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AUDITING AND ASSURANCE

EXAM REVISION NOTES

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MODULE I

INTRODUCTION TO AUDITING AND ASSURANCE

Foundational Architecture: The Assurance Engagement Paradigm: Auditing is an objective, systematic, and independent examination of financial statements, records, transactions, operations, and underlying evidence of an entity, conducted by an authorized professional auditor.

Fundamental Objectives of an Audit: In accordance with Standard on Auditing (SA) 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing," the overarching objectives of an auditor are categorized into primary and secondary objectives.

Classification of Errors (Unintentional): 1. Errors of Omission: Occur when a transaction is completely or partially omitted from books of original entry.

- **2. Errors of Commission:** Arise from clerical negligence, incorrect ledger posting, wrong casting (arithmetical addition), or erroneous folio referencing.
- **3. Errors of Principle:** , debiting building repairs instead of capitalizing plant extensions).
- **4. Compensating Errors:** Occur when an error in one account offsets an equal and opposite error in another account, leaving the trial balance deceptively balanced.

Scope of Audit and External Audit Engagements: The scope of an audit refers to the boundary, depth, and specific audit procedures deemed necessary to achieve the objective of the audit.

External Audit Engagements vs. Non-Assurance Engagements: An external audit engagement is a formal contractual relationship governed by SA 210 (Agreeing the Terms of Audit Engagements).

- **Statutory External Audit:** "); Audit Report with positive opinion (SA 700 / 705)
- **Review Engagement:** "); Review Report (based primarily on inquiry and analytical procedures)
- **Agreed-Upon Procedures (AUP):** Standards on Related Services (SRS 4400); Zero Assurance; Report of Factual Findings (users draw their own conclusions)
- **Compilation Engagement:** Standards on Related Services (SRS 4410); Zero Assurance; Compilation Report (collecting, classifying, and Sum of marizing financial data)

Personal Attributes Soft Skills

- **Integrity Moral Courage:** Integrity Moral Courage: Absolute honesty, truthfulness, and fortitude to resist managerial pressure or intimidation.
- **Objectivity:** Unbiased evaluation of facts without allowing personal feelings, commercial ties, or preconceptions to sway judgment.
- **Tact Interpersonal Diplomacy:** Tact Interpersonal Diplomacy: Ability to conduct firm, incisive inquiries with auditees without causing unnecessary friction.
- **Tenacity Inquisitiveness:** Tenacity Inquisitiveness: Willingness to probe inconsistencies, anomalies, and unexplained variances to their logical root.
- **Clear Communication:** Precision in oral hearings and written drafting of audit queries, management letters, and audit reports.

Comprehensive Classification and Typology of Audits: In modern commercial practice, audits are categorized based on organizational authority, practical conduct, timing, scope, and specialized functional objectives.

B. Comprehensive Comparison: Internal Audit vs. External Audit

- **Governing Authority Mandate:** , Section 139 of Companies Act 2013) and appointed by shareholders at AGM.
- **Primary Objective:** ; Express an independent opinion on the true and fair view of the annual financial statements.
- **Qualification Required:** Chartered Accountant, Cost Accountant, or other professional as decided by Board.
- **Reporting Accountability:** ; Reports directly to the shareholders and external stakeholders of the enterprise.

Forensic Investigative Audits: Forensic Audit: Integration of accounting, auditing, and investigative legal techniques to gather admissible court evidence of corporate fraud, bribery, money laundering, or asset diversion.

- **Investigation:** , incoming partner checking solvency, tax evasion inquiry) with no statutory time limits.

Inherent Limitations of Auditing and The Assurance Expectation Gap: In accordance with SA 200, the auditor cannot obtain absolute assurance that the financial statements are completely free from material misstatement due to fundamental inherent limitations of an audit.

The Reasonableness Gap: Occurs when public expectations of the audit function are irrational or unfeasible under realistic economic and legal constraints.

International Auditing and Assurance Standards Board (IAASB): Operating under the auspices of the International Federation of Accountants (IFAC), the IAASB is an independent global standard-setting body.

