1. I will always be true to myself.
2. Daily I will write one question of audit.
3. Audit's paper can be of 40 pages be ready.
4. Practice fast reading.
5. 90 marks /120 mrks in audit will be like butter. (easy)

WORK NOT DOCUMENTED,
→ NOT DONE !!

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Lec. 3.

Chp 1 : Nature and Scope of Auditing.

A] AUDIT TEAM AND FLOW.

> Basic flow for practical knowledge

1. Client Proposal
2. Risk formalities
3. Acceptance of Audit
4. Meeting with Management
5. Planning Meeting with Team
6. Process understanding
7. Risk understanding.
8. Controls understanding
9. 7 & 8 is covered under WT's
10. Control Testing
11. Substantive Testing
12. Reporting/conclusion
13. QRM Team.

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B] Meaning and Definition of Auditing :

"An audit is 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 theron."

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c] SA 200 : OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND CONDUCT OF THE AUDIT IN ACCORDANCE WITH Sa's.

a) Overall Objective of Auditor
b) Scope of Audit
c) Aspects to be covered in Audit
d) Reasonable Assurance.
e) Inherent Limitations of Audit.
f) Auditor Requirement / Responsibility of Auditor.

A] OVERALL OBJECTIVES OF THE AUDITOR :

As per SA-200 "Overall objectives of the Independent Auditor" in conducting an audit of financial statements, the overall objectives of the auditor are:

a) To obtain reasonable assurance about whether the financial statement as a whole are free from materi misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on wheth the (F.S) financial statements are prepared, in all mate respects in accordance with an applicable FRF, and

b) To report on the financial statements and communicat as required by the SAs, in accordance with the auditor's findings.

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In all cases when reasonable assurance cannot be obtained and a qualified opinion in the auditor's report is insufficient, the SA's require that the auditor disclaim an opinion or withdraw from the engagement.
↓
SA 705

IMP note: The user, however, should not assume that the auditor's opinion is an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise.

Eg: IBL Ltd took a capital investment decision of establishing a plant at Gorakhpur but it proved unsuccessful as demand didn't rise thereby leading to a great loss for IBL. However, it was correctly shown in financial statement and auditor gave a true and fair remark but it does not define it's efficiency.

D] SA 705 : MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT.

Objective of the auditor	To express clearly an appropriately modified opinion on the financial statements when the auditor : (a) concludes, based on the evidences obtained that the financial statements as a whole are not free from material misstatements. or (b) is unable to obtain sufficient and appropriate evidences to conclude that financial statements as a whole are free from material misstatements.

Types of modified opinion:

There are three types of modified opinions, namely -

1. A qualified opinion.

2. An adverse opinion.

3. A disclaimer of opinion.

A] Qualified Opinion :

(i) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements are material but not pervasive.

(ii) The auditor shall qualify an opinion when he is unable to obtain sufficient appropriate audit evidence and he concludes that the possible effects on the financial statements of undetected misstatements are material but not pervasive.

B] Adverse opinion :

(i) The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregrate, are both material and pervasive.

C] Disclaimer of Opinion:

(i) The auditor shall disclaim an opinion when he is unable to obtain sufficient appropriate audit evidence and he concludes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

AUDIT REPORT

- UNMODIFIED
- MODIFIED
  - Emphasis of Matter
    - Other matter
  - Modified Opinion.
    - Qualified Opinion.
    - Adverse Opinion
    - Disclaimer of opini

SA 210 - AGREEING THE TERMS OF AUDIT ENGAGEMENT.

A] What is an Engagement?

Ans.

1) Engagement means an arrangement to do something.

2) In the context of auditing, it means a formal agreement between auditor and client under which auditor agrees to provide auditing services.

3) It takes the shape of engagement letter.

B] Objective of Auditor :

1) The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed through:

a) Establishing whether the preconditions for an audit are present.

b) Confirming that there is a common understanding between the auditor and management & Those charge with Governance (TCWG) of the terms of the audit engagement.

