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MAGIC BOOK

AUDITING & ETHICS

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SUMMARISED
CHARTS OF

AUDITING & ETHICS

CHARTS OF CHAPTER 1

NATURE ,OBJECTIVE & SCOPE OF AUDIT

ADVANTAGES & LIMITATIONS OF AUDIT

Advantages of Audit

- It safeguards **the financial interest of the person** who are not associated with management of entity, be it shareholders or partners
- It acts as a **moral check on employees** from committing defalcations or embezzlement
- Audited statement of accounts are helpful in **settling liability for taxes, negotiating loans & determining the purchase consideration for business**
- They are helpful in **settling trade disputes for higher wages or bonus as well as insurance claims**
- They are of help in **settlement of accounts** at time of **admission or death** of partner
- Audit ascertains whether **necessary books of accounts & allied records** have been kept, & any weakness in that regard
- Audit helps in **detection of wastages & losses** especially those that occur due to inadequate internal checks or internal controls
- Audit reviews **existence & operations of various controls & reports** inadequacies or **Weakness in them**
- Government may require audited & certified statements before it **gives financial assistance or issues license for particular trade**

Inherent Limitations of Audit (FATO)

1. **Nature of Financial Reporting – Judgement by Management** & many financial statements also involve subjective decisions which differs from different management perspective
2. **Nature of Audit Procedures** - Auditors job is to do audit & **not do official investigation** into alleged wrong doing. Fraud if done will always be carefully organized to conceal it
3. **Timeliness of Financial Statements & Balance between Benefit & Cost** – We want **more information early to get more benefit**, but it may involve **more cost** which we are not ready to incur and there is fixed deadline of financial statements. So **maintaining balance between Benefit & cost is difficult** and also completing audit in time
4. **Other Matters That Affect Limitation of Audit** -
 - **Fraud involving Senior Management or collusion**
 - **Existence & completeness of related party relationships**
 - **Non-compliance** with laws & regulations
 - **Future events or conditions** that may cause entity to **cease continue as going concern**

Difference Between Audit & Review

Audit is a reasonable assurance engagement.

However, **Review is a limited assurance engagement**. It provides **lower level of assurance than audit**. Further, **review involves fewer procedures** and gathers sufficient appropriate evidence on the basis of which **limited conclusions can be drawn up**.

However, **both “audit” and “review” are related to financial statements prepared on the basis of historical financial information**

CHAPTER 1 NATURE , OBJECTIVE & SCOPE OF AUDIT

Audit Definition

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 thereon**

Scope of Audit

- Audit should cover **all aspects of Enterprise relevant to financial statements** being audited
- To form an opinion on Financial Statements , auditor should be reasonably satisfied information contained in **accounting records & other source data is reliable & sufficient** for preparation of financial statements
- Auditor assess **reliability & sufficiency of accounting records & source data by**
 1. Making a **study & evaluation of accounting systems & internal control**
 2. Carrying out **tests , enquiries & other verification procedures**
- Auditor should also decide **whether Information is properly disclosed in financial statements** as per statutory requirements
- Auditor determines Information is properly disclosed by
 1. Comparing **Financial Statements with Accounting records & other source data**
 2. **Considering judgements that management has made** in preparing financial statements
- Auditor is not expected to perform duties **which fall outside the scope of his competence**
- Constraints on the **scope of audit should be set out in his report** & a **qualified or disclaimer of opinion** should be expressed as appropriate

Auditor Should Keep in Mind Following Points to Ensure Financial Statements are not Misleading

(Entries & Financial Statements)

- Accounts have been drawn with reference to **entries from Books of Accounts**
- Entries are adequately **supported by sufficient & appropriate audit evidence**
- None of the entries have been **omitted in process of compilation** & nothing which is **not in Books of account is included in Financial Statements**
- Information Conveyed by Statements is **clear & unambiguous**
- Amounts in Financial Statements are **properly classified , described & disclosed as per AS**
- Statement of Accounts presents **True & Fair picture of operational results & Assets & Liabilities**

Types of Audit

Audit required under law

- Companies as required by Companies Act 2013
- Banking Companies
- Electricity supply Companies
- Cooperative Societies
- Public & Charitable Trusts
- Corporations set up under Act of Parliament or State Legislature like LIC
- Specified Entities under various Section of Income Tax Act , 1961

Voluntary audit

- Proprietary Entities
- Partnership Firms
- Hindu Undivided Families

As per SA 200 Over-all Objectives of Independent Auditor -

- To obtain **Reasonable Assurance** about whether financial statements as a whole **are free from material misstatement &**
- To **report** on Financial Statements & **Communicate** as required **by SA's**

SUMMARY OF SA , SRE , SAE , SRS

Assurance – Practitioner gives **Assurance to users of financial statements**

Historical Financial Statements –

1. **Absolute Assurance** – Not Possible in Audit (Inherent Limitation of Audit)
2. **Reasonable Assurance** – High Level of Assurance – Audit Assignment – **Standards on Audit (SA's) 100 – 999**
3. **Limited Assurance** – Lower Level of Assurance & Performing Fewer Procedures as compared to Reasonable Assurance Eg – LR – **Standards on Review Engagement (SRE's) 2000 – 2699**

Prospective Financial Information – Information based on events may occur in future & possible actions. Eg – Report on Internal Controls, Budgets , Projected Financial Statements

1. **Limited Assurance** – It is moderate level of assurance, because on future, we can never give Reasonable Assurance ---
Standards on Assurance Engagements (SAE) – 3000 - 3699

Standards on Quality Control (1 -99) – All Engagements follow System of Quality Control – Historical as well as Assurance Engagements, so Reports are issued as appropriate

Relationship of Audit with Other Disciplines

Auditing and Accounting: Auditing **reviews the financial statements** which are nothing but a result of the overall accounting process.

Auditing and Law: An auditor should have a **good knowledge of business laws affecting the entity.**

Auditing and Economics: Auditor is expected to be **familiar with the overall economic environment of the client.**

Auditing and Behavioural Science: **Knowledge of human behaviour is essential for an auditor to effectively discharge his duties.**

Auditing and Statistics & Mathematics: Auditor is also expected to have the knowledge of **statistical sampling for meaningful conclusions** and mathematics for verification of inventories.

Auditing and Data Processing: EDP **auditing in itself is developing as a discipline in itself.**

Auditing and Financial Management : Auditor is expected to have **knowledge about various financial techniques such as working capital management, funds flow, ratio analysis, capital budgeting etc.**

Auditing and Production: Good auditor is one who understands the client and his business functions such as **production, cost system, marketing etc.**

Non-Assurance – Practitioner does not give Assurance , but perform agreed upon procedures regarding Financial Information . Eg – Accounting , Compilation of Consolidated Financial Statements , Tax Representation , Designing & Implementing Internal Controls



Standards on Related Services (SRS) 4000-4699

Why Standards are Needed ??

- Standards ensure **carrying out of audit against established benchmarks** at par with global practices.
- Improve **quality of financial reporting** thereby helping users to make diligent decisions.
- Promote **uniformity as audit of financial statements** is carried out following these Standards
- Equip **Professional accountants with Professional knowledge and skill.**
- **Ensure Audit Quality**