MODULE II

AUDIT PLAN, PROCESS, DOCUMENTATION, AND INTERNAL CONTROL

The Operational Architecture of an Audit Engagement: The successful execution of an independent audit depends upon methodical planning, structured documentation, and an in-depth evaluation of the entity's internal control architecture.

Client Acceptance and Continuance (SA 220 SQC 1)

- **Integrity of Management:** Assessing the commercial reputation, corporate governance record, and operational integrity of owners, directors, and key management personnel.
- **Engagement Team Competence:** Evaluating whether the audit firm has the necessary technical capabilities, industry knowledge, professional personnel, and time resources.
- **Ethical Requirements Independence:** Ethical Requirements Independence: Ensuring absolute compliance with independence rules, eliminating self-interest, self-review, or familiarity threats.
- **Communication with Predecessor Auditor:** In India, under Clause 8 of Part I of the First Schedule to the Chartered Accountants Act, 1949, communicating with the previous auditor in writing is mandatory prior to acceptance.

Overall Audit Strategy vs. Detailed Audit Plan: Under SA 300, the planning process involves two interconnected structural instruments:

- **Overall Audit Strategy:** Sets the overarching scope, timing, and direction of the audit, guiding the development of the more detailed audit plan.
- **Detailed Audit Plan:** More operational and granular than the overall strategy.

Merits of an Audit Program

- **Clear Distribution of Work:** Clearly assigns duties and operational boundaries to individual audit assistants based on capability.

- **Fixing Individual Accountability:** Audit staff sign or initial each completed audit step, establishing clear personal responsibility for negligent oversight.
- **Progress Tracking and Monitoring:** Enables the audit partner or manager to monitor completed vs.
- **Documentary Defense Against Negligence:** Serves as conclusive documentary evidence in court of the thoroughness and due care exercised by the auditor.
- **Uniformity and Continuity:** Ensures that successive audits across financial years maintain consistent quality and procedural depth.

Specimen Substantive Audit Program: Audit of Trade Receivables (Sundry Debtors): Standard on Auditing (SA) 230, "Audit Documentation" (historically termed "Working Papers"), defines audit documentation as the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

Classification of Audit Files: Permanent vs. Current Audit Files: To ensure systematic organization, audit documentation is traditionally segregated into two distinct files:

Internal Control, Internal Check, and Internal Audit: The credibility and efficiency of an audit depend directly upon the strength of the client's internal operational architecture.

The Five Integrated Components of Internal Control

- **1. Control Environment:** ; Corporate code of conduct, active independent audit committee, whistleblower hotline.
- **2. Risk Assessment Process:** ; Formal enterprise risk management (ERM) matrix assessing FX volatility, supply chain risks, cyber threats.
- **3. Information System Communication:** ; Integrated ERP software (SAP S/4HANA) with automated audit trails and real-time ledger updates.
- **4. Control Activities:** ; Dual authorization for fund transfers, segregation of duties, physical access badges, periodic reconciliations.

Internal Check: Cash Receipts Banking

- **Mail Opening:** "
- **Listing Register:** Listing Register: Cheques and remittances entered immediately into a Rough Cash Book / Remittance Register.
- **Receipt Generation:** Official printed, sequentially pre-numbered receipts issued; electronic receipts automatically sent to payees.
- **Daily Banking:** Total cash and cheques deposited into the bank intact every afternoon; bank paying-in slips verified by head cashier.
- **Segregation:** Cashiers prohibited from making entries into debtors' ledgers or dispatching account statements to customers.

Internal Check: Credit Sales Debtors

- **Order Processing:** Customer orders reviewed and verified for terms, pricing, and product availability.
- **Credit Approval:** Credit department conducts independent solvency check and formally sanctions credit limits prior to order acceptance.
- **Warehouse Dispatch:** Goods dispatched only against authorized Sales Invoices / Delivery Challans signed by store manager.
- **Invoice Preparation:** Invoices generated electronically from dispatch data; sequentially numbered with automated ledger posting.
- **Periodic Statements:** Independent credit controllers dispatch monthly statements of accounts directly to customers for balance confirmation.