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c] Pre-conditions for an Audit:

1) The use by management of an acceptable FRF in the preparation of the financial statements & the agreement of management & where appropriate, TCWG to the premise on which an audit is conducted.

2) In order to establish whether the pre-conditions for an audit are present, the auditor shall:

A] Determine whether the financial reporting framework to be applied in the preparation of the financial statements is ~~applicable~~ acceptable; and.

B] Obtain the agreement of management that it acknowledges and understands its responsibilities for followings:

i) The preparation of the financial statements in accordance with the applicable FRF

ii) Exercising necessary internal control to enable the preparation of F.S that are free from material misstatement, whether due to fraud or error.

iii) to provide auditor with:

(a) Access to all relevant information such as records, documentation and other matters;

(b) Additional information that the auditor may request from management for the purpose of the audit and

(c) Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

D] What happens if preconditions for an audit are not present?

i) If the preconditions for an audit are not present, the auditor shall discuss the matters with management

2) Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement..

(a) the auditor has determined that financial reporting framework to be applied in the preparation of the financial statements is unacceptable or

(b) If the agreement of management is not obtained on matters relating to understanding of responsibility of management on preparation of financial statements, internal controls for preparation of financial statements, providing access to all information to auditor and unrestricted access to persons within the entity.

E] Limitation on Scope prior to Audit Engagement Acceptance:

1) If management or TCWG impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statement, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

F] Other factors affecting Audit Engagement Acceptance:

1) If the preconditions for an audit are not present, the auditor shall discuss the matter with management.

2) The auditor shall not accept the proposed audit engagement:

a) If the auditor has determined that the FRF to be applied in the preparation of the F.S is unacceptable.

b) If the management does not agree with its responsibilities prescribed above.

G] Agreement on Audit Engagement Terms:

1) The auditor shall agree the terms of the audit engagement with management or TCWG, as appropriate.

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2) The audit engagement letter is sent by auditor to his client.

3) The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:

a) The objective and scope of the audit of the FS

b) The responsibilities of the auditor.

c) The responsibilities of the management.

d) Identification of the applicable FRF for the preparation of the FS &

e) Reference to the expected form and content of any reports to be issued by the auditor & a statement that there may be circumstances in which a report may differ from its expected form and content.

4) If law or regulation prescribes in sufficient detail the terms of the audit engagement referred above, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities.

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4] Recurring Audits:

1) In case of recurring audits, the auditor shall assess whether circumstances requires revision ~~to~~ in terms of the audit engagement and whether there is a need to remind the entity of the existing terms of the audit engagement.

2) The auditor may decide not to send a new audit engagement letter or other written agreement each period.

3) However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

a) Any indication that the entity misunderstands the objective and scope of the audit.

b) Any revised or special terms of the audit engagement

c) A recent change of senior management.

d) A significant change in ownership.

e) A significant change in nature or size of the entity's business, legal or regulatory requirements or changes in other reporting requirements.

I] ACCEPTANCE OF A CHANGE IN THE TERMS OF THE AUDIT ENGAGEMENT:

a) Request from entity to change the terms of Audit engagement - when reasonable justification exists?

1) A request from the entity for the auditor to change the terms of the audit engagement may result from a change in circumstances affecting the need for the service,

2) A misunderstanding as to the nature of an audit as originally requested or a restriction on the scope of the audit engagement, whether imposed by management or caused by other circumstances.

3) The auditor considers the justification given for the request, particular the implications of a restriction on the scope of the audit engagement.

4) A change may not be considered reasonable if it appears that change relates to information that is incorrect, incomplete or otherwise unsatisfactory.

5) An example might be where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion.

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b) What should auditor consider before agreeing to change the audit engagement to the engagement providing lower level of assurance?

1) If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.

2) Before agreeing to change in audit engagement to a review or a related service, an auditor who was engaged to perform an audit in accordance with SA's may also need to assess any legal or contractual implications of the change.

