

# CONTENTS

	PAGE
<i>Preface to second edition</i>	I-5
<i>Preface to first edition</i>	I-7
<i>Syllabus</i>	I-9
<i>Chapter-heads</i>	I-11

## 1 **INTRODUCTION**

<b>1.1</b>	Meaning and definition of auditing	1
<b>1.1-1</b>	Narrow concept of auditing	1
<b>1.1-2</b>	Auditing in a broad sense	2
<b>1.1-3</b>	Elements of financial audit	4
<b>1.2</b>	Book-keeping, accountancy and auditing	4
<b>1.2-1</b>	Book-keeping	4
<b>1.2-2</b>	Accountancy	5
<b>1.2-3</b>	Auditing	5
<b>1.3</b>	Objectives of auditing	5
<b>1.4</b>	Objectives of financial audit	5
<b>1.4-1</b>	Evolution of the objectives	5
<b>1.4-2</b>	Primary objective of an audit - Expression of opinion as to truthfulness and fairness of financial statements	6
<b>1.4-3</b>	Secondary objective - Detection and prevention of frauds and errors	7
<b>1.4-4</b>	Auditor's duty with regard to detection and prevention of frauds and errors	10
<b>1.5</b>	Advantages of auditing	11
<b>1.5-1</b>	To owners - Present and potential	12
<b>1.5-2</b>	To others	12
<b>1.5-3</b>	To management	13
<b>1.6</b>	Inherent limitations	13
<b>1.7</b>	Structure of audit theory	14

## CONTENTS

**I-14**

	PAGE
1.7-1 Postulates	14
1.7-2 Concepts/Principles	15
1.7-3 Standards	15
1.7-4 Procedures	16
1.7-5 Techniques	16
1.7-6 Difference between standards and procedures	16
1.7-7 Difference between principles and techniques	17
1.8 Qualities of an auditor	17
1.9 Relationship with Accounting	18
1.10 Distinction between auditing and investigation	20
KEY POINTS	21
TEST YOUR KNOWLEDGE	23

## 2 TYPES OF AUDIT

2.1	Introduction	27
2.2	Classification on the basis of organisational structure	28
2.2-1	Private audit	28
2.2-2	Government audit	29
2.2-3	Statutory audit	30
2.2-4	Distinction between audit of a limited company and audit of a firm	30
2.3	Classification on the basis of specific objectives	31
2.3-1	Independent financial audit	31
2.3-2	Internal audit	31
2.3-3	Independent audit v. Internal audit	32
2.3-4	Cost audit	32
2.3-5	Management audit	32
2.3-6	Tax audit	33
2.3-7	Secretarial audit	33
2.4	Classification on the basis of time	34
2.4-1	Continuous audit	34
2.4-2	Annual audit	36
2.4-3	Continuous audit v. Annual audit	37
2.4-4	Interim audit	37

	PAGE
2.4-5 Balance sheet audit	37
2.4-6 Continuous audit v. Balance sheet audit	38
2.5 Classification on the basis of scope of audit	39
2.5-1 Complete audit	39
2.5-2 Partial audit	39
2.5-3 Detailed audit	39
KEY POINTS	40
TEST YOUR KNOWLEDGE	43

### 3

#### AUDIT PLANNING AND DOCUMENTATION

3.1 Overview of audit process	46
3.2 Considerations for commencing an audit	47
3.3 Audit programme	50
3.3-1 Concept	50
3.3-2 Development of audit programme	50
3.3-3 Advantages of an audit programme	51
3.3-4 Disadvantages of an audit programme and safeguards	53
3.4 Audit notebook	54
3.4-1 Concept	54
3.4-2 Contents	54
3.4-3 Advantages	54
3.4-4 Disadvantages	55
3.5 SA 230 (Revised) : Audit documentation	55
3.6 Filing of working papers	56
3.7 Ownership and custody of working papers	57
KEY POINTS	58
TEST YOUR KNOWLEDGE	60

