MM VIRTUALS

CA INTER

AUDITING & ETHICS

PART-1

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AUDITING & ETHICS

1 NATURE, OBJECTIVE AND SCOPE OF AUDIT

CHAPTER OVERVIEW

Q. No.1 "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 xpressing an opinion thereon."
Explain stating clearly how the person conducting this task should take care to ensure that financial statements would not mislead anybody. [MTP-Oct. 19]

Or

The person conducting audit should take care to ensure that financial atements would not mislead anybody. Explain stating clearly the meaning of Auditing. [RTP-May 20]

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.**

The person conducting this task should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:

(i) The accounts have been drawn up with reference to **entries in the books of account**;

(ii) The entries in the books of account are adequately **supported by sufficient and appropriate** evidence;

(iii) None of the entries in the books of account has been omitted in the process of **compilation** and nothing which is not in the books of account has found place in the statements;

(iv) The information conveyed by the statements is **clear and unambiguous**

(v) The **financial statement amounts** are properly classified, described and disclosed in **conformity with accounting standards**;

(vi) The statement of accounts **present a true and fair picture** of the **operational results** and of the **assets and liabilities.**

Q. No. 2: The objective of an audit of financial statements, prepared within a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements.

Or

State the objectives of Audit according to SA 200. [RTP-May 20]

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 atements as a whole are **free from material misstatement**

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

An analysis of above brings out following points clearly: -

(1) Auditor's objective is to obtain a *reasonable assurance* whether financial statements as a whole are free from material misstatement whether due to fraud or error.

Reasonable assurance is to be **distinguished from absolute assurance. Absolute assurance is a complete assurance** or a guarantee that financial statements are free from material misstatements. However, **reasonable assurance is not a complete guarantee**. Although it is a **high-level of assurance but it is not complete assurance.**

Audit of financial statements is carried out by the auditor with professional competence and skills in accordance with Standards on Auditing..It leads to **high level of assurance** which is called as **reasonable assurance but it is not absolute assurance.**

(2) Misstatements in financial statements can occur due to fraud or error or both. The auditor seeks to obtain **reasonable assurance whether financial statements *as a whole* are free from material misstatements caused by fraud or error**. He has to see

effect of misstatements on financial statements as a whole in totality.

(3) The opinion is reported and communicated in **accordance with audit findings through a written report** as required by Standards on Auditing.

Q. No. 3: List the points that merit consideration in regard to scope of audit.

Or

SCOPE OF AUDIT-WHAT IT INCLUDES

GST & Co., a firm of Chartered Accountants has been appointed to audit the accounts of XYZ Ltd. The partner wanted to cover principal aspects while conducting its audit of financial statements. Advise those principal aspects. [RTP-May 18]

Or

Discuss: Principal aspects to be considered by an auditor while conducting an audit of final statements of accounts.

The following points merit consideration in regard to scope of audit:

1. The audit should be organized to **cover adequately all aspects** of the enterprise relevant to the financial statements being audited.
2. To form an opinion on the financial statements, the auditor should be reasonably satisfied as to whether the **information** contained in the underlying accounting records and other source data is **reliable and sufficient** as the basis for the preparation of the financial statements.
3. In forming his opinion, the auditor should also decide whether the relevant **information** is properly **disclosed** in the financial statements subject to statutory requirements, where applicable.
4. The auditor **assesses the reliability and sufficiency** of the **information** contained in the underlying accounting records and other source data by:
   (a) making a **study and evaluation of accounting systems and internal controls,**
   (b) carrying out such other **tests, enquiries** and other verification procedures of accounting transactions and account balances as he considers appropriate in the particular circumstances.

5. The auditor determines whether the relevant information is properly disclosed in the financial statements by:
   (a) **comparing** the financial statements with the underlying accounting records and other source data to see whether they properly summarize the transactions and events recorded therein,
   (b) considering the judgments that management has made in preparing the financial statements accordingly, the auditor assess the selection and consistent application of accounting policies, the manner in which the information has been classified, and the adequacy of disclosure.
6. The auditor is not expected to perform **duties** which fall **outside the scope** of his competence. For example, the professional skill required of an auditor does not include that of a technical expert for determining physical condition of certain assets.
7. **Constraints** on the scope of the audit of financial statements that impair the auditor's ability to express an unqualified opinion on such financial statement should be set out in his report, and a qualified opinion or disclaimer of opinion should be expressed as appropriate.