The Three Levels of Materiality (SA 320)

- **Overall Materiality (Financial Statement Level):** The overarching monetary threshold established for the financial statements as a whole.
- **Performance Materiality:** The amount or amounts set by the auditor at less than materiality for the financial statements as a whole (typically set at 60% to 80% of overall materiality) to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.
- **Specific / Assertion-Level Materiality:** , related-party transactions, directors' remuneration, statutory non-compliance penalties).

Empirical Casework: Forensic Analysis, Audit Trail Verification, and Internal Controls: Empirical accounting investigations across modern industrial enterprises illustrate that financial distortion, fraud, and misstatement rarely occur as isolated incidents; rather, they stem from structural vulnerabilities within accounting workflows, segregation-of-duties lapses, or inadequate internal audit scrutiny.

- **Ledger amp; Voucher Integrity:** ; Companies Act (Sec.
- **Revenue amp; Cost Allocation:** ; Ind AS 115 (Revenue from Contracts with Customers) amp; CAS 1 to 24 Cost Accounting Standards.
- **Fiscal Risk amp; Tax Compliance:** ; GST Law Section 16/36 Rules amp; Income Tax Act Transfer Pricing Provisions.
- **Working Capital Governance:** ; Tandon amp; Chore Committee Norms for Bank Working Capital Credit Appraisal.

MODULE III

VOUCHING AND VERIFICATION

Substantive Testing Architecture: Evidence of Transactions and Balances: Substantive testing represents the empirical core of the auditing profession. While internal control testing determines the reliance an auditor can place on enterprise systems, substantive procedures provide the direct evidence required to substantiate financial statement assertions.

Classification of Vouchers: 1. , original supplier invoices, stamped receipts, cash memos, purchase orders, title deeds).

- **2. Collateral / Secondary Vouchers:** , carbon copies of receipts, delivery challans, goods received notes, counterfoils of paying-in slips, certified duplicate bills).

Auditor's Legal Duty Regarding Valuation: Judicial Precedents: The auditor is not an engineering valuer, surveyor, or professional appraiser. In London General Bank (No.

B. Substantive Verification of Cash in Hand

Substantive Audit of Working Capital: Debtors and Creditors

B. Audit of Sundry Creditors (Trade Payables): The primary audit risk regarding trade payables is understatement or complete omission of liabilities. The auditor's substantive procedures emphasize completeness:

- **Reconciliation with Supplier Statements:** Reconcile subsidiary ledger creditor balances with original monthly statements received from major suppliers.
- **Search for Unrecorded Liabilities (Out-of-Period Liability Testing):** , 30–60 days after year-end) to identify payments relating to goods or services received prior to the balance sheet date that were omitted from creditors.
- **Scrutiny of Goods Received Notes (GRN):** Match unbilled GRNs (goods received before year-end for which no vendor invoice was processed) with accrued liability provisions.
- **Verification of Debit Balances:** Investigate debit balances in the creditors' ledger to ensure they represent genuine advances or recoverable returns, and verify their separate presentation as current assets.

Verification of Plant, Machinery Equipment

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- **Fixed Asset Register (FAR):** Verify that the company maintains an updated FAR recording asset code, description, location, cost, accumulated depreciation, and physical status.
- **Physical Verification:** Review management's physical verification schedule.
- **Capital vs. Revenue Expenditure:** Scrutinize repairs and maintenance accounts to ensure that major capital additions (enhancing capacity or operating efficiency) are capitalized, while routine maintenance is expensed.
- **Depreciation Accounting:** Verify that depreciation is calculated in accordance with Schedule II of the Companies Act 2013 or useful lives supported by technical appraisal.
- **Disposals Scrap:** Disposals Scrap: Verify approvals for scrapped/sold machinery, ensuring accumulated depreciation and asset cost are derecognized and profit/loss is recognized in P L.

