

## Ch.1 - Nature, Objective and Scope of Audit

### ① Meaning, Nature, Objective and Scope of Audit:

### ② Inherent Limitations of Audit:

As per SA-200 "Overall Objectives of the Independent Auditor and Conduct of an Audit in accordance with standards on Auditing", auditor is not expected to and cannot reduce audit risk to zero and therefore cannot obtain absolute assurance that f.s. as a whole are free from material misstatements whether caused due to error or fraud. (\* Risk of expressing inappropriate opinion when f.s. are materially misstated).

This is because of following inherent limitations of audit:

(a) Nature of financial reporting: Preparation of f.s. is responsibility of Management and for this purpose, management is required to select the appropriate accounting policies, FRF and ensure that f.s. are prepared as per selected policies and FRF. Prep<sup>n</sup> of f.s. involves management judgement which may not be objective.

(b) Nature of Audit Procedures: There are certain practical and legal limitations due to which auditor may not be able to collect audit evidence.  
For. Ex:

(i) Test checking of transactions and balances is an example of Practical limitation

Transactions that are not being examined by auditor may have misstatements.

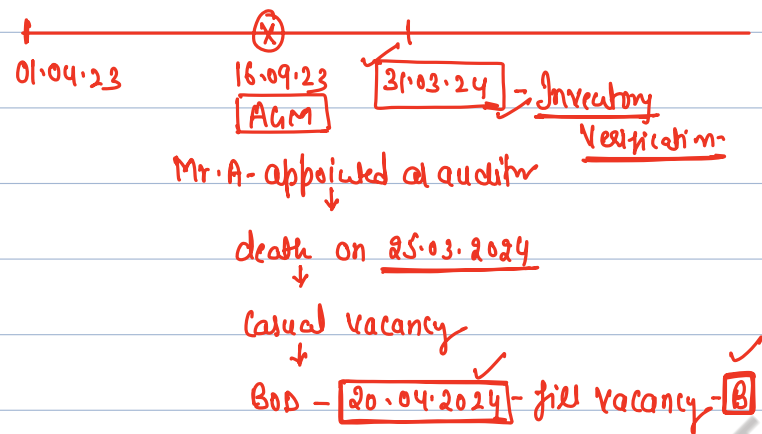
(ii) Auditor cannot force management for providing necessary information.

In case required information is not provided to auditor, auditor may state in fact in his audit report. (Legal limitations)

(C) Not in nature of Investigation: Audit is not an official investigation into alleged wrongdoings; hence he cannot obtain absolute assurance.

(D) Timeliness of financial reporting: Relevance of information decreases over time and hence auditor cannot verify and check every matter.

Hence a balance has to be struck between reliability of information and cost of obtaining information.



(E) Future Events: Future Events may adversely affect an entity due to which a business might not be able to continue.

Auditor is not able to comment on happening of future events as he examines the f.s. which contains historical financial information.

(3) Meaning, Nature and Types of Engagement:

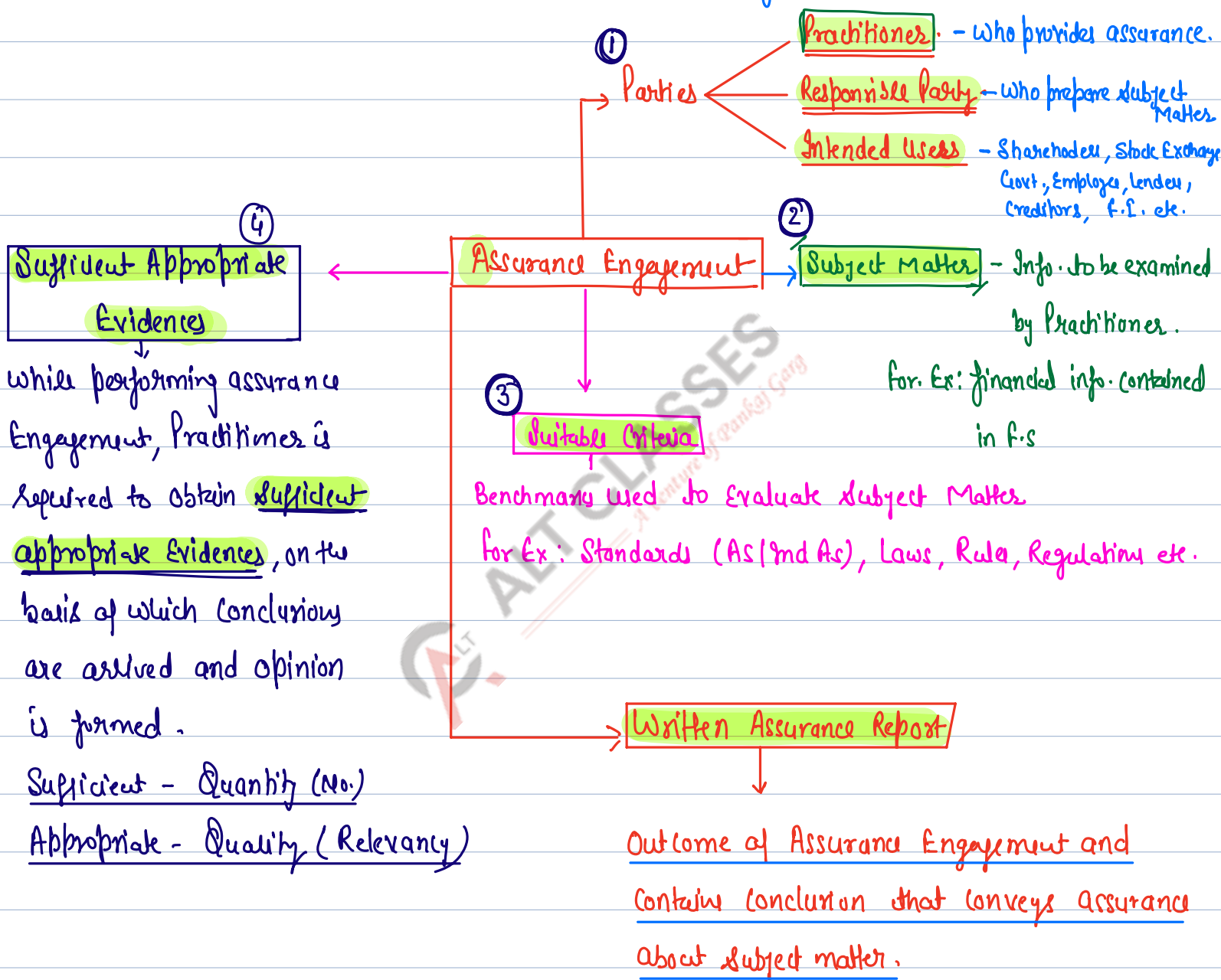
(A) Engagement: In relation to audit, it is a formal agreement between auditor and client, whereby auditor agrees to provide auditing services to the client.