Q. No. 4: Scope of audit-What it does not include.

Auditor is not expected to perform duties which fall outside domain of his competence. For example, physical condition of certain assets like that of sophisticated machinery cannot be determined by him.

Similarly, it is not expected from an auditor to determine suitability and life of civil structures like buildings. These require different skillsets which may be performed by qualified engineers in their respective fields.

Audit is distinct from investigation. **Investigation is a critical examination of the accounts with a special purpose.**

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.

The **scope of audit is general** and broad whereas **scope of investigation is specific and narrow.**

Q. No. 5: Discuss (INHERENT) Limitations of audit. [May 11 (8Marks)]

Or

"The process of auditing is such that it suffers from certain limitations". Discuss.

Or

ABC Ltd. Requested the auditor to provide for absolute assurance in respect of its ten branches scattered in Mumbai and confirm that financial statements are free from material misstatements due to fraud or error. Advise.

Or

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. Explain. [RTP-Nov. 18]

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.

The inherent limitations of an audit arise from:

i. **The Nature of Financial Reporting:** The preparation of financial statements involves **judgment by management** in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve **subjective decisions** or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.

ii. **The Nature of Audit Procedures**: There are **practical and legal limitations** on the auditor's ability to obtain audit evidence.

- management or others may **not provide, intentionally or unintentionally, the complete information** that is relevant to the preparation and presentation of the financial
to the preparation and presentation of the financial.
- Fraud may involve sophisticated and carefully organised schemes designed to conceal it. The auditor is neither **trained as nor expected to be an expert** in the authentication of documents.
- An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.
- We have to clearly understand that **audit is distinct from investigation. Investigation is a critical examination of the accounts** with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.
- The **objective of audit, on the other hand as we have already 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.
- Therefore, **audit is never started with a pre-conceived notion** about state of affairs; about wrong-doing; about some wrong having been committed. The auditor seeks to report what he finds in normal course of examination of accounts. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. It may happen that auditor has given some findings of serious concern. Such findings may prompt for calling an investigation.

iii. **Timeliness of Financial Reporting and the Balance between Benefit and Cost**: The matter of difficulty, time, or cost involved is **not in itself a valid basis** for the auditor to omit an audit procedure for which there is **no alternative**. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a **balance to be struck between the reliability of information and its cost.**

iv. **Other Matters that Affect the Limitations of an Audit:** In the **case of certain assertions or subject matters**, the potential effects of the **limitations** on the auditor's **ability to detect** material misstatements are particularly **significant**. Such assertions or subject matters include:

(a) Fraud, particularly **fraud involving senior management** or collusion.

(b) The existence and completeness of **related party relationships** and transactions,

(c) The occurrence of **non-compliance with laws and regulations.**

(d) Future events or conditions **that may cause an entity to cease to continue** as a going concern.

Q. No. 6: WHAT IS AN ENGAGEMENT 003F

Engagement means an **arrangement to do something**. In the context of auditing, it means a **formal agreement between auditor and client under which auditor agrees to provide auditing services.** It takes the **shape of engagement letter**.

External audit engagements

The purpose of external audit engagements is to **enhance the degree of confidence of intended users of financial statements.** Such engagements are also **reasonable assurance engagements.**

Q. No. 7: BENEFITS OF AUDIT-WHY AUDIT IS NEEDED ?

companies are required to get their annual accounts audited by an external auditor. Even non-corporate entities may choose to have their accounts audited by an external auditor because of benefits of such an audit.

Q. No. 8: What is the importance of having the accounts audited by independent professional auditors? [May 01 (8 Marks)]

Or

What are the advantages of Independent audit. [May 12 (8 Marks)]

Or

Discuss the following: Advantages of Independent Auditor.

