ISA-200

Overall Objectives of the independent auditor and the conduct of audit in accordance with international standards on auditing

1-Purpose of Audit: The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with applicable financial reporting framework. An audit conducted in accordance with ISAs and relevant ethical requirements enables the auditor to form that opinion.

2-Scope of Audit: Scope of an audit is determined in accordance with the requirements of legislation, regulations of relevant professional bodies, and where appropriate, in accordance with the terms of appointment and requirements of client.

3-Responsibilities of Management and Those Charged with Governance: The financial statements subject to audit are those of entity, prepared by management of entity with oversight from those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

4-Premise/ Preconditions for accepting an audit engagement: premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted—that management and, where appropriate those charged with governance have acknowledged and understand that they have the following responsibilities that are fundamental to the conduct of an audit.

1- For the preparation of financial statements in accordance with applicable financial reporting framework that give a true and fair view.
2- For such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement whether due to error or fraud. and
3- To provide the auditor with:
   a- Access to all information of which management and, where appropriate, Those charged with governance are aware and that is relevant to the preparation of financial statements such as records, documentations, and other matters;
   b- Additional information that the auditor may request from management and, where appropriate, those charged with management for the purpose of audit; and
   c- Unrestricted access to persons within the entity from when the auditor determine it necessary to obtain audit evidence.

5-Users of Financial Statements & Their information needs:

1) Investors— To help them determine whether they should buy hold or sell the shares/securities etc.
2) Employees— To know about stability & profitability of their employer.
3) Lenders— To enable them to determine whether their loan and interest will be paid when due.
4) Suppliers— To enable them to determine creditability of organization.
5) Customers— To know about continuance of enterprise.
6) Government—In order to regulate the activities of enterprises.
7) Public **8)** Managers **9)** Financial Analysts **10)** Advisors**.**

6-Basis of Auditor's Opinion: ISAs require the auditor to obtain reasonable assurance about whether the financial statements are as a whole free from material misstatement, whether due to error or fraud. Reasonable assurance is a high level of assurance. It is obtained when auditor has obtained sufficient appropriate audit evidence to

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reduce the audit risk to acceptably low level. However, reasonable assurance is not an absolute level of assurance because there are inherent limitations of an audit.

7-Inherent Limitations of Audit:

1- Need for judgment
2- Test nature of Audit
3- Inherent limitations of Internal control
4- Evidences available are persuasive rather than conclusive.
5- Planned frauds are difficult to be located

8-Reasons behind inherent limitations of audit:

1- The nature of financial statements.
2- The nature of audit procedures.
3- The need for the audit to be conducted within a reasonable time at a reasonable cost.

9-Results of inherent limitations of audit and subsequent discovery of misstatements: Because of inherent limitations of an audit there is an unavoidable risk that some material misstatements of financial statements may not be detected, even though the audit is properly planned and performed in accordance with ISAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with ISAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence.
Whether the auditor has performed an audit in accordance with ISAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor.

10-Materiality: The concept of materiality is applied by the auditor both in planning and performance of audit. In general, misstatements, including omissions are considered to be material if, individually or in aggregate they could reasonably be expected to influence the economic decisions of users taken on the basis of financial statements.

11-Responsibilities of an Auditor: The ISAs require that an auditor should **exercise professional judgment** and **maintain professional behavior** throughout the planning and performance of the audit and, among other things:

- **Identify and assess the risks of material misstatements**, whether due to error or fraud, based on an understanding of the entity and its environment including the entity's internal control;
- **Obtain sufficient appropriate audit evidence** about whether material misstatements exist, through designing and implementing appropriate responses to assessed risks; and
- **Form an opinion** on the financial statements based on conclusions drawn from the audit evidence obtained.

12-Professional Judgment: The application of relevant training, knowledge & expertise, within the context provided by auditing, accounting & ethical standards in making informal decisions in the circumstances of audit engagement is called professional judgment. It is essential to proper conduct of an audit. It is necessary in particular regarding decisions about:

- Materiality
- Audit Risk
- Nature, timing and extent of audit procedure used to meet the requirements of ISAs and gather audit evidence
- Evaluating whether sufficient appropriate audit evidence has been obtained
- Evaluation of management's judgments in applying the entity's applicable financial reporting framework

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- Assessing the reasonableness of estimates made by management in preparing financial statements.

13-Professional Skepticism: An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and critical assessment of audit evidences is called professional skepticism. Professional skepticism includes being alert to:

- Audit evidences which contradicts with other audit evidences obtained;
- Information that brings into question the reliability of the documents and responses to inquiries to be used as audit evidence;
- Conditions that may include possible fraud; and
- Circumstances that suggest the need for audit procedures in addition to those as required by ISAs.

14-Overall objectives of an auditor:

- To obtain reasonable assurance about whether the financial statements, as a whole, are free from material misstatement.
- To report on financial statements, and communicate as require by ISAs, in accordance with auditor's findings.

15-Objectives of having an audit: The primary objective of having an audit is to enable the auditor to form and express a professional and independent opinion on whether the financial statements give a true and fair view of the financial position of the company and of its profit and/or loss account for the period under review. Other objectives are:

- To ensure compliance with statutory requirements;
- To detect frauds and errors in accounting record ;
- To advice client for improvement in financial system;
- To prevent frauds and errors; and
- Moral Check.