(B) Types of Engagements: 2 Types

(A) Assurance Engagement

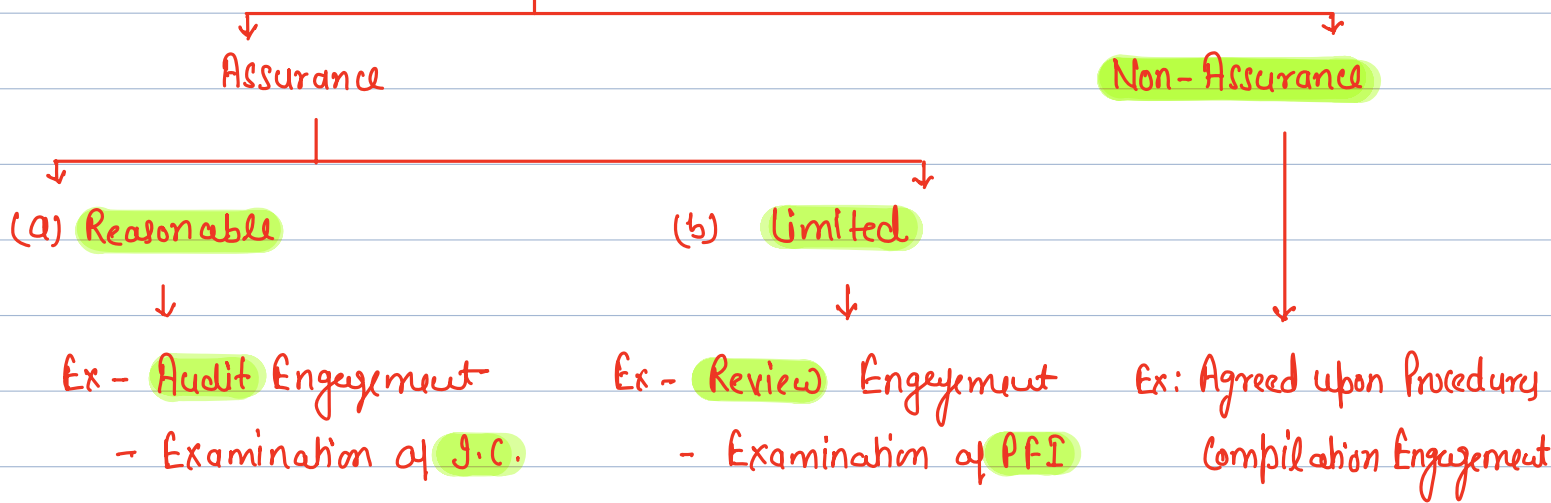
(B) Non-Assurance Engagement

Imp. Assurance Engagement: An engagement in which a practitioner expresses an opinion / conclusion, designed to enhance the degree of confidence of intended users (other than the responsible party), about the outcome of evaluation of subject matter against criteria.



<u>Type of Assurance!</u>		
(a) Absolute Assurance (100%)		Certification
(b) Reasonable "	(High, but not absolute)	Audit
(c) Limited "	(Lower than reasonable)	Review

# Examples of Engagements



Audit Engagement: Detailed examination of historical financial information contained in financial statements to obtain reasonable assurance.

Review Engagement: limited examination of historical financial information contained in financial statements to obtain limited assurance.  
(SRE 2400, 2410)

Historical financial information: Information expressed in financial terms about economic events occurred in past.

Examination of PFI: Limited examination of Assumptions used in preparation of Prospective Financial Information (PFI) to obtain moderate (limited) assurance. (\* Reasonableness and realistic)

Prospective financial information: Information based on assumptions about occurrence of future events and possible action by an entity.

While examining PFI, practitioner obtains evidence as to:

(a) whether assumptions used are not unreasonable;

(b) PFI is prepared on the basis of assumptions.

(c) PFI is properly presented and all significant assumptions are disclosed adequately.

Examination of I.C.: Examination of design, description and operating effectiveness  
(SAE-3402) of Internal Controls prevailing in the Entity to obtain Reasonable Assurance.

Agreed upon Procedures: Non-assurance engagement in which a practitioner performs the procedures as agreed with the client and third party; and reports on facts identified during the engagement.  
(SRS-4400)

Ex: ABC Ltd. approach XYZ Bank for working capital limit against trade receivable of Rs. 31.03.2024.

3rd party - XYZ Bank ask ABC Ltd. to make available a report of confirmation from trade receivable > 1 lakh. Procedure

client - ABC Ltd. engages C.A.M. for obtaining confirmation from trade receivable and issuing a report thereon.

Compilation Engagement: Non-Assurance engagement in which a practitioner compiles the financial data on the basis of records and information given to him. (Prep<sup>n</sup> of F.S.)

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