Or

RAG is proprietorship firm engaged in the manufacturing of textile and handloom products. It sells its finished products both in the domestic as well as in the international market. The company is making total turnover of Rs. 30 crores. It has also availed cash credit limit of Rs. 5 crores from Canara Bank. In the year 2018-19, proprietor of the firm is worried about the financial position of the company and is under the impression that since he is out of India, therefore firm might run into losses. He approaches a CA about advantages of getting his accounts audited throughout the year so that he may not suffer due to accounting weaknesses. Advise regarding advantages of getting accounts audited. [MTP-March 18, Oct. 18]

Or

The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory. Explain. [RTP-Nov. 18]

a) It **safeguards the financial interests** of persons who are not associated with the management of the organisation e.g. partners or shareholders.

b) It acts as a **moral check** on employees from committing defalcations or embezzlement.

c) Auditing statements of accounts are helpful in **settling** of taxes, **negotiating loans** and for determining the purchase consideration for a business.

d) Audited statements are useful for **settling** trade disputes for higher wages or bonus.

e) Audited statements also help in **detection of wastages and losses** and shows the different ways by which these might be checked especially those that occurred due to absence or inadequacy of internal checks or internal control measures.

f) Independent audit ascertains whether the **necessary books of accounts** and allied records have been **properly kept** and helps the client in making good deficiencies or inadequacies in this respect.

g) As an appraisal function, audit reviews the existence and operations of various controls in the organisations and **reports weaknesses**, inadequacies etc.

h) Audited accounts are of great help in the **settlement of accounts at the time** of admission or death of the partner.

i) **Government** may require audited and certified statements before it gives assistance or issues the license for a particular trade.

Q. No. 9: Discuss the types of audits required under law.

a) Audit is not legally obligatory for all types of business organisations or institutions.

b) On this basis audits may be of two broad categories i.e., audit required under **law and voluntary** audits.

Audits required under law:-

(a) Companies governed by **the Companies Act, 2013.**

(b) Banking companies governed by the Banking Regulation Act, 1949;

(c) Electricity supply companies governed by the Electricity Supply Act, 1948;

(d) Co-operative societies registered under the Co-operative Societies Act, 1912

(e) Public and charitable trusts registered under various Religious and Endowment Acts;

(f) Corporations set up under an Act of Parliament or State Legislature such as the LIC of India.

(g) Specified entities under various sections of the Income-tax Act, 1961.

In the voluntary category are the audits of the accounts of :

- proprietary entities,
- partnership firms ,
- Hindu undivided families

Q. No. 10: WHO APPOINTS AN AUDITOR ?

Generally, an auditor is **appointed by owners or in some cases by constitutional or government authorities in accordance with applicable laws and regulations**. For example, **in case of companies, auditor is appointed by members (shareholders) in Annual General Meeting (AGM)**. Shareholders are owners of a company and auditor is appointed by them in AGM.

However, **in case of government companies in India, auditor is appointed by Comptroller and Auditor General of India (CAG)**, an independent constitutional authority.

Take case of a **firm** who engages an auditor to audit its accounts.

In such a case, auditor is **appointed by partners of firm.**

There may be a situation in which auditor may be appointed by a **government authority in accordance with some law or regulation**.

For example, an auditor may be appointed **under tax laws by a government authority.**

Q. No. 11: TO WHOM REPORT IS SUBMITTED BY AN AUDITOR ?

The outcome of an audit is written audit report in which auditor expresses an opinion. The report is submitted to person making the appointment.

In case of **companies,these are shareholders- in case of a firm, to partners who have engaged him.**

Q. No. 12: MEANING OF ASSURANCE ENGAGEMENT

"Assurance engagement" means an engagement in which a practitioner the expresses a conclusion designed to enhance the degree of confidence of intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

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.

Following elements comprise an assurance engagement: -

1. A three party relationship involving a practitioner, a responsible party, and intended users

An assurance engagement involves abovesaid three parties. A **practitioner is a person who provides the assurance**. The term practitioner is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.

A responsible party is the party responsible for preparation of subject matter.

Intended users are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.

2. An appropriate subject matter

It refers to the **information to be examined** by the practitioner.

For example, financial information contained in financial statements while conducting audit of financial statements.

