An audit is an **independent examination** of **financial information** of any **entity** whether profits oriented or not and irrespective of size and legal form, when such examination is conducted with a view to **express the opinion** thereon

Judgment of a person not subordinate to wishes of others (not under influence)

Used by	**Purpose**	**Adv**
Owner	Performance & profitability	Real picture of profits and partners share
Mgmt	Decision making	Judge Reasons for losses Ensure ICS
Lenders/ Creditors	Credit worthiness	Negotiating loans and judge recoverability
Customers	Consistency of business	
Govt.	Direct and indirect tax	Computation & Settling of taxes
Employees	Bonus	Discourage committing frauds Settling trade disputes related to bonus
Analyst	Investment opportunities	Devise expected profits
Insurer		Claim for damage

What ensures independence

1. Companies Act- provisions disqualifying certain persons undertaking audit
2. Vast powers to access books of accounts
3. Power to qualify report
4. Provisions for misconduct by CA in CA Act
5. Peer review- audit of CA by CA

Why independence

1. Maintain high degree of credibility of financial statements
2. Ensure reliability of accounting system

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1. Profit & Loss a/c
2. Balance Sheet
3. CFS
4. Notes to accounts

Disclosure of accounting policies- accounting principles and methods off applying them as per AS-1

Fundamental accounting assumptions- going concern, consistency and accrual

Partnership/prop./trust/AOP/BOI etc.

Charitable/religious also included

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Types of Audit

Required by Law | **Voluntary audit**

External auditor

1. Independent of mgmt
2. Reports to shareholders/ govt.
3. Concerned about true and fair view
4. Scope determined by law
5. Totally independent
6. Prescribed format by law

Internal auditor

1. Appointed by mgmt.
2. Reports to mgmt
3. Concerned about efficiency
4. Scope determined by mgmt.
5. Less independent
6. No prescribed format

Expression of opinion → **True and fair view** →

1. Statements prepared using acceptable policies, consistently applied
2. Prepared as per relevant regulation
3. Disclosure of material items

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Principal aspects covered → **Qualities required**

Examine ICS	Whether appropriate or not
Review system	Of accounting and maintaining records
Validity of transaction	Evidences available
Ascertain distinction	Between capital and revenue items
Comparison	P&L and BS with books of accounts
Verification of assets/ liabilities	Title/ existence
Statutory compliance	Banks/ govt. etc

Technical skills- good hand in audit and accounting system

Caution- Proper skill and care

Knowledge- clients business, laws

Communication skills- interact with officers, staff, third party

Judgment- as to sample size and which items to check

Logical skills- analyze and interpret

Tact- deal with different people/ situation

Integrity- honest, sincere, straight forward

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Limitations of audit

ICS	If controls are weak, no assurance can be obtained
Nature of evidence	Persuasive rather than conclusive
Involvement of judgment	May not always be correct
Test checking	Not possible to detail check, impossible to detect **fraud and errors**

Principles governing audit

1. Integrity, objectivity and independence
2. Confidentiality
3. Skill and competence
4. Work performed by others- delegated to staff, still responsible for his opinion
5. Documentation- matters related to audit, works as proof of checking
6. Planning- conduct audit effectively
7. Audit evidence
8. Accounting system and internal control
9. Audit conclusions and reporting

Objective of audit

Primary- Express his opinion on **true and fair view** of audit

Secondary- Detection of **misstatement** by taking proper care. It is the **responsibility of mgmt**. but if errors are evident, auditor should communicate the same

Audit risk

Inherent risk	Control risk	Detection risk
Risk of material misstatement	Internal control fails to operate	Substantive procedure may not detect material misstatement
Arises at level of mgmt.	Arises at level of mgmt.	Arises at auditors level
If high, risk is assessed as high	If high risk is assessed as high	Inversely proportional to IR and CR

Types of errors

By nature

Self revealing errors	Appears during accounting	Cheque withdrawn not accounted
Non self revealing errors	Not appear while preparing accounts	Revenue exp. Shown as capital exp.
Unintentional error	Not deliberate mistakes	Unaccounted records
Intentional errors	Deliberate mistakes	Bad debts recovered not recorded
Unconcealed error	No efforts made to conceal error	
Concealed error	Fraudulent error	
Error affecting trial bal	TB does not tally	
Not effecting trial bal	TB tallies	

Accounting error

Error of principle	Fundamentally incorrect entry
Compensating error	Nullified by impact of other entry
Error of omission	Transaction not recorded wholly or partly
Error of commission	Incorrect recording of transaction

Audit vs. Investigation

Audit	Investigation
Scope- true and fair view	Critical examination af accounts for special purpose
Period usually is 1yr	More than 1year may be covered
Covers books of accounts	May cover other records
Only qualified persons permitted	Person employed or outside agency may perform
Appointed by shareholders	Third party appoints investigators
Testing approach	Exhaustive and thorough checking
Financial aspects covered	Non financial aspects also covered
Not based on suspicion	Based on suspicion

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Continuous audit

1. Done by continuous visit of auditor
2. Detailed checking can be done
3. Early detection of fraud and errors but requires surprise checking
4. Staff deters from committing fraud
5. uneconomical
6. client may tamper entries after checking which can be stopped by special audit marks
7. interruption of work
8. stage wise completion required else missing links will occur while checking
9. time consuming

Final audit

1. Done when books are closed
2. Cost effective
3. No interruption of work
4. Only a post mortem analysis
5. Only sample testing can be done

Interim audit

Audit done between 2 audits, generally for declaring dividends

Joint Audit

Audit done by more than 1 auditor

1. Pooling of expertise
2. Lower work load
3. Fees being shared
4. Superiority complex may occur
5. Problems of coordination
6. Lack of clear definition of responsibility