This study material has been prepared by the faculty of the Board of Studies. The objective of the study material is to provide teaching material to the students to enable them to obtain knowledge in the subject. In case students need any clarifications or have any suggestions to make for further improvement of the material contained herein, they may write to the Director of Studies.

All care has been taken to provide interpretations and discussions in a manner useful for the students. However, the study material has not been specifically discussed by the Council of the Institute or any of its Committees and the views expressed herein may not be taken to necessarily represent the views of the Council or any of its Committees.

Permission of the Institute is essential for reproduction of any portion of this material.

© THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

All rights reserved. No part of this book may be reproduced, stored in retrieval system, or transmitted, in any form, or by any means, Electronic, Mechanical, photocopying, recording, or otherwise, without prior permission in writing from the publisher.

Revised Edition : July, 2014

Website : www.icai.org
E-mail : bosnoida@icai.in
Committee / Department : Board of Studies
ISBN No. :
Price (All Modules) : ₹ -

Published by : The Publication Department on behalf of The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002
Printed by :
A WORD ABOUT STUDY MATERIAL

Auditing is, perhaps, one of the most practical-oriented subjects in the C.A. curriculum. This paper aims to provide working knowledge of generally accepted auditing procedures and of techniques and skills needed to apply them in audit engagements. A good knowledge of the subject would provide a strong foundation to students while pursuing the Chartered Accountancy course. A good understanding of the theoretical concepts, particularly, in the context of auditing standards would make practical training an enriching and enjoyable experience. While studying this paper, students are advised to integrate the knowledge acquired in other subjects, specifically, accounting and corporate laws in a meaningful manner. Such learning would only help a student to become a better professional.

The study material deals with the conceptual theoretical framework in detail. Its main features are as under:

- The entire syllabus has been divided into nine chapters.
- In each chapter, learning objectives have been stated. The learning objectives would enable you to understand the sequence of various aspects dealt within the chapter before going into the details so that you know the direction of your studies.
- In each chapter, the topic has been covered in a step by step approach. The text has been explained, where appropriate, through illustrations and practical problems. You should go through the chapter carefully ensuring that you understand the topic and then can tackle the exercises.

Handbook on Auditing Pronouncements comprises of Standards on Auditing and Guidance Notes.

This Practice Manual aims to provide guidance as to the manner of writing an answer in the examination. Main features of Practice Manual are as under:

- Important Definitions have been given for quick recapitulation. Students are expected to attempt the questions and then compare it with the actual answers.
- Compilation of questions appearing during last twenty examinations.
- Exercises have been given at the end of each topic for independent practice.

In case you need any further clarification/guidance, please send your queries at rajeev.sachdeva@icai.in and karuna.bhansali@icai.in.

This study material has been revised in view of Companies Act, 2013, Notification/Circulars issued by MCA etc. by Auditing team of experts. This revised study material contains the
‘highlights of changes’ in the tabular form to aid the students to know what and where the updation are made in the module. The changes have been inserted in the bold italics for convenience of the students. It may be noted that Chapter 7 is not given in bold and italics mode as its totally rewritten however very important and major changes are also being made in Chapter 8.

- Attention is invited to the Significant Additions/Modifications made in this edition of the study material which are given on the next page.
- Please note that the changes over the previous edition have been indicated in **bold and italics** in the chapters.
- New case studies have been added to explain the application of the existing concepts in chapter 7 and these have been indicated in grey background.
- Feedback form is given at the end of this study material wherein students are encouraged to give their feedback/suggestions.

In case you need any further clarification/guidance, please send your queries at Rajeev.sachdeva@icai.in and karuna.bhansali@icai.in.
## Significant Additions/Modifications in This Edition

<table>
<thead>
<tr>
<th>Chapter No.</th>
<th>Chapter Name</th>
<th>Section/Sub Section wherein Additions / updation have been done</th>
<th>Page Number</th>
</tr>
</thead>
</table>
| 1           | Nature of Auditing            | 1.2 Definition of Audit  
1.9 Audit and Investigation                                                                                                  | 1.36        |
| 2           | Basic concepts in Auditing    | 2.1 Concept of Auditor’s Independence  
2.4 True and Fair View                                                                                                           | 2.3  
2.18        |
| 4           | Internal Control              | 4.15 Internal Audit  
4.16 Relationship between the Statutory and the Internal Auditors                                                                  | 4.33  
4.35        |
| 5           | Vouching                      | 5.2.2 Transaction with Related Party  
5.2.3 Remuneration paid to Directors  
5.2.5 Payments controlled by the Companies Act, 2013  
5.2.13 Preliminary Expenses                                                                                                      | 5.8  
5.11  
5.17        |
| 6           | Verification of Assets and Liabilities | 6.2 Depreciation  
6.11.6 Special Considerations in the Case of a Company  
6.11.7 Debentures                                                                                                                   | 6.6  
6.59  
6.62        |
| 7           | The Company Audit - I         | Whole Chapter as per the Companies Act, 2013 except SA 700 series part                                                            |             |
| 8           | The Company Audit - II        | Almost whole Chapter as per the Companies Act, 2013                                                                              |             |
| 9           | Special Audit                 | Role of Comptroller and General Audit                                                                                            | 9.10        |
PAPER – 6: AUDITING AND ASSURANCE