3. Suitable criteria

These refer to benchmarks used to evaluate the subject matter like standards, guidance, laws, rules and regulations.

4. Sufficient appropriate evidence

The practitioner performs an assurance engagement to obtain sufficient arrived appropriate evidence. It is on the basis of evidence that conclusions are and an opinion is formed by auditor.

"Sufficient" relates to quantity of evidence obtained by auditor.

"Appropriate" relates to quality of evidence obtained by auditor. 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.

5. A written assurance report in appropriate form

A written report is provided containing conclusion that conveys the assurance about the subject matter. A written assurance report is the outcome of an assurance engagement.

Q. No. 13. Meaning of Review Or
Audit Vs. Review

We have learnt that audit is **a *reasonable assurance engagement***. It provides **reasonable assurance**. 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.

Q. No. 14: Types of Assurance Engagements- Reasonable assurance engagement vs. Limited assurance engagement

As already discussed, assurance engagements provide assurance to users.
The difference is of degree. Reasonable assurance engagement like audit provides reasonable assurance which is a high level of0020assurance.
Limited assurance engagement like review provides lower level of assurance than audit. It is only a moderate level of assurance.

Reasonable assurance engagement	***Limited assurance engagement***
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 thebasis 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**.

Besides reasonable assurance engagements and limited assurance engagements, there is another kind of assurance which is related to matters other than historical financial information. Such an assurance may relate to **prospective financial information and not to historical financial information**. It may relate to providing assurance on internal controls in an entity.

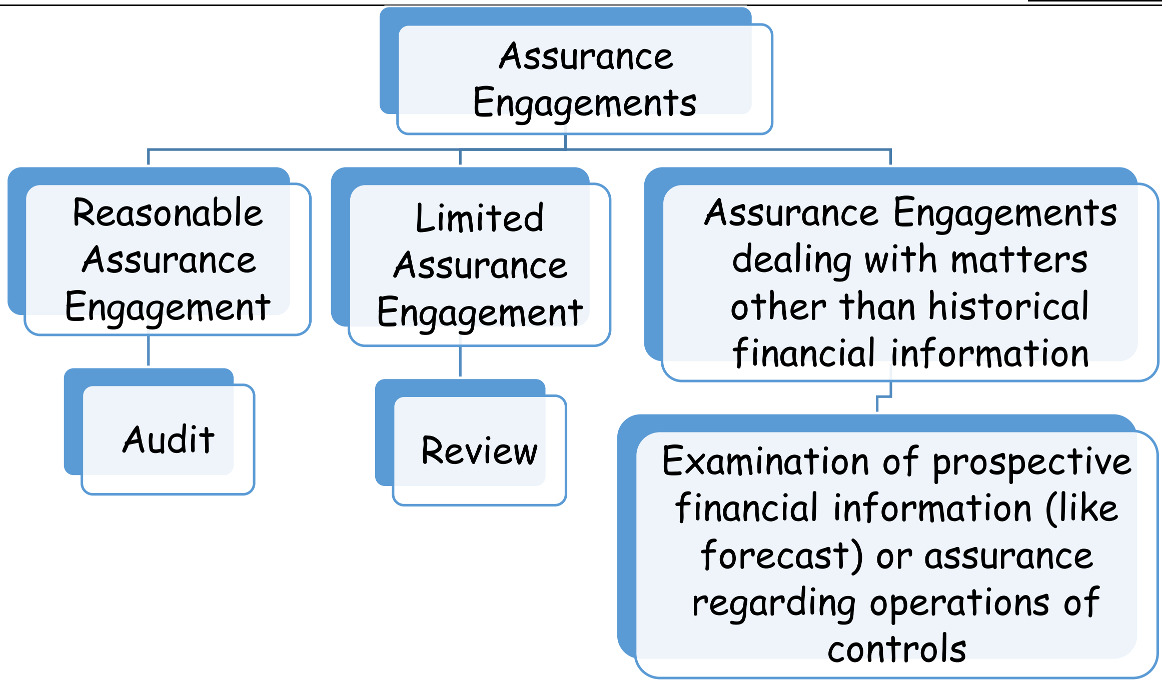
"Prospective financial information" means financial information based assumptions about events that may occur in the future and possible actions by an entity. It can be in the form of a forecast or projection or combination of both.

