

Nature, Objective & Scope of Audit

ORIGIN OF AUDITING

- 1) Auditing has existed even in ancient times in many societies of world including India. The reference to auditing is found in Kautilya's Arthshastra even in 4th century BC. It talks about fixed accounting year, a process for closure of accounts and audit for the same. **Concepts of periodical checking and verification** existed even in those times.
- 2) 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.
- 3) 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.
- 4) Presently, **Comptroller and Auditor General of India** is an independent constitutional authority **responsible for auditing government receipts and expenditures**.
- 5) 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 Accountancy in the country.

MEANING AND NATURE 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 thereon."

Analysis of the Definition

An incisive analysis of above meaning of auditing brings out following points clearly: -

- 1) Audit is an **independent examination** of financial information.

Note:

- a) Independence, here, implies that the **judgement of a person is not subordinate** to the wishes or direction of another person who might have engaged him. The auditor should be independent of entity whose financial statements are subject to audit so that **he can form an opinion without being affected by any influence**. Independence increases auditor's ability to act objectively without creeping in of any biases.
- b) Consider, for example, a person who requests his brother, a Chartered Accountant, to audit accounts of his proprietary concern and issue a report. Can CA audit accounts of concern in which his brother is sole proprietor? No, he cannot. It is due to the fact that there would be no independence in such a case due to relationship by birth between CA and his brother. He would be subject to influence from his brother.
- c) Take another case where a CA has invested in shares of a company. Can he audit accounts of such a company in which he holds shares? The answer is resounding NO. It is due to the fact that by holding shares of the company, his own self-interest gets involved. His own

money is invested in the company and he may not be able to form judgment independently on the financial statements of the company.

- 2) The entity whose financial information is examined **need not necessarily be profit oriented** like in case of a business. It can be a non-profit organization like an NGO or a charitable trust. Audit can be undertaken in respect of any organization be it a **small, medium or large**. Further, it can be conducted for any entity irrespective of its legal structure i.e. such an entity may be a **proprietary concern, a partnership firm, a LLP, a private company, a public company, a society or a trust**.
- 3) The purpose of audit is to **express an opinion** on the financial statements.
- 4) Understand that **preparation and presentation of financial statements** of an entity is **responsibility of management** of entity.
- 5) The auditor **expresses an opinion on financial statements** by means of written audit report.

In doing so, he has to see that financial statements would not mislead anybody by ensuring that:

- a) the **accounts** have been drawn up with reference to **entries in the books of account**;
- b) the entries in the books of account are **adequately supported by sufficient and appropriate evidence**;
- c) none of the entries in the books of account has been **omitted** in the process of compilation;
- d) the information conveyed by the statements is **clear and unambiguous**;
- e) the **financial statement** amounts are properly **classified, described and disclosed** in conformity with accounting standards; and
- f) the statement of accounts presents a **true and fair picture** of the operational results and of the assets and liabilities.

Conclusion

Auditing provides assurance. Its basic nature *lies* in providing assurance to users - providing confidence to users of financial statements. Such an assurance **lends credibility to financial statements**. Audited financial statements provide confidence to users that financial information reflected in financial statements can be relied upon.

INTERDISCIPLINARY NATURE OF AUDITING- RELATIONSHIP WITH DIVERSE SUBJECTS

Auditing is **interdisciplinary** in nature. It draws from diverse subjects including accountancy, law, behavioral science, statistics, economics and financial management and makes use of these subjects.

- 1) **Auditing and Accounting:** Auditing reviews the financial statements which are nothing but a result of the **overall accounting process**.
- 2) **Auditing and Law:** An auditor should have a **good knowledge of business laws** affecting the entity.

- 3) **Auditing and Economics:** Auditor is expected to be familiar with the **overall economic environment** of the client.
- 4) **Auditing and Behavioral Science:** **Knowledge of human behavior** is essential for an auditor to effectively discharge his duties
- 5) **Auditing and Statistics & Mathematics:** Auditor is also expected to have the knowledge of **statistical sampling for meaningful conclusions and mathematics for verification of inventories.**
- 6) **Auditing and Data Processing:** **EDP** auditing in itself is developing as a **discipline in itself.**
- 7) **Auditing and Financial Management:** The auditor is expected to have knowledge about various **financial techniques** such as working capital management, funds flow, ratio analysis, capital budgeting etc.
- 8) **Auditing and Production:** Good auditor is one who **understands the client and his business functions** such as production, cost system, marketing etc.

