

## NSA 01

# OBJECTIVES AND GENERAL PRINCIPLES GOVERNING AN AUDIT OF FINANCIAL STATEMENTS

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## **Introduction**

01. The purpose of this Nepal Standards on Auditing (NSA) is to establish standards and provide guidance on the objective and general principles governing an audit of financial statements. This NSA is to be read in conjunction with the Preface to Nepal Standards on Auditing.
02. This NSA contains the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material.
03. Compliance with the basic principle requires the application of auditing procedures and reporting practices appropriate to the particular circumstances.
04. This NSA needs only be applied to material matters.

## **Objective of an Audit**

05. **The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework.** The phrases used to express the auditor's opinion are "give a true and fair view" or "present fairly in all material respects" which are equivalent terms.

Although the auditor's opinion enhances the credibility of the financial statements, the user cannot assume that the opinion is an assurance as to the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

## General Principles of an Audit

**06. The auditor should comply with ethical principles governing professional responsibilities.**

07. Ethical principles governing the auditor's professional responsibilities are :

a) Integrity, Objectivity and Independence

The auditor should be straight forward, honest and sincere in rendering professional services. The auditor must be fair and should not allow prejudice, bias or influence of others to override his/her objectivity. The auditor 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, objectivity and independence. The auditor should be independent in fact and appearance.

b) Professional Competence and Due Care

The auditor should perform professional services with due care and competence and has a continuing duty to maintain professional knowledge and skill at a level required to ensure that the client receives the advantage of competent professional service.

c) Confidentiality

The auditor should respect the confidentiality of information acquired during the course of performing professional services and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose.

d) Professional Behaviour

The auditor should act in a manner consistent with the good reputation of the profession and refrain from any conduct that might bring discredit to the profession.

e) Technical Standards

The auditor should carry out professional services in accordance with the relevant technical and professional standards. Auditors have a duty to carry out with care and skill, instructions of clients insofar as they are compatible with the requirements of integrity, objectivity and independence.

**08. The auditor should conduct an audit in accordance with the Nepal Standards on Auditing.** These contain basic principles and essential procedures together with related guidance in the form of explanatory and other material.

**09. The auditor should plan and perform the audit with an attitude of professional skepticism recognizing that circumstances may exist which cause the financial statements to be materially misstated.** An attitude of professional skepticism means the auditor makes a critical assessment, with a questioning mind, of the validity of audit evidence obtained and is alert to audit evidence that contradicts or brings into question the reliability of documents or management representation. For example, an attitude of professional skepticism is necessary throughout the audit process for the auditor to reduce

the risk of overlooking suspicious circumstances, of overgeneralizing when drawing conclusions from audit observations, and of using faulty assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof. In planning and performing an audit, the auditor neither assumes that management is dishonest nor assumes unquestioned honesty. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.

### Scope of an Audit

10. The term "Scope of an Audit" refers to the audit procedures deemed necessary in the circumstances to achieve the objective of the audit. **The procedures required to conduct an audit in accordance with NSA should be determined by the auditor having regard to the requirements of NSA, relevant professional bodies, legislation, regulations and, where appropriate, the terms of the audit engagement and reporting requirements.**

### Reasonable Assurance

11. An audit in accordance with NSA is designed to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process.
12. However, there are inherent limitations in an audit that affect the auditor's ability to detect material misstatements. These limitations result from factors such as :
  - a) The use of testing
  - b) The inherent limitations of any accounting and internal control system (e.g. the possibility of collusion)
  - c) The fact that most audit evidence is persuasive rather than conclusive
13. The work undertaken by the auditor to form an opinion is permeated by judgment, in particular regarding:
  - a) The gathering of audit evidence, e.g. in deciding the nature, timing and extent of audit procedures; and
  - b) The drawing of conclusion based on audit evidence gathered, e.g. assessing the reasonableness of the estimates made by management in preparing the financial statements.
14. Other limitations may affect the persuasiveness of evidence available to draw conclusions on particular financial statement assertions (e.g. transactions between related parties). In these cases certain NSA(s) identify specified procedures which will, because of the nature of the particular assertions provide sufficient appropriate audit evidence in the absence of :
  - a) Unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or

- b) Any indication that a material misstatement has occurred.

### **Responsibility for the Financial Statements**

- 15. While the auditor is responsible for forming and expressing an opinion on the financial statements, the responsibility for preparing and presenting the financial statements is that of the management of the entity. The audit of the financial statements does not relieve management of its responsibility.

### **Compliance with International Standards on Auditing**

- 16. Compliance with this NSA ensures compliance in all material respects with ISA 200 (Objectives and General Principles Governing an Audit of Financial Statements)

### **Effective Date**

- 17. This Nepal Standards on Auditing becomes operative for Financial Statements covering periods beginning on or after 01 Shrawan, 2060 corresponding to July 17, 2003.

### **Public Sector Perspective**

- 1. *Irrespective of whether an audit is being conducted in the private or public sector, the basic principles of auditing remain the same. What may differ for audits carried out in the public sector is the audit objective and scope. These factors are often attributable to differences in the audit mandate and legal requirements or the form of reporting (for example, public sector entities may be required to prepare additional financial reports).*
- 2. *When carrying out audits of public sector entities, the auditor will need to take into account the specific requirements of any other relevant regulations, ordinances or directives from appropriate authorities which affect the audit mandate and any special auditing requirements, including the need to have regard to issues of national security. Audit mandates may be more specific than those in the private sector; and often encompass a wider range of objectives and a broader scope than is ordinarily applicable for the audit of private sector financial statements. The mandates and requirements may also effect, for example, the extent of the auditor's discretion in establishing materiality, in reporting fraud and error, and in the form of the audit report. Differences in audit approach and style may also exist. However, these differences would not constitute a difference in the basic principles and essential procedures.*