3) If the auditor concludes that there is reasonable justification to change the audit engagement to a review or a related service, the audit work performed to the date of change may be relevant to the changed engagement. In order to avoid confusing the reader, the report on the related service would not include reference to:

(a) The original audit engagement

(b) Any procedures that may have been performed in the original audit engagement, except where the audit engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

4) If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

c) Recourse ~~ava~~ available to auditor in situation of non-agreement to a change in terms of engagement and lack of permission from management to continue original audit engagement:

i) If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

(a) withdraw from the audit engagement where possible under applicable law or regulation and

(b) Determine whether there is any obligation, either contractual or otherwise to report the circumstances to other parties, such as those charged with governance, owners or regulators.

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Chp 1 : Nature and Scope of Auditing.

1. Meaning of Independence :

1) To define "independence" precisely is not possible since independence is a state of mind and personal character.

2) According to the Guidance Note of the ICAI on "Independence of Auditors" independence implies that the judgement of a person is not subordinate to the wishes or directions of another person who have engaged him.

3) It stipulates that the independence is a condition of mind and personal character and should not be confused with the visible standards of independence.

2. INDEPENDENCE IS :

(a) Independence of mind - the state of mind that permits the provision of an opinion without being affected by influences allowing an individual to act with integrity and exercise objectivity and professional skepticism; and

(b) Independence in appearance - the avoidance of facts and circumstances that are so significant that a third party would reasonably conclude an auditor's integrity, objectivity or professional skepticism had been compromised."

Independence of the auditor has not only to exist in fact but also appear to so exist to all reasonable persons.

(1) The auditor has to conduct himself in such a way that no reasonable person, can doubt his objectivity and integrity. In fact, the word independent as a prefix in audit proposition in itself enshrines the concept of independence of an auditor and it is thus, considered fundamental concept in the theory of auditing.

(2) The relationship between the auditor and the client should be such that firstly, he himself is satisfied about his clients and then it is understood by others that the independence of the auditor is not affected.

3. Requirements of Law Ensuring Independence:

(1) Law also makes an attempt to ensure auditor's independence for instance:

(A) The Companies Act, 2013 contains specific provisions to ensure the independence of the auditor. e.g.

a) the right of access given to the auditor to the books of account and other documents.

b) provisions disqualifying certain persons to act as auditor.

c) Provisions relating to appointment, removal, etc are to ensure the independence of the auditor.

(B) Various provisions in the schedules to the Chartered Accountant's Act, 1949 on misconduct are also an attempt to protect the independence of the auditor and to keep the professional competence.

4. THREATS TO INDEPENDENCE :

1) Self-interest threats: It may occur as a result of the financial or other interests of a professional accountant or of a relative.
Examples:
(a) Direct or indirect financial interest in a client.
(b) Loan or guarantee to or from the concerned client.
(c) Undue dependence on a client's fee.
(d) Close business relationship with an audit client.
(e) Potential employment with the client.
(f) Contingent fees for the audit engagement.

2) Self-review threats : It may occur when a previous judgement needs to be re-evaluated by the professional accountant responsible for the judgement.
Examples:

(a) when an auditor having recently been a director or senior officer of the company; and

(b) when auditors perform services that are themselves subject matters of audit.

3. Advocacy threats - It may occur when a professional accountant promotes a position or opinion to the point that subsequent objectivity may be compromised.
Example:

(a) an auditor dealing with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes.

4. Familiarity threats : They are self-evident, and occur when auditors form relationships with the client where they end up being too ~~sympathatic~~ sympathetic to the client's interests.
Example:
(a) Close relative of the audit team working in a senior position in the client company.
(b) Former partner of the audit firm being a director or senior employee of the client.
(c) Long association between specific auditors and their specific client counterparts, and
(d) Acceptance of significant gifts or hospitality from the client company, its directors or employees.

5. Intimidation threats :
(1) It occurs when auditors are deterred from acting objectively with an adequate degree of professional skepticism.
(2) Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately

reduce work in response to reduced audit fees.

5. SAFEGUARDS TO INDEPENDENCE :

(1) The Chartered Accountant has a responsibility to ~~retain~~ remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

The following are the guiding principles in this regard:-

1) Auditors should always be and appears to be independent of the entities that they are auditing.