OBJECTIVE OF AN AUDIT

In conducting audit of financial statements, objectives of auditor in accordance with SA-200 "**Overall Objectives of the Independent auditor** and the conduct of an audit in accordance with Standards on Auditing" are:

- a) To **obtain reasonable assurance** about whether the financial statements as a whole are free from material misstatement; and whether due to fraud or error, thereby enabling the auditor to **express an opinion** on whether the financial statements are prepared, in all material respects, in accordance with an **applicable financial reporting framework**; and
- 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.
- 2) 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.
- 3) Audit of financial statements is carried out by the auditor with professional competence and skills in accordance with Standards on Auditing. Audit procedures are applied in accordance with SAs, audit evidence is obtained and evaluated. On basis of that, conclusions are drawn and opinion is formed. It leads to **high level of assurance** which is called as **reasonable assurance** but it is not absolute assurance.
- 4) 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.**

- 5) Obtaining reasonable assurance that financial statements as a whole are free from material misstatements enables the auditor **to express an opinion** on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
- 6) The **opinion is reported and communicated** in accordance with audit findings through a written report as required by **Standards on Auditing.**



SCOPE OF AUDIT

- 1) The **purpose of an audit** is to enhance the **degree of confidence of intended users** in the financial statements. Users of financial statements may be **shareholders, employees, customers, government and regulatory authorities**, bankers etc.
- 2) 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.
- 3) **Applicable financial reporting framework** means a framework adopted in the preparation and presentation of the financial statements that is **acceptable in view** of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

For example, in case of companies in India, financial reporting framework is provided under **Schedule III of Companies Act, 2013.**

The following points are included in scope of audit of financial statements:

1) Coverage of all aspects of entity

Audit of financial statements should be **organized adequately** to cover all aspects of the entity relevant to the financial statements being audited.

2) Reliability and sufficiency of financial information

a) 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.

b) The auditor makes a judgment of reliability and sufficiency of financial information by making a study and assessment of accounting systems and internal controls and by **carrying out appropriate tests, enquiries and procedures**.

3) Proper disclosure of financial information

a) The auditor should also decide whether relevant information is **properly disclosed** in the financial statements. He should also keep in mind **applicable statutory requirements** in this regard.

It is done by ensuring that financial statements properly **summarize transactions and events** recorded therein and by considering the judgments made by management in preparation of financial statements.

b) The management responsible for preparation and presentation of financial statements **makes many judgments** in this process of preparing and presenting financial statements. For example, **choosing of appropriate accounting policies** in relation to various accounting issues like choosing method of charging depreciation on fixed assets or choosing appropriate method for valuation of inventories.

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

d) Understand that financial statements of an entity are **prepared on historical financial information basis**. "*Historical financial information*" means information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

For example, when purchases and sales are reflected in financial statements of an entity, these are examples of historical financial information. These are about transactions which have occurred in past.

Note:

Since financial statements are prepared on the basis of historical financial information, it is logical that audit of financial statements is also **based upon such historical financial information**. Therefore, audit of financial statements is based upon historical financial information.

SCOPE OF AUDIT-WHAT IT DOES NOT INCLUDE

- 1) 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.
- 2) 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.
- 3) An auditor is **not an expert** in authentication of documents. The genuineness of documents **cannot** be authenticated by him because he is **not an expert** in this field.
- 4) **An audit is not an official investigation into alleged wrong doing**. 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.

AUDITING VS INVESTIGATION

- 1) **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.
- 2) 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.
- 3) The **scope of audit is general and broad** whereas **scope of investigation is specific and narrow**.
- 4) 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.

AUDIT- MANDATORY OR VOLUNTARY?

- 1) It is not necessary that **audit is always legally mandatory**. There are entities like companies who are compulsorily required to get their accounts audited under law. Even non-corporate entities may be compulsorily requiring audit of their accounts under tax laws.
- 2) **For example**, in India, every person is required to get accounts audited if turnover crosses certain threshold limit under income tax law.
- 3) It is also possible that **some entities like schools** may be required to get their accounts audited for the **purpose of obtaining grant or assistance from the Government**.
- 4) **Audit is not always mandatory**. Many entities may get their accounts audited voluntarily

because of benefits from the process of audit. Many such concerns have their internal rules requiring audit due to advantages flowing from an audit.