(One Paper- Three hours -100 Marks)

Level of knowledge: Working Knowledge

Objective:
To understand objective and concept of auditing and gain working knowledge of generally accepted auditing procedures and of techniques and skills needed to apply them in audit and attestation engagements.

Contents:
2. Standards on Auditing and Guidance Notes — Overview, Standard-setting process, Role of International Auditing and Assurance Standards Board, Standards on Auditing issued by the ICAI; Guidance Note(s) on — Audit of Fixed Assets, Audit of Inventories, Audit of Investments, Audit of Debtors, Loans and Advances, Audit of Cash and Bank Balances, Audit of Miscellaneous Expenditure, Audit of Liabilities, Audit of Revenue, Audit of Expenses and provision for proposed dividends.
3. Auditing engagement — Audit planning, Audit programme, Control of quality of audit work — Delegation and supervision of audit work.
4. Documentation — Audit working papers, Audit files: Permanent and current audit files, Ownership and custody of working papers.
5. Audit evidence — Audit procedures for obtaining evidence, Sources of evidence, Reliability of audit evidence, Methods of obtaining audit evidence — Physical verification, Documentation, Direct confirmation, Re-computation, Analytical review techniques, Representation by management, Obtaining certificate.
6. Internal Control — Elements of internal control, Review and documentation, Evaluation of internal control system, Internal control questionnaire, Internal control check list, Tests of control, Application of concept of materiality and audit risk, Concept of internal audit.
7. Internal Control and Computerized Environment, Approaches to Auditing in Computerised Environment.
8. Auditing Sampling — Types of sampling, Test checking, Techniques of test checks.
10. **Audit of payments** — General considerations, Wages, Capital expenditure, Other payments and expenses, Petty cash payments, Bank payments, Bank reconciliation.

11. **Audit of receipts** — General considerations, Cash sales, Receipts from debtors, Other Receipts.

12. **Audit of Purchases** — Vouching cash and credit purchases, Forward purchases, Purchase returns, Allowance received from suppliers.

13. **Audit of Sales** — Vouching of cash and credit sales, Goods on consignment, Sale on approval basis, Sale under hire-purchase agreement, Returnable containers, Various types of allowances given to customers, Sale returns.

14. **Audit of suppliers’ ledger and the debtors’ ledger** — Self-balancing and the sectional balancing system, Total or control accounts, Confirmatory statements from credit customers and suppliers, Provision for bad and doubtful debts, Writing off of bad debts.

15. **Audit of impersonal ledger** — Capital expenditure, deferred revenue expenditure and revenue expenditure, Outstanding expenses and income, Repairs and renewals, Distinction between reserves and provisions, Implications of change in the basis of accounting.

16. **Audit of assets and liabilities.**

17. **Company Audit** — Audit of Shares, Eligibility, Qualifications and Disqualifications of Auditors, Appointment of auditors, Removal of auditors, Remuneration of Auditors, Powers and duties of auditors, Branch audit, Joint audit, Reporting requirements under the Companies Act, 2013, Other Important Provisions under the Companies Act, 2013 relating to Audit and Auditors and Rules made thereunder.

18. **Audit Report** — Qualifications, Disclaimers, Adverse opinion, Disclosures, Reports and certificates.

19. Special points in audit of different types of undertakings, i.e., Educational institutions, Hotels, Clubs, Hospitals, Hire-purchase and leasing companies (excluding banks, electricity companies, cooperative societies, and insurance companies).

20. Features and basic principles of government audit, Local bodies and not-for-profit organizations, Comptroller and Auditor General and its constitutional role.

