

# 1. FUNDAMENTALS OF AUDITING

## 1. BOOKS OF ACCOUNTS:

As per companies act, 2013 “books of account” as defined in Section 2(13) includes records maintained in respect of:

- all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
- all sales and purchases of goods and services by the company;
- the assets and liabilities of the company; and
- The items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.3

## 2. FINANCIAL STATEMENTS:

### a) Definition as per SA 200:

A structured representation of historical financial information, including related notes, intended to communicate an entity’s economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework.

The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information.

### b) Definition as per Companies Act:

Financial statements includes following

- Profit and Loss account or Income and Expenditure account
- Balance Sheet
- Cash flow Statement
- Statement of change in equity, if applicable

Any explanatory notes annexed to or forming part of financial statements

### c) Users of financial statements:

Users	Purpose
<b>Management</b>	For day-to-day decision-making and <u>performance evaluation</u> .
<b>Proprietor / Shareholders</b>	To analyse performance, <u>profitability</u> and financial position. <b>Note:</b> Prospective investors are interested in the track record of the company.
<b>Lenders - Banks &amp; Fin. Institutions</b>	To determine the financial position and <u>strength</u> of the Company, Debt Service Coverage, etc.
<b>Suppliers</b>	To determine the <u>credit worthiness</u> of the company.
<b>Customers</b>	To know the <u>general business viability</u> before entering into long-term contracts and arrangements.
<b>Government</b>	<ul style="list-style-type: none"> <li>• To ensure prompt collection of Direct and Indirect Tax revenues.</li> <li>• To evaluate performance and contribution to social objectives.</li> </ul>
<b>Research scholars</b>	For study, <u>research</u> and analysis purpose.
<b>Employees</b>	Job security, bonus.

## 3. APPLICABLE FINANCIAL REPORTING FRAMEWORK:

(N17 - 4M)

In view of the nature of the entity and the objective of the financial statements the management adopt the financial reporting framework in the preparation and presentation of the financial statements.

In other words, a financial reporting framework is nothing but, set of rules and regulations that are to be followed for preparation and presentation of financial statements.

E.g: For a company the AFRFW is Sch-III and Accounting standards

4. **GENERAL PURPOSE FINANCIAL STATEMENTS (GPFS):** (M17 - 4M)  
If the F/S are prepared in accordance with General Purpose Framework (GPFW) then they are called as GPFS.
5. **SPECIAL PURPOSE FINANCIAL STATEMENTS (SPFS):**  
Financial statements prepared in accordance with a special purpose framework.  
In other words, if the financial statements are prepared as per the requirement of a specific user then these financial statements are said to be SPFS.
6. **GENERAL PURPOSE FRAMEWORK:**  
A financial reporting framework designed to meet the common financial information needs of a wide range of users. (Framework - Rules and Regulations)  
**Characteristics of GPFW:**
- Fundamental accounting assumptions are followed in this framework.
  - GAAP is applied only in this framework.
  - Accounting standards are also followed in this framework.
  - These financials are prepared usually on annual basis and periodically.
- This financial reporting framework may be a Compliance Framework (or) a Fair Presentation Framework.
7. **COMPLIANCE FRAMEWORK (CFW):**
- It refers to a framework where F/S are prepared and presented in accordance with the requirements of such framework without any departure.
  - The words "True and Fair View" do not appear in the financial statements in this type of framework.
  - **E.g.:** Most of the special purpose financial statements are prepared as per compliance framework.
8. **FAIR PRESENTATION FRAMEWORK:**
- It refers to a framework where F/S are prepared and presented in accordance with the requirements of such framework (CFW) AND Contains disclosures beyond the requirements of such framework or may depart from the requirement of the framework, so as to achieve fair presentation.
  - The words true and fair view appear only in this framework.  
**E.g:** Most of the general purpose financial statements are prepared as per fair presentation framework.
9. **LEGAL FORM:**  
There are several types of legal forms in which people ordinarily do businesses.  
The following are the various types of legal forms:
- Proprietorship firm
  - Partnership firm
  - Limited Liability Partnership
  - Society and
  - Company
10. **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 the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

**11. FRAUD:**

An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

**a) Fraudulent financial reporting:**

It involves intentional misstatements, including omissions of amounts or disclosures in financial statements, to deceive financial statement users. Either Overstatement or understatement of performance / position.

**b) Misappropriation of assets:**

Involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. Also it involved misuse of resources.

**12. ERROR:**

The term "error" refers to unintentional mistakes in financial statements such as:

- Clerical errors, like errors of omission, errors of commission, errors of duplication and compensating errors.
- Misapplication of accounting policies (Called errors of principle).
- From the point of view of audit these errors are two types namely – Self revealing errors and Non-self-revealing errors.

**13. MEANING OF AUDIT:**

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

**14. OBJECTIVE OF THE AUDIT/AUDITOR:**

To express opinion on financial statements in order to ensure

- whether the financial statements are free from material misstatements and
- Whether they are prepared as per Applicable Financial Reporting Framework.

**15. AUDITOR:**

"Auditor" is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. Where an SA expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "auditor" is used.

Practically the meaning of auditor includes the following persons (mentioned in Point No. 16)

**16. ENGAGEMENT TEAM:**

- a) Engagement Partner
- b) Audit Manager
- c) Paid assistant
- d) Senior article assistant
- e) Junior article assistant
- f) Any other designation

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To **MASTER MINDS**, Guntur

**THE END**