16-Disadvantages of having an audit:

- If you have an audit you have to pay for it. The auditor's fee and expenditure can be high which is one major reason why businesses which are not required to have an audit rarely do it.
- The nature of audit involves the use of client's record and taking up staff and management's time. This is also disruptive to some degree.

17-Steps taken by auditor before forming an opinion:

1. Audit is organized in such a way that it covers all areas.
2. Records are reliable and sufficient.
3. Sufficient understanding of financial system and internal control system is obtained.
4. Professional Judgment is applied in deciding the nature and extent of work done.
5. Financial statements are properly disclosed.
6. Relevant information is properly disclosed.

18-Audit Evidence: Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based is called audit evidence. It includes both information contained in accounting record and other information.

19-Audit Risk: The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated is called audit risk.

20-Detection Risk: The risk that the procedures performed by the auditor to reduce the audit risk to acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements is called detection risk.

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21-Risk of material misstatement: The risk that the financial statements are materially misstated prior to audit is called Risk of Material Misstatement. This consists of two components.

I- **Inherent Risk:** The susceptibility of an assertion to misstatement that could be material before consideration of any related accounts is called Inherent Risk.

II- **Control Risk:** The risk that a misstatement that could occur in an assertion and that could be material, will not be prevented, or detected or corrected by entity's internal controls on a timely basis is called Control Risk.

22-Misstatement: A difference between the amount, classification, presentation or disclosure of a reported financial statement item and the amount, classification, presentation or disclosure that is required for that item to be in accordance with applicable financial reporting framework. Misstatements can arise due to error or fraud.

23-Fundamental principles of professional ethics:

- Independence
- Integrity
- Objectivity
- Professional Competence & Due Care
- Confidentiality
- Professional Behavior
- Technical Standards

24-Sufficient and Appropriate Audit evidence: The sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of quantity of audit evidence. The quantity of audit evidence is affected by auditor's assessment of risks of misstatement and also by the quality of such audit evidence. Appropriateness is the measure of quality of audit evidence i.e. its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

25-True and Fair View: The idea of true & fair view involves a certain level of abstraction but it can be described in an appropriate manner as following:

Truth: An auditor should gather sufficient appropriate audit evidence during the audit about the truthfulness of financial statements. This implies that the financial statements are based upon facts & realities, these are not erroneous, representing things as it is, and in accordance with reasonable or correct audit evidence.

Fair view: The auditor should ensure the fairness of financial statements based upon followings:

- The accounts should show all material facts effecting profits & valuation of assets & liabilities.
- All unusual, exceptional or non-recurring items of income & expenditure should be disclosed separately.
- There should be no misstatement.
- The prior income, expenses and adjustments should be separately disclosed.
- The accounts should neither overstate nor understate the financial position.
- The events subsequent to the data of balance sheet must have been appropriately dealt with in accounts.
- The accounts should also comply with the presentation & disclosure requirements of law contained in schedule IV or V of Companies Ordinance, 1984.

26-Qualitative Characteristics of financial statements giving true & fair view.

- Understandability
- Relevance—Materiality
- Reliability—Faithful representation, Substance over form, Neutrality, Prudence, Competence
- Comparability

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27-Matters that enhance the effectiveness of audit procedures and its application:

1. Adequate planning
2. Proper assignment of personal in engagement team
3. Application of professional skepticism
4. Supervision and review of audit work performed.

28-Sources that may provide directions on application of financial reporting framework:

- Legal & Ethical environment including statutes, regulations, court decisions, and professional ethical obligations.
- Published accounting interpretations of varying authority issued by standard setting, professional or regulatory organizations.
- Published views of varying authority on emerging accounting issues issued by standard setting professional or regulatory organization.
- General & industry practices widely recognized & relevant.
- Accounting literature.

29-Assurance engagement and its elements: "Assurance engagement is an engagement in which auditor is required to express an opinion on a subject matter whether the subject matter conforms in all material respects with suitable criteria giving a high level of assurance." Elements of an assurance engagement are:

- A three party relationship involving a professional accountant a responsible party and an intended user.
- A subject matter
- Suitable criteria
- An engagement process
- A conclusion

IMPORTANT POINTS

- The auditor shall not represent compliance with ISAs in the auditor's report unless he has complied with the requirements of this ISA and all other ISAs relevant to the audit.
- In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an ISA. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement. The need for the auditor to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and in the specific circumstances of the audit that procedure would be ineffective in achieving the aim of the requirement.
- If an objective in a relevant ISA can't be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with ISAs, to modify the auditor's opinion or withdraw from engagement. Failure to achieve an objective represents a significant matter requiring documentation in accordance with ISA-230.
- In all cases when reasonable assurance can't be obtained and a qualified opinion is insufficient in the circumstances, the ISAs require that the auditor disclaim an opinion or withdraw or resign from engagement where withdrawal is possible under the applicable law or regulations.
- Fundamental accounting assumptions are: (i) Going Concern (ii) Accrual (iii) Consistency
- Where conflicts exist between the financial reporting framework and other sources from which directions on its application may be obtained, the source with highest authority prevails.
- The form of opinion expressed by the auditor will depend upon the applicable financial reporting framework and any applicable law or regulation.
- Where the financial reporting framework is a fair presentation framework, the opinion required by the ISAs is on whether the financial statements are presented fairly, in all material respects, or give a true & fair view.

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Where the financial reporting framework is a compliance framework, the opinion required is on whether the financial statements are prepared, in all material respects, in accordance with the framework.

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