**Note:**

(i) *The provisions of the Companies Act, 1956 which are still in force would form part of the syllabus till the time their corresponding or new provisions of the Companies Act, 2013 are enforced.*

(ii) *If new legislations are enacted in place of the existing legislations, the syllabus would include the corresponding provisions of such new legislations with effect from a date notified by the Institute.*
AUDITING is the heart of Chartered Accountancy Course as much as it is at the head of the profession of Accounting. The intent of this paper is to understand objective and concept of auditing and gain working knowledge of generally accepted auditing procedures and of techniques and skills needed to apply them in audit and attestation engagements. While studying this paper, students are advised to integrate the knowledge acquired in other subjects, specifically, accounting, corporate laws and taxation in a meaningful manner. Such learning would only help a student to become a better professional. In nutshell, Auditing and Assurance is a subject which involves application of theoretical knowledge of other subjects.

For the simplicity of the students it is suggested that the entire syllabus may be segregated into the following six parts which may be studied with the help of Chapters viz.

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Topics to be covered in each part</th>
<th>Reference of Chapters</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part 1</td>
<td>Auditing Concepts, Auditing engagement, Documentation, Audit evidence</td>
<td>Refer Chapter 1 &amp; 2</td>
</tr>
<tr>
<td>Part 2</td>
<td>Standards on Auditing and Guidance Notes</td>
<td>Prescribed by ICAI in the form of list of publication Given in Handbook on Auditing Pronouncements</td>
</tr>
<tr>
<td>Part 3</td>
<td>Internal Control, Internal Control and Computerized Environment, Approaches to Auditing in Computerized Environment, Audit Sampling, Analytical review procedures.</td>
<td>Refer Chapter 3 &amp; 4</td>
</tr>
<tr>
<td>Part 4</td>
<td>Audit of payments, Audit of receipts, Audit of Purchases, Audit of Sales, Audit of suppliers’ ledger and the debtors’ ledger, Audit of impersonal ledger, Audit of assets and liabilities.</td>
<td>Refer Chapter 5 &amp; 6</td>
</tr>
<tr>
<td>Part 5</td>
<td>Company Audit, Audit Report</td>
<td>Refer Chapter 7 &amp; 8</td>
</tr>
<tr>
<td>Part 6</td>
<td>Special points in audit of different types of undertakings, i.e., Educational institutions, Hotels, Clubs, Hospitals, Hire-purchase and leasing companies (excluding banks, electricity companies, cooperative societies, and insurance companies), Features and basic principles of government audit, Local bodies and not-for-profit organizations, Comptroller and Auditor General and its constitutional role.</td>
<td>Refer Chapter 9</td>
</tr>
</tbody>
</table>
For the better understanding of the Standards on Auditing (SAs) given in Part 2 it may be noted that they contain two distinct sections, one, the Requirements section and, two, the Application Guidance section.

The fundamental principles of the Standard are contained in the Requirements section and represented by use of “shall”. The application and other explanatory material contained in a Standard on Auditing (SA) is an integral part of the SA as it provides further explanation of, and guidance for carrying out, the requirements of an SA, along with the background information on the matters addressed in the SA. It may include examples of procedures, some of which the auditor may judge to be appropriate in the circumstances. Such guidance is, however, not intended to impose a requirement. Further, the standard portion or principles enunciated in a Standard need not to be given in bold face.

For the remaining part of syllabus our study is divided in nine chapters viz. Nature of Auditing, Basic Concepts in Auditing, Preparation for an Audit, Internal Control, Vouching, Verification of Assets and Liabilities, The Company Audit – I, The Company Audit – II and Special Audits. Chapters from 1 to 4 are the backbone of the syllabus of Auditing and Assurance. These four chapters are basically based on Standards on Auditing. After preparing these chapters, students will be able to understand the other chapters like Vouching, Verification of Assets and Liabilities and Special Audit.

The Chapter 1 - Nature of Auditing deals with the Concept and objective of Auditing, aspects to be covered in Audit, Basic Principles Governing an Audit, Scope and Inherent Limitations of Audit, and Relationship of Auditing with other Disciplines. In this chapter, student will be able to understand the functional classification, qualities of an auditor, objectives of audit, basic principles of an audit, and different types of audit and relationship of auditing with other disciplines. The student should try to carefully understand the basic concepts and the structure of the auditing to gain the in depth knowledge of the subject. As already discussed these chapters are interlinked with Standards on Auditing. Therefore, to better understand the implication of this chapter, it is suggested to read it with SA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing and SA 240, “The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements”. Instead of cramming the contents, the student should try to bring out the very idea of the chapter. This exercise will enable him to bridge the linkage for the further study.

After understanding the nature of auditing, student should try to link it with the basic concepts in auditing i.e. Chapter 2 which deals with Concept of Auditor’s Independence, Audit Evidence, Concept of Materiality, Concept of True and Fair and Disclosure of Accounting Policies. Student should refer SA 500 on Audit Evidence, SA 320 on Materiality in Planning and Performing an Audit, SA 520 on Analytical Procedures and SA 505 on External Confirmations etc. alongwith this chapter. The fair understanding of the chapter has its roots in the above mentioned SAs. Hence, it is suggested that the students should understand the SAs comprehensively.