### 4

#### INTERNAL CONTROL SYSTEM

4.1 Introduction	62
4.2 Meaning and nature of internal control system	62
4.3 Features	62

	PAGE
<b>4.4</b> Inherent limitations of internal control (as laid down by SA 315)	63
<b>4.5</b> Components of an internal control system	64
<b>4.6</b> Internal control system and the auditor	65
<b>4.6-1</b> Study and evaluation of internal control system	65
<b>4.6-2</b> Material weakness in internal control	66
<b>4.6-3</b> Surprise checks (based on Guidance Note on Surprise Checks issued by ICAI)	66
<b>4.7</b> Internal check	67
<b>4.7-1</b> Definition	67
<b>4.7-2</b> Objects/characteristics of internal check system	67
<b>4.7-3</b> Advantages of internal check	68
<b>4.7-4</b> Disadvantages of internal check	68
<b>4.7-5</b> Internal check and the auditor	68
<b>4.7-6</b> Cut-off procedures	69
<b>4.8</b> Internal audit	70
<b>4.8-1</b> Meaning and definition	70
<b>4.8-2</b> Scope of internal audit (on the basis of SA 610)	70
<b>4.8-3</b> Growing need in India	71
<b>4.8-4</b> Relationship between internal auditor and statutory auditor	72
<b>4.9</b> Inter-relationship of internal control, internal check and internal audit	73
<b>4.9-1</b> Internal control and internal check	73
<b>4.9-2</b> Internal audit and internal check	73
<b>4.10</b> Internal check with regard to specific transactions	74
<b>4.10-1</b> Credit sales	74
<b>4.10-2</b> Cash receipts (including from debtors)	77
<b>4.10-3</b> Cash sales at counter	78
<b>4.10-4</b> Purchase of goods for inventory	79
<b>4.10-5</b> Cash payments (including to creditors)	80
<b>4.10-6</b> Petty cash payments	81
<b>4.10-7</b> Wages and salaries	82
<b>4.10-8</b> Stock	84
<b>4.10-9</b> Sales return	86
<b>4.10-10</b> Purchase returns	86

	PAGE
<b>4.11</b> Major types of frauds and errors	87
<b>4.11-1</b> Sales and cash receipts	87
<b>4.11-2</b> Purchases and cash payments	88
<b>4.11-3</b> Wages	89
<b>4.11-4</b> Stock	89
KEY POINTS	90
TEST YOUR KNOWLEDGE	93
<b>Annex 4.1 :</b> Section 177 of the Companies Act, 2013 contains the provisions with regard to the audit committee	96

## 5

### EVIDENCE IN AUDITING

<b>5.1</b> Significance of audit evidence	98
<b>5.2</b> Basic principles relating to audit evidence	98
<b>5.3</b> Procedures to obtain evidence	100
<b>5.4</b> Test checking/selective verification	102
<b>5.4-1</b> Concept	102
<b>5.4-2</b> Importance	102
<b>5.4-3</b> Safeguards for the application of test checking	102
<b>5.4-4</b> Advantages	103
<b>5.4-5</b> Disadvantages	103
<b>5.4-6</b> Test checking and audit-in-depth	103
<b>5.4-7</b> Test checking and routine checking	104
<b>5.4-8</b> Auditor's duty regarding test checking	105
KEY POINTS	105
TEST YOUR KNOWLEDGE	105

## 6

### VOUCHING

<b>6.1</b> Introduction	107
<b>6.2</b> Meaning and definition of vouching	107
<b>6.3</b> Objects of vouching	108
<b>6.4</b> Routine checking and vouching	108
<b>6.5</b> Vouchers	108
<b>6.5-1</b> Types of voucher	108

## CONTENTS

**I-18**

	PAGE
6.5-2 Examination of voucher/Principles of vouching	108
6.5-3 Missing vouchers	109
6.6 Importance of vouching	110
6.7 Vouching of sales items	111
6.7-1 Vouching of credit sales	111
6.7-2 Sales return	112
6.8 Vouching of purchase transactions	112
6.8-1 Credit purchases	112
6.8-2 Purchase returns	113
6.9 Vouching of cash receipts or debit side of cash book	114
6.9-1 General approach	114
6.9-2 Vouching of cash sales	114
6.9-3 Rent received	115
6.9-4 Dividends and interest income	116
6.9-5 Commission	116
6.10 Vouching of cash payments	118
6.10-1 General approach	118
6.10-2 Cash purchases	119
6.10-3 Wages and salaries	119
6.10-4 Freight and carriage expenses	120
6.10-5 Repairs and renewals	121
6.10-6 Agent's commission	121
TEST YOUR KNOWLEDGE	122

## 7

### VERIFICATION OF ASSETS

7.1 Meaning and definition of verification of assets	124
7.2 Objects of verification of assets	124
7.3 Difference between vouching and verification	125
7.4 Difference between verification and valuation of assets	126
7.5 Auditor's duty with regard to valuation of assets	126
7.6 Verification of specific fixed assets	127
7.6-1 Freehold land	127
7.6-2 Building	128

