

SA 200 (AAS 1)

BASIC PRINCIPLES GOVERNING AN AUDIT

*(Effective for all audits relating to
accounting periods beginning on or after April 1, 1985)*

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Standard on Auditing (SA) 200*, "Basic Principles Governing an Audit" should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services"¹, which sets out the authority of SAs.

* Issued in April, 1985.

¹ Published in the July 2007 issue of the Journal.

Handbook of Auditing Pronouncements-I

Introduction

1. This Standard describes the basic principles which govern the auditor's professional responsibilities and which should be complied with whenever an audit is carried out.
2. An audit is the 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 thereon². In this Standard, the term "financial information" encompasses financial statements.
3. Other Standards on Auditing to be issued by the Institute will elaborate on the principles set out herein to give guidance on auditing procedures and reporting practices.
4. Compliance with the basic principles requires the application of auditing procedures and reporting practices appropriate to the particular circumstances.

Integrity, Objectivity and Independence

5. The auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.

² .Para 3.1 of the "Preface to the Statement on Standard Auditing Practices" issued by the Council of the Institute of Chartered Accountants of India in 1982 states as follows:

"3.1 The SAPs will apply whenever an independent audit is carried out; that is, in the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size, or legal form (unless specified otherwise) when such an examination is conducted with a view to expressing an opinion thereon. The SAPs may also have application as appropriate, to other related functions of auditors."

The said Preface has been withdrawn pursuant to issuance of the Revised "Preface to Standards on Quality Control, Auditing, Review, Other Assurance and Related Service", by the Institute of Chartered Accountants of India. The Revised Preface is effective from April 1, 2008. The text of the revised Preface is reproduced elsewhere in this Handbook.

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Confidentiality

6. The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

Skills and Competence

7. The audit should be performed and the report should be prepared with due professional care by persons who have adequate training, experience and competence in auditing.

8. The auditor requires specialised skills and competence which are acquired through a combination of general education, technical knowledge obtained through study and formal courses concluded by a qualifying examination recognised for this purpose and practical experience under proper supervision. In addition, the auditor requires a continuing awareness of developments including pronouncements of ICAI on accounting and auditing matters, and relevant regulations and statutory requirements.

Work Performed by Others

9. When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, such as in the case of the work of branch auditors appointed under the Companies Act, 1956, the auditor's report should expressly state the fact of such reliance.

10. The auditor should carefully direct, supervise and review work delegated to assistants. The auditor should obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose.

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Documentation

11. The auditor should document matters which are important in providing evidence that the audit was carried out in accordance with the basic principles.

Planning

12. The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on a knowledge of the client's business.

13. Plans should be made to cover, among other things:

- (a) acquiring knowledge of the client's accounting system, policies and internal control procedures;
- (b) establishing the expected degree of reliance to be placed on internal control;
- (c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and
- (d) coordinating the work to be performed.

14. Plans should be further developed and revised as necessary during the course of the audit.

Audit Evidence

15. The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information.

16. Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect.

17. Substantive procedures are designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system.

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They are of two types:

- (i) tests of details of transactions and balances;
- (ii) analysis of significant ratios and trends including the resulting enquiry of unusual fluctuations and items.

Accounting System and Internal Control

18. Management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business. The auditor should reasonably assure himself that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal controls normally contribute to such assurance.

19. The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

20. Where the auditor concludes that he can rely on certain internal controls, his substantive procedures would normally be less extensive than would otherwise be required and may also differ as to their nature and timing.

Audit Conclusions and Reporting

21. The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. This review and assessment involves forming an overall conclusion as to whether:

- (a) the financial information has been prepared using acceptable accounting policies, which have been consistently applied;
- (b) the financial information complies with relevant regulations and statutory requirements;
- (c) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

22. The audit report should contain a clear written expression of opinion on the financial information and if the form or content of the report is laid down

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in or prescribed under any agreement or statute or regulation, the audit report should comply with such requirements. An unqualified opinion indicates the auditor's satisfaction in all material respects with the matters dealt with in paragraph 21 or as may be laid down or prescribed under the relevant agreement or statute or regulation, as the case may be.

23. When a qualified opinion, adverse opinion or a disclaimer of opinion is to be given or reservation of opinion on any matter is to be made, the audit report should state the reasons therefor.

Effective Date

24. This Standard on Auditing becomes operative for all audits relating to accounting periods beginning on or after April 1, 1985.