WHAT IS AN ENGAGEMENT?

Engagement means an . 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.

For example, in India, 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**.

BENEFITS OF AUDIT - WHY AUDIT IS NEEDED

- 1) Audited accounts **provide high quality information**. It gives confidence to users that information on which they are relying is qualitative and it is the outcome of an exercise carried out by following Auditing Standards recognized globally.
- 2) **In case of companies**, shareholders may or may not be involved in daily affairs of the company. The financial statements are prepared by management consisting of directors. As **shareholders are owners** of the company, they **need an independent mechanism** so that financial information is qualitative and reliable. **Hence, their interest is safeguarded by an audit**.
- 3) An **audit acts as a moral check on employees** from committing frauds for the fear of being discovered by audit.
- 4) Audited financial statements are **helpful to government authorities** for determining **tax liabilities**.
- 5) Audited financial statements can be **relied upon by lenders, bankers** for making their credit decisions i.e. whether to lend or not to lend to a particular entity.
- 6) An audit may also **detect fraud or error or both**.
- 7) An audit reviews existence and operations of various controls operating in any entity. Hence, it is **useful at pointing out deficiencies**.

WHO APPOINTS AN AUDITOR?

- 1) 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.

- 2) However, in case of **government companies in India**, auditor is appointed by **Comptroller and Auditor General of India (CAG)**, an independent constitutional authority.
- 3) Take case of a **firm** who engages an auditor to audit its accounts. In such a case, auditor is appointed by **partners of firm**.
- 4) 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.

TO WHOM REPORT IS SUBMITTED BY AN AUDITOR?

- 1) The outcome of an audit is written audit report in which auditor expresses an opinion. The **report is submitted to person making the appointment**.
- 2) In case of companies, these are shareholders- in case of a firm, to partners who have engaged him.

QUALITIES OF AUDITOR

- 1) 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.
- 2) **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**.
- 3) 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**.
- 4) 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.
- 5) 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.

CONCEPT OF TRUE AND FAIR

- 1) The concept of true and fair is a **fundamental concept** in auditing.
- 2) The phrase "**true and fair**" in the auditor's report signifies that the auditor is required to **express his opinion** as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit.
- 3) This requires that the **auditor should examine the accounts with a view to verify** that all assets, liabilities, income and expenses are stated as amounts which are **in accordance with accounting principles and policies** which are relevant and no material amount, item or transaction has been omitted.
- 4) **What constitutes a 'true and fair' view is a matter of an auditor's judgment in the particular circumstances of a case.**
- 5) **In more specific terms, to ensure true and fair view, an auditor has to see:**
 - a) that the assets are neither undervalued or overvalued, according to the applicable accounting principles,
 - b) no material asset is omitted;
 - c) the charge, if any, on assets are disclosed;
 - d) material liabilities should not be omitted;
 - e) the profit and loss account and balance sheet discloses all the matters required to be disclosed;
 - f) accounting policies have been followed consistently; and
 - g) all unusual, exceptional or non-recurring items have been disclosed separately

Note:

- 1) **SA 700 "Forming an Opinion and Reporting on Financial Statements"**, requires the auditor to form an **opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained**; and **express clearly that opinion through a written report that also describes the basis for the opinion.**
- 2) The auditor is required to **express his opinion on the financial statements** that, the accompanying financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of the Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with Accounting Standards.

MEANING OF ASSURANCE ENGAGEMENT

“**Assurance engagement**” means an engagement in which a practitioner expresses a conclusion designed to **enhance the degree of confidence of the 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**.

ELEMENTS OF AN ASSURANCE ENGAGEMENT

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) 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.
 - b) A **responsible party** is the party responsible for **preparation of subject matter**.
 - c) **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 appropriate evidence. It is on the basis of evidence that conclusions are arrived 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. 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**.

MEANING OF REVIEW; AUDIT VS. REVIEW

- 1) We have learnt that audit is a **reasonable assurance engagement**. It provides reasonable assurance.
- 2) However, review is a **limited assurance engagement**. It provides **lower level of assurance than audit**.
- 3) Further, review involves **fewer procedures** and gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up.
- 4) However, **both "audit" and "review"** are related to **financial statements** prepared on the basis of **historical financial information**.