Audit of Interest Income: Interest income arises from bank deposits, loans granted, debentures, and inter-corporate deposits:

- **Accrual Basis Verification:** Verify that interest income is recognized on a time-proportionate accrual basis taking into account the principal outstanding and the effective interest rate.
- **Inspection of Underlying Securities:** Inspect fixed deposit receipts (FDRs), loan agreements, and debenture certificates; verify interest calculation formulas.
- **Tax Deducted at Source (TDS) Verification:** Reconcile gross interest income with Form 26AS, Form 16A TDS certificates, and the Annual Information Statement (AIS) from the Income Tax Department portal.
- **Non-Performing Assets (NPAs):** For lending entities or NBFCs, ensure interest on doubtful/non-performing loans is recognized only upon actual cash realization, in compliance with RBI prudential norms.

Audit of Employee Benefits Payroll

- **Payroll Testing:** Select monthly payroll registers; verify gross salaries against employment contracts, appointment letters, and approved wage revision agreements.
- **Attendance Verification:** Trace employee muster rolls, biometric swipe logs, or electronic timesheet records to ensure salaries are paid only to genuine employees (detect "ghost workers").
- **Statutory Deductions Remittances:** Statutory Deductions Remittances: Check timely deduction and statutory deposit of Provident Fund (PF), Employees State Insurance (ESI), Professional Tax, and TDS (Section 192).
- **Managerial Remuneration:** Verify executive compensation against limits under Section 197 and Schedule V of the Companies Act 2013, ensuring board/shareholder approvals.
- **Retirement Provisions (AS 15 / Ind AS 19):** Verify actuarial valuation reports for gratuity, leave encashment, and defined benefit pension obligations.

Auditor's Duties in Attendance at Physical Inventory Counting (SA 501)

- **Pre-Count Review:** Evaluate management's written instructions and procedures for recording and controlling the results of the physical inventory count.
- **Observation of Procedures:** Observe the performance of management's count procedures to evaluate whether instructions are being followed diligently.
- **Inspection of Physical Condition:** Inspect the inventory to identify damaged, deteriorated, slow-moving, or obsolete items requiring write-down.
- **Performance of Test Counts:** Perform independent test counts, tracing items from the warehouse floor to the count sheets (testing completeness) and tracing items from count sheets to the warehouse floor (testing existence).
- **Cut-Off Documentation:** Obtain details of the last Goods Received Notes (GRN) and dispatch notes issued immediately prior to the count to test cut-off accuracy.

Verification of Physical Demat Securities

- **Physical Securities:** Physically inspect share certificates, bond debentures, and government securities held in the company's safe deposit vault on the balance sheet date.
- **Demat Holdings:** For scripless securities, obtain direct independent holding statements from Depositories (NSDL / CDSL) and Depository Participants (DPs) reconciled with the investment ledger.
- **Custody of Third Parties:** Where securities are pledged with banks as loan collateral, obtain direct confirmation certificates under SA 505.
- **Verification of Ownership:** Verify that investments are registered in the company's legal name, in compliance with Section 187 of the Companies Act 2013.

Audit of Secured Unsecured Borrowings

- **Borrowing Powers Approvals:** Borrowing Powers Approvals: Inspect Board minutes and special resolutions passed under Section 180(1)(c) of the Companies Act 2013 authorizing debt limits.
- **Loan Agreements:** Review sanction letters and loan agreements for interest rates, repayment schedules, restrictive covenants, and hypothecation terms.
- **Registration of Charges (Section 77):** Verify that charges created on company assets are registered with the Registrar of Companies (ROC) within 30 days via Form CHG-1/CHG-9.
- **Direct Confirmations:** Obtain independent bank loan confirmation statements under SA 505 showing outstanding principal, accrued interest, and undrawn limits.

MODULE IV

COMPANY AUDITOR AND AUDIT REPORT

Statutory Governance Architecture: Chapter X of Companies Act, 2013: The corporate form of organization is founded upon the legal separation of ownership from managerial control. To protect the public, equity shareholders, financial institutions, and the state from managerial malfeasance and financial misreporting, the Companies Act, 2013 enacts a rigorous, comprehensive statutory framework under Chapter X (Sections 139 to 148).

A. Statutory Qualifications (Section 141(1) (2))

- **Chartered Accountant:** An individual is eligible for appointment as an auditor of a company only if they are a within the meaning of the Chartered Accountants Act, 1949, and holds a valid Certificate of Practice (CoP) issued by the Institute of Chartered Accountants of India (ICAI).
- **firm:** A (including a Limited Liability Partnership - LLP registered under the LLP Act, 2008) whereof a majority of partners practicing in India are qualified for appointment may be appointed as an auditor of a company.