	PAGE
7.6-3 Plant and machinery	129
7.6-4 Furniture and fixtures	129
7.6-5 Motor vehicles	130
7.7 Verification of intangible assets	132
7.7-1 Patents	132
7.7-2 Copyrights	133
7.7-3 Trademarks	133
7.7-4 Goodwill	135
7.8 Current assets	135
7.8-1 Investments	135
7.8-2 Debtors	136
7.8-3 Cash-in-hand	137
7.8-4 Cash at bank	137
7.8-5 Inventories	139
7.8-6 Bills receivable	142
7.9 Verification of other items	144
7.9-1 Deferred revenue expenditure/Miscellaneous expenditure	144
7.9-2 Capital commitments	145
KEY POINTS	145
TEST YOUR KNOWLEDGE	146

## 8

### VERIFICATION OF LIABILITIES

8.1 Concept	149
8.2 Objects of verification of liabilities	149
8.3 Audit procedures for verification of liabilities	150
8.3-1 Loans and borrowings	150
8.3-2 Trade creditors	151
8.3-3 Contingent liabilities	151
8.3-4 Provision for income-tax	152
8.3-5 Debentures	153
TEST YOUR KNOWLEDGE	153

**9**

**COMPANY AUDITOR : APPOINTMENT AND REMOVAL**

<b>9.1</b>	Eligibility for appointment of an auditor	155
<b>9.1-1</b>	Auditor's qualifications	155
<b>9.1-2</b>	Disqualifications of an auditor	155
<b>9.1-3</b>	Automatic vacation on becoming disqualified	156
<b>9.2</b>	Appointment of auditor	156
<b>9.2-1</b>	Appointment of Auditor of listed as well as company to which Companies (Audit and Auditors') Rules, 2014	157
<b>9.2-2</b>	Appointment of auditor in case of Government companies (section 139)	159
<b>9.3</b>	Compulsory re-appointment	159
<b>9.4</b>	Ceiling on number of audits	160
<b>9.5</b>	Remuneration of the auditor	160
<b>9.6</b>	Removal of auditor	161
<b>9.6-1</b>	Removal of auditor from his office before the expiry of his term	161
<b>9.6-2</b>	Resignation of the auditor	161
<b>9.6-3</b>	Appointment of an auditor in place of a retiring auditor	161
<b>9.6-4</b>	Power of Tribunal to direct removal of auditor	162
	TEST YOUR KNOWLEDGE	162

**10**

**RIGHTS AND DUTIES OF A COMPANY AUDITOR**

<b>10.1</b>	Rights/Powers of an auditor	165
<b>10.2</b>	Duties of Auditor	166
<b>10.3</b>	Branch Audit	167
	TEST YOUR KNOWLEDGE	168

**11**

**AUDITOR'S REPORT**

<b>11.1</b>	The audit report : As a means of communication	169
<b>11.2</b>	Certificate v. Report	169
<b>11.3</b>	Elements of audit report	170
<b>11.4</b>	Audit report of a limited company	171
<b>11.4-1</b>	Duty to report	171



	PAGE
<b>11.4-2</b> Duty to enquire	172
<b>11.4-3</b> Duty to report on additional matters	174
<b>11.5</b> True and fair view	176
<b>11.5-1</b> Objective of financial audit	176
<b>11.5-2</b> Meaning of a 'true and fair view'	176
<b>11.6</b> Types of audit report	177
<b>11.6-1</b> Unmodified opinion report	177
<b>11.6-2</b> Audit report with an 'emphasis of matter' or 'other matter' paragraph	178
<b>11.6-3</b> Modified report	179
<b>11.6-4</b> Difference between qualified opinion, disclaimer of opinion and adverse opinion	181
<b>11.6-5</b> Difference between clean audit report and qualified audit report	182
KEY POINTS	183
TEST YOUR KNOWLEDGE	184
<b>Annex 11.1</b> : The Companies (Auditor's Report) Order, 2003	187

## 12

### LIABILITIES OF AUDITOR

<b>12.1</b> Introduction	190
<b>12.2</b> Classification of liabilities of the auditor	190
<b>12.3</b> Civil liability under common law	191
<b>12.3-1</b> Liability for negligence towards clients	191
<b>12.3-2</b> Liability for negligence towards third parties	192
<b>12.4</b> Liability under the Companies Act, 2013	194
<b>12.4-1</b> Civil liability under the Companies Act	194
<b>12.4-2</b> Criminal liability under the Companies Act	195
KEY POINTS	197
TEST YOUR KNOWLEDGE	198
<b>Annex 12.1</b> : Some of the legal cases and decisions discussed in detail	199