It is to be noted that in **such type of assurance engagements, examination is not of historical financial information.**

"Prospective financial information." relates to **financial information based on assumptions** about occurrence of **future events and possible actions by an entity.** Therefore, historical financial information is rooted in past events which have already occurred whereas **prospective financial information is related to future events.**

Hence, such type of **assurance engagement provides only a"moderate" level of assurance.**

Check box	Example of assurance engagement	Type of assurance engagement
✓	Audit of Financial statement	Reasonable assurance engagement
✓	Review of Financial Statement	Limited assurance engagement
✓	Examination of Prospective financial information	Provides assurance regarding reasonability of assumptions forming basis of projections and related matters
✓	Report on Controls operating at an organization	Provides assurance regarding design andoperation of controls



Q. No. 15: QUALITIES OF AUDITOR

An auditor is concerned with the **reporting on financial matters of business and other institutions**. Financial matters inherently are to be set with the problems of human fallibility; errors and frauds are frequent. **Tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability** are some of qualities which an auditor should have. In short, all those personal qualities that go to make a good businessman contribute to the making of a good auditor.

In addition, he must have the shine of culture for attaining a great height. He must have the highest degree of integrity backed by adequate independence. The auditor, **who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education**. He is called upon constantly to *critically* review financial statements and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert. **An exhaustive knowledge of accounting in all its branches is the *sine qua non* of the practice of auditing**. He must know thoroughly all accounting principles and techniques.

Q. No. 16: ENGAGEMENT AND QUALITY CONTROL STANDARDS: AN OVERVIEW

The following Standards issued under authority of ICAI Council are collectively known as *Engagement Standards:* -

1. **Standards on auditing (SAs)** which apply **in audit of historical financial information.**
2. **Standards on review engagements (SREs)** which apply in **review of historical financial information.**
3. **Standards on Assurance engagements (SAEs)** which apply in **assurance engagements other than audits and review of historical financial information.**
4. **Standards on Related Services (SRSs)** which apply **in agreed upon procedures to information, compilation engagements and other related service engagements.**

The purpose of issue of these standards is **to establish high quality standards and guidance in the areas of financial statement audits and in other types of assurance services.**

Q. No. 17: Standards on Auditing

Standards on Auditing apply in the context of an audit of financial statements byan independent auditor. It is important to remember that Standards on Auditing **apply in audit of historical information.**

Q. No. 18: Standards on Review Engagements .

Standards on review engagements apply in the context of review of financial statements. We have already understood that review is a limited assurance engagement and it provides assurance which is lower than that provided by audit.It is due to the fact that review involves fewer procedures as compared to audit. Since a review also provides assurance to users, it also involves obtaining sufficient appropriate evidence. For example, **when an auditor performs review of interim financial information of an entity.**

Examples of Standards on Review engagements are:

- SRE 2400 (Revised) Engagements to Review Historical Financial Statements
- SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

It is to be noted that both **Standards on auditing and Standards on review engagements apply to engagements involving historical financial information.**

Q. No. 19: Standards on Assurance Engagements

There is another set of standards which **apply in assurance engagements dealing with subject matters other than historical financial information.** Such assurance engagements do not include "audit" or "review" of historical financial information. These standards are known as Standards on Assurance Engagements. For example, an assurance engagement relating to examination of prospective financial information.

It is to be noted that in such type of **assurance engagements, examination is not of historical financial information or engagement** may relate to **providing assurance regarding non-financial matters like design and operation of internal control in an entity.**

Examples of Standards on Assurance Engagements are:

- SAE 3400 The Examination of Prospective Financial Information
- SAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

Q. No. 20: Standards on Related Services

Lastly, there are standards on related services. These standards apply in engagements to **perform agreed-upon procedures regarding financial information.**

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.

An engagement in which practitioner may be called upon to **assist management with the preparation and presentation of historical financial information without obtaining assurance on that information.**

Such type of compilation engagements fall in the **category of related services.**

These types of services are called related services and standards have been issued to deal with practitioner's responsibilities in this regard.