TYPES OF ASSURANCE ENGAGEMENTS- REASONABLE ASSURANCE ENGAGEMENT VS LIMITED ASSURANCE ENGAGEMENT

- 1) 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 of assurance**. **Limited assurance** engagement like review provides **lower level of assurance than audit**. It is only a **moderate level of assurance**.

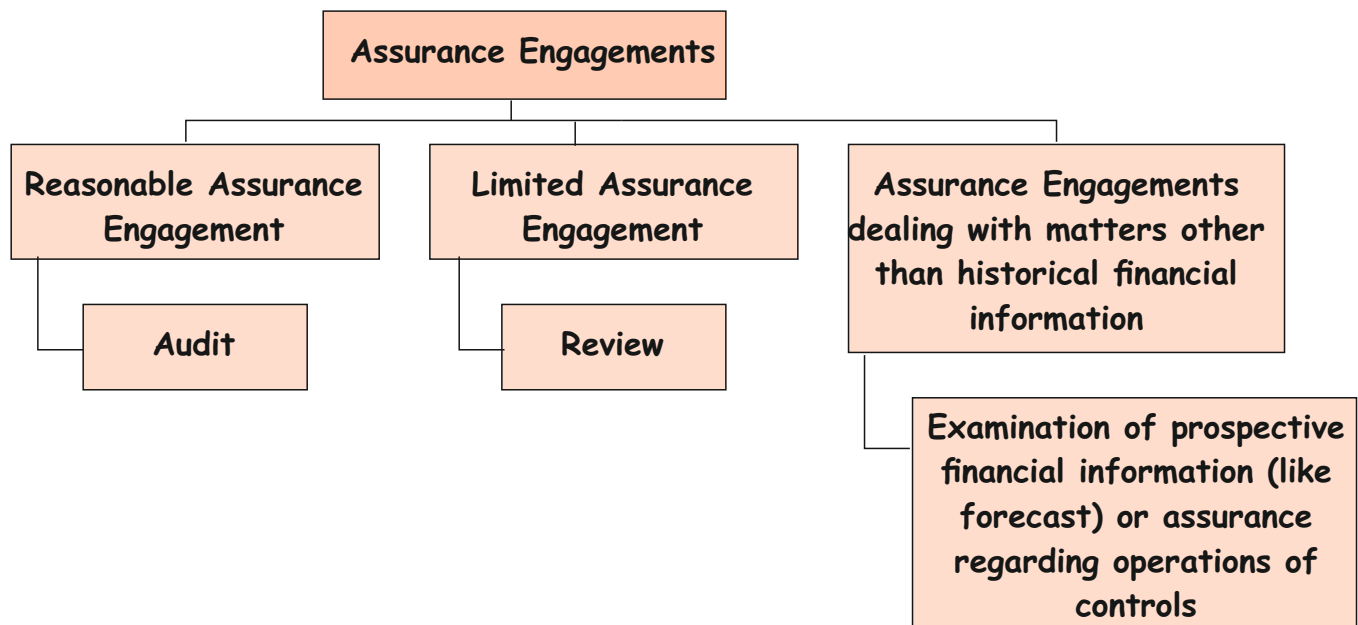
Reasonable assurance engagement	Limited assurance engagement
1) Reasonable assurance engagement provides high level of assurance .	1) Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
2) It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	2) It performs fewer procedures as compared to reasonable assurance engagement.
3) It draws reasonable conclusions on the basis of sufficient appropriate evidence.	3) It involves obtaining sufficient conclusions . appropriate evidence to draw limited
4) Example of reasonable assurance engagement is an audit engagement .	4) Example of limited assurance engagement is review engagement .

- 2) 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.
- 3) "Prospective financial information" means financial information **based on 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.

- 4) It is to be noted that in such type of assurance engagements, **examination is not of historical financial information.**
- 5) Here, it is important to note the difference between **"Historical financial information"** and **"Prospective financial information."** The **former** relates to information expressed in financial terms of an entity about **economic events, conditions or circumstances occurring in past periods.** The **latter** relates to financial information based on **assumptions about occurrence of future events and possible actions by an entity.**
- 6) Therefore, historical financial information is rooted in past events which have already occurred whereas prospective financial information is related to future events.
- 7) In assurance reports involving prospective financial information, the practitioner obtains **sufficient appropriate evidence** to the effect that **management's assumptions on which the prospective financial information** is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions and it is properly presented and all material assumptions are adequately disclosed.
- 8) **Prospective financial information relates to future events.** While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future- oriented. The auditor is, therefore, **not in a position to express an opinion** as to whether the results shown in the prospective financial information will be achieved.
- 9) Therefore, in such **assurance engagements,** practitioner provides **a report assuring that nothing has come to practitioner's attention to suggest that these assumptions do not provide a reasonable basis for the projection.**
- 10) Hence, such type of assurance engagement provides only a **"moderate" level of assurance.**

Examples of assurance engagements

Example of engagement assurance	Type of assurance engagement
Audit of statements financial	Reasonable assurance engagement
Review of financial statements	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 and operation of controls



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.

