# AAS-2: OBJECTIVE AND SCOPE OF THE AUDIT OF FINANCIAL STATEMENTS

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# INTRODUCTION

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 Standards' 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

- The **objective of an audit** of financial statements, prepared within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, is to **enable an auditor to express an opinion on such financial statements.**
- 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

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

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

# SCOPE OF AN AUDIT

2. The **audit** should be **organized** 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.

# SCOPE OF AN AUDIT

**3.** 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.

# SCOPE OF AN AUDIT

**4.** 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; and

**(b)** considering the judgments 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.

# SCOPE OF AN AUDIT

5. The **auditor's** work involves **exercise of judgment**, *for example*, in deciding the extent of audit procedures and in assessing the reasonableness of the judgments 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 there from. Because of these factors, absolute certainty in auditing is rarely attainable.

# SCOPE OF AN AUDIT

6. 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 recognizes 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.**

# SCOPE OF AN AUDIT

7. 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 statements. It is a matter in which a decision is arrived at on the basis of the **auditor's professional experience and judgment.**

# SCOPE OF AN AUDIT

8. 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.

# SCOPE OF AN AUDIT

9. **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.**