2) Auditors should abide himself with the key fundamental principles i.e. integrity, objectivity and professional skepticism.

3) Auditor should consider threats to independence before accepting any audit assignment.

4) In case of existence of any threats to independence, auditor should not accept the engagement or put in place safeguards that eliminate them. If necessary safeguards cannot be put in place due to circumstances, auditor should withdraw.

5) If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

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SA 220: QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS.

1. Independence:

1) The engagement partner shall form a conclusion on compliance with independence requirements.

2) In doing so, the engagement partner shall:

a) Obtain relevant information to identify circumstances and relationship that create threats to independence.

b) Evaluate information on identified breaches of the firm's independence policies and procedures; and

c) Take appropriate action to eliminate such threats or reduce them to an acceptable level or to withdraw from the audit engagement.

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A] SCOPE OF AUDIT

i] What it Includes ?

→ Purpose :

1) Scope refers to range or reach of something. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.

2) Users of financial statements may be shareholders, employees, customers, government and regulatory authorities, bankers, etc.

3) Enhancing of degree of confidence 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.

4) The following points are included in the scope of Audit of financial statements :

What it includes ?

(i) Coverage of all aspects of entity :

(i) Audit of financial statements should be organised adequately to cover all aspects of the entity relevant to the financial statements being audited.

(2) Reliability & sufficiency of financial information:

(1) The auditor should be reasonably satisfied that information contained in underlying accounting records and other source data (like bills, vouchers, documents, etc) is reliable and sufficient basis for preparation of financial statements.

(2) The auditor makes a judgement of reliability and sufficiency of financial information by studying and assessing of accounting systems & internal controls and by carrying out ~~opposite~~ appropriate tests, enquiries and procedures.

(3) Proper disclosure of financial information:

(1) The management responsible for preparation & presentation of financial statements makes many judgements.

(2) The auditor should also decide whether relevant information is properly disclosed in the financial statements.

(3) He should also keep in mind applicable statutory requirements in this regard.

(4) It is done by ensuring that financial statements properly summarize transactions & events & by considering judgements made by management in preparation of financial statements.

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Eg:
choosing method of charging depreciation on fixed assets or choosing appropriate method for valuation of inventories.

(5) The auditor evaluates selection and consistent application of accounting policies by management whether such a selection is proper & whether chosen policy has been applied consistently on a period-to-period basis.

2] WHAT IT DOES NOT INCLUDE ?

A) Auditor is not expected to perform duties which fall outside the domain of his competence:

(1) for eg: physical condition of certain assets like that of sophisticated machinery ~~th~~ cannot be determined by him.

(2) Similiarly, it is not expected from auditor to determine suitability and life of civil structures like buildings.

(3) These require different skillsets which may be performed by qualified engineers in their respective fields.

(B) An auditor is not an expert in authentication of documents:

(1) The genuineness of documents cannot be authenticated by him because he is not expert in this field.

(C) An audit is not an official investigation into alleged wrong doing:

(1) He 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.

3] AUDIT is distinct from INVESTIGATION ?

Ans. (1) Investigation is a critical examination of the accounts with a special purpose.
Eg: if a fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.

(2) The objective of audit, on the other hand, as has already been discussed, is 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 thereon.

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(3) Therefore, audit is never started with a pre-conceived notion about state of affairs; about wrong-doing some wrong having been committed.

(4) The auditor seeks to report what he finds in normal course of examination of accounts.

(5) However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor.

(6) It may happen that auditor has given some findings of serious concern. Such finding may prompt for calling an investigation.

(7) The scope of audit is general and broad whereas scope of investigation is specific and narrow.

Reasonable Assurance w.r.t Misstatement :

(1) Auditor is required to obtain reasonable assurance as to whether the financial statements are free from material misstatements.

(2) Reasonable assurance is to be distinguished from absolute assurance.

(3) Absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements. [It is a high-level of assurance but it is not complete assurance. → Reasonable assurance.]

