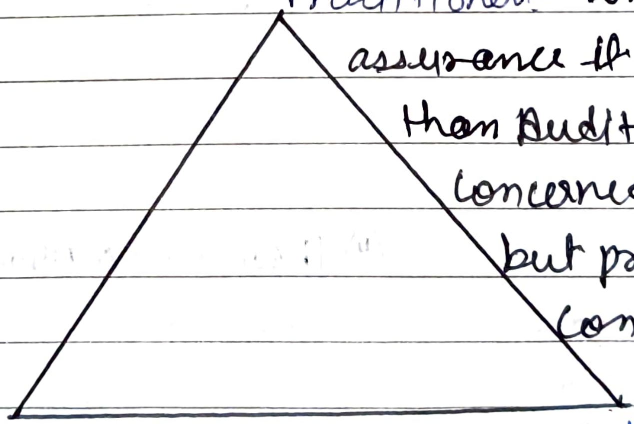
Assurance pyramid



Elements of Assurance engagement.

Three party Relationship

Practitioner:- who provides the assurance it is a broader than Auditor, Auditor is concerned only with HFI but practitioner is concerned with PFI also.



Responsible party
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party responsible for preparation of Subject matter.

Intended users
↓
For whom an assurance report is provided

(1) Appropriate Subject Matter.

Information examined by practitioner

In audit: Financial Information in FS is ASM.

(2) Suitable Criteria.

Refers to benchmark used to evaluate the Subject matter.

eg: standards, laws, guidance notes.

(3) Evidence.

Sufficient :- Quantity

Appropriate :- Quantity.

Auditor should obtain S&A evidence to draw Conclusion.

(4) Written Assurance report.

To provide Conclusion that convey assurance about subject matter.

It is outcome of assurance engagement

Illustration

CA DOLLY ↓ Practitioner.

Examination — Summary FS

Review engagement

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(On the basis of SRE) → Suitable Criteria

↓ appropriate Subject matter.

↓ prepared by management ↓ Responsible party

Provide a report → For shareholders → Intended users.

↓ Written assurance Report

Scope of Audit

What is Included:-

① Coverage of all aspects.

Audit of FS should cover all aspect relevant to FS

② Reliability and Sufficiency.

Auditor should be satisfied that

(a) Accounting records.

(b) Source.

must be reliable and sufficient to prepare FS.
For this, Auditor shall asses accounting system and internal control.

③ Disclosure of financial Information.
Auditor shall ensure that FS properly discloses relevant information as per statutory requirement
For this, FS should summarize transactions + events.

management forms Judgement in Preparing + presenting FS (for ex: Selection of Accounting policies) The Accounting policies should be:- (a) properly selected. (b) Consistently applied. Ex. of accounting policies:- Method of depreciation Method of valuation of Inventory.

What is not Included:-

① Auditor is not expected to perform any procedure which falls outside his Competence.
eg:
(a) Civil structure of Building:- done by Enginer.
(b) Genuineness or Authentication of document.
(c) physical condition of Sophisticated machinery.

POD	Investigation	Audit.
meaning	Critical examination for a particular purpose	Examination of financial statement and to obtain reasonable assurance that FS are free from mm
Powers:	Legal powers is provided.	No-specific legal powers are provided
objective	To ensure existence of fraud.	To express opinion.
Scope.	is narrow and specific	Broad and general.

Auditor and Audit.

- Auditor
  - Appointment.
    - ① non govt co: By members
    - ② Govt Co: By CAAG → Comptroller and Audit General.
  - Submission of report
    - → who makes the appointment eg- company: Members, Firm: partners
- Audit
  - Mandatory
    - → Required under Law eg: ① CA 2013 Statutory Audit of Companies
  - Voluntary.
    - → not compulsory eg: ① of partnership ② of Prop/HUF

Qualities of Auditor.

① Auditor shall have human Qualities like Tact, Good temper, Integrity, Industry, Judgement clear headedness, discretion etc.

② He should shine a better culture.

③ He must possess highest level of Integrity, backed by Independence.

④ Auditor should have thorough knowledge, of Accounting and its principles.

Auditor shall ensure that FS shall not mislead anyone by ensuring.

F = Financial statement is properly classified described and disclosed.

I = Information is clear and unambiguous in FS.

T = True and Fair is presented by (FS about P/L and BS)

N = No omission of accounting Entries.

E= Entries in Books of Accounted are there in the FS.

S= Sufficient and Appropriate evidence is obtained.