The Chapter 3 requires the students to identify the major areas for preparation for an audit for which they should refer SA 300 on Planning an Audit of Financial Statements, SA 220 on
Quality Control for Audit of Financial Statements, SA 230 on Audit Documentation etc. After going through the text of these SAs the students can apprehend the chapter which deals with Auditor's Engagement, Audit Process, Techniques, Procedure, Planning, Programme, Risk, Continuous and Final Audit, Planning and Materiality, Audit Working Papers and Obtaining Certificate from Management.

Chapter 4 is on Internal Control which deals with Concept, Environment, Inherent limitations, Accounting and Financial Control, Internal Control - Management and the Auditor, Relationship between the Assessments of Inherent and Control Risks, Internal Control and the Computerized Information System (CIS) Environment, Internal Check, Internal Audit. To comprehend this chapter the students should try to establish linkage with the SA namely 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment, SA 330 on The Auditor's Responses to Assessed Risks, SA 610 Using the Work of Internal Auditors etc. While answering to the questions of this chapter, students should be analytical and objective, without losing focus on the statement.

Vouching and verification are very important chapters. While studying these chapters, students should have knowledge of basics of an audit. Students should not stuff the steps for vouching and verification. Instead they should apply their knowledge.

Vouching is discussed in Chapter 5 which deals with Audit of cash transactions, Audit of Trading Transactions, Audit of Ledgers, Balance Sheet Audit and Analytical Procedures. The general approach to study the chapter is to examine the existing internal control system in the organisation. The appropriate ledger accounts involved, if any should also be scrutinized. Further the vouching ends with the routine checking of the receipts and payments involved and preparation of bank reconciliation statement.

Similarly the Verification of Assets and Liabilities is discussed in the Chapter 6. The main aspects covered here include Capital and Revenue Expenditure, Depreciation, Reserves, Verification of assets, Current Assets, Book-debts, Bank Balances, Cash in hand, Miscellaneous Expenditure, Verification of Liabilities, Contingent Liabilities, Events occurring after the Balance Sheet Date, Prior Period and Extraordinary Items and Changes in Accounting Policies. The basic features to study involve existence, ownership, control, rights, valuation, disclosure and presentation of the items involved. Further, student may interlink this chapter with Guidance notes, Standards on Auditing and Accounting Standards.

The Chapter 7 - The Company Audit-I deals with Qualifications and Disqualifications, Appointment, Remuneration, Removal, Powers, Duties of auditor, Ceiling on number of audits, Audit Report, Audit of Branch Office Accounts, Joint Audit, Special Audit, Cost Audit and Statutory Report. . For gaining the in depth knowledge of the subject the student should focus on the various provisions of the Companies Act, 2013, and the reporting mechanism as suggested by SAs in 700 series, and Statement on Reporting Under Section 227 (1A) of The Companies Act, 1956.

The Chapter 8 - The Company Audit-II deals with General Considerations in a Company Audit, Specific Provisions as regards Accounts in the Companies Act, 2013, Special requirements of Company Audit, Audit of Share Capital, Option on Share Capital, Shares Transfer Audit.
Verification of Issue of Bonus Shares, Audit of Debentures, Audit of Dividends and Presentation of Financial Statements. Again as contemplated by the chapter 7 the requirements for understanding this chapter is same. Since the chapter deals directly with the provisions of the Companies Act, 2013 the students should be very clear and concise in their application attribute. They should avoid going round and round by harping on one or two points repetitively in different ways. Instead they should reach the heart of the question and explain the major features or matters in a logical point-wise manner with sub-headings for each point and try to give a few examples in support of your reasoning.

The Chapter 9 Special Audits deals with Government Audit, Audit of Local Bodies, Audit of Non-Governmental Organizations (NGO's) and Miscellaneous Audits. Students are expected to study the procedure involved in various audits and try to establish the linkage with the knowledge gained from other disciplines like accounting for audit of partnership firms in learning the audit procedure. Further the students can relate their basic understanding while going through the other audits like audit of schools, hotels, cinemas etc. The important points in any audit include constitution, minute book, internal control, vouching of receipts and payments, verification of assets and liabilities etc. The students should try to encapsulate the procedures in various audits to command good holding of marks.