SA 200A (AAS 2)

OBJECTIVE AND SCOPE OF THE AUDIT OF FINANCIAL STATEMENTS

*(Effective for all audits relating to
accounting periods beginning on or after April 1, 1985)*

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Standard on Auditing (SA) 200A*, "Objective and Scope of the Audit of Financial Statements" should be read in the context of the "Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services" ³ , which sets out the authority of SAs.
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* Issued in April, 1985.

³ Published in the July 2007 issue of the Journal.

Introduction

1. This Standard describes the overall objective and scope of the audit of general purpose financial statements of an enterprise by an independent auditor. According to para 3.3 of the Preface to the Statements of Accounting Standards⁴ issued by the Institute of Chartered Accountants of India, “the term ‘General Purpose Financial Statements’ includes balance sheet, statement of profit and loss and other statements and explanatory notes which form part thereof, issued for the use of shareholders/members, creditors, employees and public at large.” References to financial statements in this Standard should be construed to refer to general purpose financial statements.

Objective of an Audit

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.

3. The auditor’s opinion helps determination of the true and fair view of the financial position and operating results of an enterprise. 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.

Responsibility for the Financial Statements

4. While the auditor is responsible for forming and expressing his opinion on the financial statements, the responsibility for their preparation is that of the management of the enterprise. Management’s responsibilities include the maintenance of adequate accounting records and internal controls, the selection and application of accounting policies and the safeguarding of the assets of the enterprise. The audit of the financial statements does not relieve management of its responsibilities.

Scope of an Audit

5. The scope of an audit of financial statements will be determined by the

⁴ The Preface to Statements of Accounting Standards issued in 1979 has been withdrawn pursuant to issuance of Revised Preface issued in 2004. The aspects relating to para 3.3. of original Preface are dealt by para 3.4 of the said Revised Preface, according to which General Purpose Financial Statements also includes Cash Flow Statements.

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auditor having regard to the terms of the engagement, the requirements of relevant legislation and the pronouncements of the Institute. The terms of engagement cannot, however, restrict the scope of an audit in relation to matters which are prescribed by legislation or by the pronouncements of the Institute.

6. The audit should be organised to cover adequately all aspects of the enterprise as far as they are relevant to the financial statements being audited. 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. 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.

7. 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 on which he wishes to rely and testing those internal controls to determine the nature, extent and timing of other auditing procedures; and
- (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.

8. 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 summarise the transactions and events recorded therein; and
- (b) considering the judgements that management has made in preparing the financial statements; accordingly, the auditor assesses the selection and consistent application of accounting policies, the manner in which the information has been classified, and the adequacy of disclosure.

9. The auditor's work involves exercise of judgement, for example, in deciding the extent of audit procedures and in assessing the reasonableness of the judgements and estimates made by management in preparing the financial statements. Furthermore, much of the evidence available to the auditor can enable him to draw only reasonable conclusions therefrom. Because of these factors, absolute certainty in auditing is rarely attainable.

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10. In forming his opinion on the financial statements, the auditor follows procedures designed to satisfy himself that the financial statements reflect a true and fair view of the financial position and operating results of the enterprise. The auditor recognises that because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any system of internal control, there is an unavoidable risk that some material misstatement may remain undiscovered. While in many situations the discovery of a material misstatement by management may often arise during the conduct of the audit, such discovery is not the main objective of audit nor is the auditor's programme of work specifically designed for such discovery. The audit cannot, therefore, be relied upon to ensure the discovery of all frauds or errors but where the auditor has any indication that some fraud or error may have occurred which could result in material misstatement, the auditor should extend his procedures to confirm or dispel his suspicions.

11. The auditor is primarily concerned with items which either individually or as a group are material in relation to the affairs of an enterprise. However, it is difficult to lay down any definite standard by which materiality can be judged. Material items are those which might influence the decisions of the user of the financial statements⁵. It is a matter in which a decision is arrived at on the basis of the auditor's professional experience and judgement.

12. 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.

13. Constraints on the scope of the audit of financial statements that impair the auditor's ability to express an unqualified opinion on such financial statements should be set out in his report, and a qualified opinion or disclaimer of opinion should be expressed, as appropriate.

Effective Date

14. This Standard on Auditing becomes operative for all audits relating to accounting periods beginning on or after April 1, 1985.

⁵ Accounting Standard (AS) 1, "Disclosure of Accounting Policies" issued by the Council of the Institute of Chartered Accountants of India.

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