(4) Thus, auditor obtains sufficient and appropriate audit evidence to reduce audit risk to an acceptable low level.

(5) However, reasonable assurance is not absolute assurance. This is due to inherent limitations of an audit.

INHERENT LIMITATIONS OF AUDIT :

(1) As per SA - 200 " Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing ",

(2) 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.

(3) This is because there are inherent limitations of an audit. The inherent limitations of an audit arise from :

(A) Nature of Financial reporting :

(1) Preparation of financial statements involves making many judgements by management :

(1) These judgement may involve subjective decisions or a degree of uncertainty.

(2) Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material ~~instat~~ misstatements due to fraud or errors.

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(2) Responsibility of preparation of financial statements and design of Internal Control:

(1) One of the premises for conducting an audit is that management acknocoledges its responsibility of preparation of financial statements in accordance with applicable FRF & for devising suitable internal controls.

(2) However, such controls may not have operated to produce reliable financial information due to their own limitations.

(B) Nature of Audit Procedures:

(1) Practical Limitation due to sampling:

(1) The auditor carries out his work by obtaining audit evidence through performance of audit procedures.

(2) However, there are practical & legal limitations on ability of auditor to obtain audit evidence.

Eg: an auditor does not test all transactions and balances. He forms his opinion only by testing samples.

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(2) Legal Limitation- Management may not provide complete information as requested by auditor:

(1) There is no way by which auditor can force management to provide complete information.

(2) In case, he is not provided with required information, he can only report.

(3) Fraud by Management:

(1) The management may consist of dishonest people and may be, itself, involved in fraud.

(2) It may be engaged in concealing fraud by designing sophisticated and carefully organised schemes which may be ~~heard~~ hard to detect by the auditor.

(3) It may produce fabricated documents to lead him to believe that audit evidence is valid.

(4) Related Party Transaction. (SA 550):

(1) It is quite possible that entity may have entered into some transactions with related parties.

(2) Such transactions may be only paper transactions and may not have actually occurred.

(3) 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.

(C) Not in nature of Investigation :

(1) As already discussed, audit is not an official investigation.

(2) Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to fraud or errors.

(D) Timeliness of financial reporting & decrease in relevance of information over time.

(1) The relevance of information decreases over time & auditor cannot verify each and every matter.

(2) Therefore, a balance has to be struck between reliability of information and cost of obtaining it.

(E) future events- Detail Discussion in SA - 560 :

(1) future events or conditions may affect an entity adversely.

(2) Adverse events may seriously affect abilility of an entity to continue its business

(3) The business may cease to exist in future due to change in market conditions, emergence of neco business models or products or due to onset of some adverse events.

1. Integrity:

i) Integrity requires auditor to be straight forward and honest in all professional and business relationships.

2) It implied fair dealing and truthfulness it effectively means that he shall not be associated with reports, returns, communications or other information which he believes contains a materially false or misleading statements; contains statements or information provided recklessly or omits required information where such omission could be misleading.

2. Objectivity:

i) The principle of objectivity requires an auditor not to compromise professional judgement because of bias, conflict of interest or undue influence of others.

3. Professional competence and due care:

i) It requires that auditor attains and maintains professional knowledge and skill at the level required to render competent professional service based on current technical and professional standards and legislation and also to act diligently and in accordance with technical and professional standards.

(2) Diligence includes responsibility to act carefully, thoroughly on a timely basis in accordance with requirements of and assignment.

4. Confidentiality :

(1) Confidentiality principle requires a professional accountant to respect the confidentiality of information acquired as a result of professional or business relationships.

(2) Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant with the understanding that the a information will not be disclosed to a third party.

(3) However, such confidential information may be disclosed, for example, when it is required by law, when it is permitted by law and is authorised by the client or employer or there is a professional duty or right to disclose when not prohibited by law.

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5. Professional Behaviour.

(1) It requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession.

(2) A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the ~~lengthy~~ integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

6. Independence - [Refer detail concept given at the end of this chapter]