## 13

### COST AUDIT

<b>13.1</b> Meaning	200
---------------------	-----

## CONTENTS

**I-22**

	PAGE
<b>13.2</b> Objectives of cost audit	200
<b>13.3</b> Importance of cost audit	201
<b>13.4</b> Provisions regarding cost audit under the Companies Act, 2013	201
<b>13.4-1</b> Provisions under the Companies Act	201
<b>13.4-2</b> Cost Audit Report	203
<b>13.5</b> Relationship between cost audit and financial audit	204
KEY POINTS	204
TEST YOUR KNOWLEDGE	205

## **14**

### **MANAGEMENT AUDIT**

<b>14.1</b> Relationship between internal auditing, operational auditing and management auditing	206
<b>14.2</b> Definition of management audit	207
<b>14.3</b> Process of management audit	207
<b>14.4</b> Importance of management audit	208
<b>14.5</b> Appointment of management auditor	209
<b>14.5-1</b> Who appoints the management auditor	209
<b>14.5-2</b> Who should be appointed as the management auditor	209
<b>14.5-3</b> Terms of appointment	209
<b>14.6</b> Audit report	209
<b>14.7</b> Management audit in relation to cost audit	210
<b>14.8</b> Management audit and statutory audit	210
KEY POINTS	211
TEST YOUR KNOWLEDGE	212

## **15**

### **TAX AUDIT**

<b>15.1</b> Introduction	213
<b>15.2</b> Scope of auditor's role under the Income-tax Act, 1961	213
<b>15.2-1</b> Compulsory tax audit under section 44AB	213
<b>15.2-2</b> Certifying information in prescribed form for claiming various deductions under the Income-tax Act	215
<b>15.2-3</b> Selective tax audit	216

	PAGE
KEY POINTS	216
TEST YOUR KNOWLEDGE	217

## **16**

### **INTRODUCTION TO EDP AUDITING**

<b>16.1</b>	Introduction	218
<b>16.2</b>	Meaning of EDP auditing	218
<b>16.3</b>	Difference between auditing of manual accounts and computerised accounts (EDP systems or computer information systems)	218
<b>16.4</b>	Types of EDP Accounting Systems	220
<b>16.4-1</b>	Processing system	220
<b>16.4-2</b>	Hardware configuration	220
<b>16.5</b>	Types of internal control in CIS/EDP environment	221
<b>16.5-1</b>	Types of general control	221
<b>16.5-2</b>	Types of application control	222
<b>16.5-3</b>	Distinguish between general controls and application controls	222
<b>16.6</b>	Audit approaches in a computer environment	223
<b>16.7</b>	CIS environment and the Auditor (Based on SA 315 and SA 330)	224
<b>16.7-1</b>	General	224
<b>16.7-2</b>	Documentation	225
<b>16.7-3</b>	Specific risks associated with internal control system in CIS environment	225
<b>16.8</b>	CAATs	225
	KEY POINTS	227
	TEST YOUR KNOWLEDGE	229

## **17**

### **RELEVANT STATEMENTS ON AUDITING**

<b>17.1</b>	SA 200 (Revised) : Overall objectives of the Independent Auditor and the conduct of an Audit in accordance with Standards on Auditing	230
<b>17.2</b>	SA 230 : Documentation	232
<b>17.3</b>	SA 240 : The Auditor's responsibility to consider Fraud and Error in an Audit of Financial Statements	232
<b>17.4</b>	SA 500 : Audit Evidence	232

## CONTENTS

**I-24**

	PAGE
<b>17.5</b> SA 315 : Identifying and Assessing the Risk of Material Misstatements through understanding the entity and its environment	232
<b>17.6</b> SA 610 : Relying upon the work of an Internal Auditor	232
<b>17.7</b> SA 300 (Revised) : Planning and Audit of Financial Statements	233
<b>17.8</b> SA 620 : Using the work of an expert	234
<b>17.9</b> SA 600 : Using the work of another auditor	235
TEST YOUR KNOWLEDGE	237

## **18**

### **PRACTICAL PROBLEMS AND SOLUTIONS**

◆ Practical Problems and Solutions	238
<b>KEY TERMS</b>	262