STANDARDS ON AUDITING

- 1) Standards on Auditing apply in the context of an **audit of financial statements** by an independent auditor. It is important to remember that Standards on Auditing apply in **audit of historical information**. These establish high quality benchmarks and are followed by auditors in conducting audit of financial statements.
- 2) Standards on Auditing have been issued on wide spectrum of issues in the field of auditing ranging from **overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement,**

audit sampling, audit evidence and forming an opinion and reporting on financial statements. These cover all significant aspects of audit of financial statements.

- 3) Some **examples of Standards on Auditing** are: -
- a) **SA 200** Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with Standards on Auditing
 - b) **SA 230** Audit Documentation
 - c) **SA 315** Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
 - d) **SA 500** Audit Evidence
 - e) Revised **SA 700** Forming an Opinion and Reporting on Financial Statements

STANDARDS ON REVIEW ENGAGEMENTS

- 1) 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**.
- 2) 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.
- 3) Examples of Standards on Review engagements are:
 - a) **SRE 2400** (Revised) Engagements to Review Historical Financial Statements
 - b) **SRE 2410** Review of Interim Financial Information Performed by the Independent Auditor of the Entity
- 4) It is to be noted that both **Standards on auditing and Standards on review engagements** apply to engagements involving **historical financial information**.

STANDARDS ON ASSURANCE ENGAGEMENTS

- 1) 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.
- 2) For example, an **assurance engagement** relating to **examination of prospective financial information**.
- 3) 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.
- 4) Examples of Standards on Assurance Engagements are:
 - a) **SAE 3400** The Examination of **Prospective Financial Information**

- b) **SAE 3420** Assurance Engagements to Report on the **Compilation of Pro Forma Financial Information Included in a Prospectus**

STANDARDS ON RELATED SERVICES

- 1) Lastly, there are standards on related services. These standards apply in **engagements to perform agreed-upon procedures** regarding **financial information**.
- 2) 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.
- 3) 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 and practitioner **issues a report clearly stating** that it is **not an assurance engagement and no opinion is being expressed**.
- 4) These types of services are called related services and standards have been issued to deal with practitioner's responsibilities in this regard.
- 5) **Examples of Standards on related services are:**
 - a) **SRS 4400** Engagements to **perform agreed-upon procedures** regarding financial information
 - b) **SRS 4410 (Revised) Compilation engagements**

Note

It is to be clearly understood that all the following standards are collectively known as the Engagement Standards :

- a) Standards on Auditing (SAs),
- b) Standards on Review Engagements (SREs),
- c) Standards on Assurance Engagements (SAEs) and
- d) Standards on related services (SRSs)

STANDARDS ON QUALITY CONTROL

- 1) **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.
- 2) 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**.

- 3) Its basic objective is that while rendering services, to which engagement standards apply, there should be a system of quality control within firms to ensure complying with professional standards/legal requirements. System of quality control ensures issuing of appropriate reports in the circumstances.
- 4) Further, it is also to be remembered that **Standards on Quality Control (SQCs)** are to be applied **for all services covered by Engagement Standards**.

WHY ARE STANDARDS NEEDED?

- 1) Standards ensure carrying out of audit against **established benchmarks** at par with global practices.
- 2) Standards **improve quality of financial reporting** thereby helping users to make diligent decisions.
- 3) Standards **promote uniformity** as audit of financial statements is carried out following these Standards.
- 4) Standards equip professional accountants with **professional knowledge and skill**.
- 5) Standards **ensure audit quality**.

DUTIES IN RELATION TO ENGAGEMENT AND QUALITY CONTROL STANDARDS

- 1) 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.
- 2) 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.
- 3) It is also to be noted that a **mere disclosure** in the report **does not absolve** a professional accountant from complying with applicable Standards.