Examples of Standards on related services are:

- SRS 4400 Engagements to perform agreed-upon procedures regarding financial information
- SRS 4410 (Revised) Compilation engagements

It is to be clearly understood that all the above standards i.e., Standards on are Auditing (SAs), Standards on Review Engagements (SREs), Standards on Assurance Engagements (SAEs) and Standards on related services (SRSs) collectively known as the Engagement Standards.

Q. No. 21: Standards on Quality Control

Standards on Quality Control (SQCs) 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.**

SQC 1 has been issued in this regard. It requires auditors/practitioners to **establish system of quality control so that firm** and its personnel comply with **professional standards and regulatory & legal requirements and reports issued are appropriate.**

Its basic objective is that while rendering services, to which engagement standards apply, there should be a system of quality control with in firms to ensure complying with professional standards/legal requirements.

System of quality control ensures issuing of appropriate reports in the circumstances.

Q. No. 22: Why are Standards needed ?

- 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**.

Q. No. 23: Duties in relation to Engagement and Quality Control Standards

It is the duty of professional accountants to see that **Standards are followed in engagements undertaken by them**. Ordinarily, these are to be followed by professional accountants. However, a situation **may arise when a specific procedure as required in Standards would be ineffective in a particular engagement**. In such a case, **he is required to document how alternative procedures performed 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**.

Q. No. 24: INTERDISCIPLINARY NATURE OF AUDITING- RELATIONSHIP WITH DIVERSE SUBJECTS.

(1) Auditing is **interdisciplinary in nature**. It draws from diverse subjects including accountancy, law, behavioural science, statistics, economics and financial management and makes use of these subjects. Since audit of financial statements is concerned with financial information, a sound knowledge of accounting principles is a fundamental requirement for an auditor of financial statements to conduct audit and express an opinion. Similarly, good knowledge of business laws and various taxation

laws helps auditor to understand financial statements in a better way in accordance with applicable laws.

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.**

TEST YOUR KNOWLEDGE

MCQs

1. Which of the following is not an advantage of audit?

(a) It provides high quality financial information0020

(b) It acts as a moral check on employees

(c) It enhances risk of management bias

(d) It helps in safeguarding interests of shareholders

2. Which of the following is NOT TRUE about an assurance engagement?

(a) It relates to providing assurance about historical financial informationonly

(b) The practitioner obtains sufficient appropriate evidence

(c) There is some information to be examined by practitioner

(d) A written assurance report in appropriate form is issued by practitioner

3. Which of the following is TRUE about Engagement Standards?

(a) Engagement standards ensure proper rights to practitioners in course ofperformance of their duties

(b) Engagement standards ensure preparation and presentation of financialstatements in a standardized manner

(c) Engagement standards ensure uniformity by practitioners in course ofperformance of their duties

(d) Engagement standards ensure savings in resources of clients

4. Consider following statements in relation to "Limited assurance engagement":

Statement I - It involves obtaining sufficient appropriate evidence to drawreasonable conclusions.

Statement II - Review of interim financial information of a company is anexample of limited assurance engagement.

(a) Statement I is correct. Statement II is incorrect

(b) Both Statements I and II are correct

(c) Both Statements I and II are incorrect.

(d) Statement I is incorrect. Statement II is correct

5. Which of the following is TRUE about Standards on auditing?
(a) These deal mainly with voluntary responsibilities of auditor0073
(b) These deal mainly with mandatory responsibilities of auditors
(c) Their sole purpose is to help government authorities in augmenting revenues
(d) These deal mainly in carrying out audit according to legal provisions

Correct /Incorrect State with reasons (in short) whether the following statements are correct or incorrect:

(i) The basic objective of audit does not change with reference to nature, size or form of an entity

(ii) The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements

(iii) 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.

ANSWERS/SOLUTIONS

Answers to MCQs:

1. (c), **2**. (a), **3**. (c), **4**. (d), **5**. (b)

Answers to Correct/Incorrect:

(i) Correct: 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.

(ii) Correct: 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.

(iii) Correct: 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.