A. Appointment of First Auditor (Section 139(6) 139(7))

- **Non-Government Company (Sec 139(6)):** Must be appointed by the Board of Directors within 30 days from the date of registration of the company.
- **Government Company (Sec 139(7)):** (Where ≥ 51% paid-up capital is held by Central/State Govts): The Comptroller and Auditor-General of India (C AG) appoints within 60 days of registration; if C AG fails, the Board appoints within the next 30 days; if Board fails, members appoint within 60 days at an EGM.

D. Mandatory Rotation of Auditors (Section 139(2)): To eliminate the familiarity threat and entrenchment, the Companies Act, 2013 mandates statutory auditor rotation for:

- All listed public companies.
- **INR 10 crore or more:** All unlisted public companies having paid-up share capital of .
- **INR 50 crore or more:** All private limited companies having paid-up share capital of .
- **INR 50 crore or more:** All companies having public borrowings from financial institutions, banks, or public deposits of .

A. Removal Before Expiry of Term (Section 140(1)): Because removing an auditor before their tenure expires can be used by management to penalize an auditor for reporting fraud or irregularities, the law prescribes an extraordinarily stringent multi-stage procedure:

- **Step 1: Board Resolution:** The Board of Directors passes a resolution recommending the removal.
- **Step 2: Central Government Approval (Form ADT-2):** The company must apply to the Central Government (Regional Director, MCA) in Form ADT-2 within 30 days of passing the Board resolution, along with statutory fees.
- **Step 3: Special Resolution:** Within 60 days of receiving Central Government approval, the company must convene a general meeting of shareholders and pass a Special Resolution (requiring ≥ 75% majority vote).
- **Step 4: Audi Alteram Partem:** Before passing any resolution, the auditor must be given a reasonable opportunity of being heard (submitting written and oral representations).

C. Remuneration of Auditor (Section 142): Under Section 142, the remuneration of the auditor is fixed by the company in its general meeting, or in such manner as may be determined therein.

Statutory Inquiries (Section 143(1)): The auditor is statutorily required to inquire into six specific matters (reporting only if dissatisfied):

- Whether loans and advances made on security are properly secured and terms prejudicial.
- Whether transactions represented merely by book entries are prejudicial to company interests.
- Whether investments (shares/debentures) sold below purchase price (except banking/investment co).
- Whether loans and advances have been shown as deposits.
- Whether personal expenses have been charged to revenue account.

Structure of the Independent Auditor's Report (SA 700 SA 701): Standard on Auditing (SA) 700 (Revised), "Forming an Opinion and Reporting on Financial Statements," establishes a standardized structural blueprint for independent audit reports across global and Indian capital markets.

Unmodified (Clean) Opinion (SA 700): Expressed when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, presenting a true and fair view.

The Materiality and Pervasiveness Matrix (SA 705)

Companies (Auditor's Report) Order, 2020 (CARO 2020): Issued by the Ministry of Corporate Affairs (MCA) under Section 143(11) of the Companies Act, 2013, the Companies (Auditor's Report) Order, 2020 (CARO 2020) significantly enhances the scope of statutory audit reporting.

Joint Audit of Financial Statements (SA 299)

- **Division of Work:** Joint auditors agree on division of work based on identifiable units, departments, or specific financial areas, documented in a formal Work Allocation Document.
- **Individual Responsibility:** Each joint auditor is solely responsible for audit work allocated to them and for the propriety of decisions regarding the nature, timing, and extent of procedures in their division.
- **Joint and Several Responsibility:** All joint auditors are jointly and severally responsible for: (a) audit work not divided among them; (b) decisions regarding compliance with accounting standards and disclosures; (c) overall presentation and true and fair view of financial statements.
- **Disagreement Among Joint Auditors:** If joint auditors disagree on an accounting or auditing matter, they are not bound to adopt the majority view; each dissenting auditor is entitled to issue a separate independent audit report.

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