In general, students should in the first instance focus on studying Auditing concepts, procedures and techniques from the study material. The knowledge gained from meticulous study should be translated in the form of succinct notes. These notes may be accompanied by the relevant proforma and diagrams so that at the later stages of preparation, the conceptual knowledge underlying different topics may be gained within minimum time and minimum efforts without going through a number of books again.

Students should also take a keen interest in updating themselves on contemporary developments in the field of auditing by regularly referring to articles on Auditing in CA Journal, Students' monthly Journal and other relevant professional journals, publications and books.

Students may also scan through the Annual Financial Statements of Companies to analyse the notes and qualifications, if any, incorporated by the Auditors in their Audit Report.

Happy Reading and Best Wishes!
CONTENTS

MODULE – 1
Chapter 1 - Nature of Auditing
Chapter 2 - Basic Concepts in Auditing
Chapter 3 - Preparation for an Audit
Chapter 4 - Internal Control

MODULE – 2
Chapter 5 – Vouching
Chapter 6 - Verification of Assets and Liabilities

MODULE – 3
Chapter 7 - The Company Audit-I
Chapter 8 - The Company Audit-II
Chapter 9 - Special Audits
Appendix: A Summary of the Significant Legal Decisions
Chapter 1 - Nature of Auditing

1.1 Introduction .............................................................................................................. 1.1
1.2 Definition of Auditing .................................................................................................. 1.3
1.3 Standards on Auditing ............................................................................................... 1.4
1.4 The Auditor .............................................................................................................. 1.11
1.5 Objective of Audit .................................................................................................... 1.13
1.6 Basic Principles Governing an Audit ........................................................................ 1.29
1.7 Scope of Audit ......................................................................................................... 1.32
1.8 Inherent Limitations of Audit .................................................................................... 1.35
1.9 Auditing and Investigation ........................................................................................ 1.36
1.10 Types of Audit ......................................................................................................... 1.37
1.11 Advantages of an Independent Audit ....................................................................... 1.39
1.12 Relationship of Auditing with other Disciplines ......................................................... 1.40

Case Study ................................................................................................................... 1.42

Chapter 2 - Basic Concepts in Auditing

2.1 Concept of Auditor’s Independence ......................................................................... 2.1
2.2 Audit Evidence ......................................................................................................... 2.5
2.3 Concept of Materiality .............................................................................................. 2.17
2.4 Concept of True and Fair ......................................................................................... 2.18
2.5 Disclosure of Accounting Policies ............................................................................ 2.21

Chapter 3 - Preparation for an Audit

3.1 Auditor’s Engagement .............................................................................................. 3.1
3.2 Audit Process ............................................................................................................ 3.4
3.3 Audit Techniques ..................................................................................................... 3.5
3.4 Audit Procedure .................................................................................................................. 3.6
3.5 Audit Planning .................................................................................................................... 3.7
3.6 Audit Programme ............................................................................................................... 3.11
3.7 Methods of work ............................................................................................................. 3.15
3.8 Continuous and Final Audit ............................................................................................ 3.16
3.9 Audit Planning and Materiality ....................................................................................... 3.18
3.10 The Overall Audit Approach ......................................................................................... 3.18
3.11 Audit Working Papers .................................................................................................... 3.20
3.12 Quality Control for Audit Work ..................................................................................... 3.26
3.13 Elements of Statistical Sampling ................................................................................... 3.30
3.14 Audit Risk ....................................................................................................................... 3.38
3.15 Surprise Checks .............................................................................................................. 3.45
3.16 Obtaining Certificate from Management ...................................................................... 3.47

Chapter 4 - Internal Control

4.1 Concept of Internal Control ............................................................................................. 4.2
4.2 Understanding the Entity and its Environment, including the Entity’s Internal Control ................................................................................................................. 4.3
4.3 Inherent limitations of Internal Control ....................................................................... 4.7
4.4 Accounting and Financial Control ............................................................................... 4.8
4.5 Internal Control and Management ............................................................................. 4.8
4.6 Internal Control and the Auditor ................................................................................ 4.9
4.7 Review of Internal Control by the Auditor ................................................................. 4.10
4.8 Testing of Internal Control ............................................................................................ 4.14
4.9 Examination in Depth .................................................................................................... 4.16
4.10 Relationship between the Assessments of Inherent and Control Risks ................. 4.17
4.11 Communication of weaknesses in Internal Control ............................................... 4.18
4.12 Internal Control in the Small Business .................................................................... 4.18

xvi
4.13 Internal Control and the Computerised Information System (CIS) Environment........ 4.19
4.14 Internal Check ......................................................................................................... 4.29
4.15 Internal Audit ........................................................................................................... 4.31
4.16 Relationship between the Statutory and the Internal Auditors ............................ 4.35