

# CA INTER AUDITING & ETHICS

NEW COURSE



Notebook style **multicoloured**  
Book penned by CA SJ



*Self Study Book. Explains all Concepts.. Simplifies all Concepts...*

Audit of Items of Financial Statements

Completion and Review

Audit Report

**F.A.S.T.**  
first attempt success tutorials

Special Features of Audit of Different  
Type of Entities

Audit of Banks

CA INTER

# Auditing & Ethics

# Brahmastra

VOLUME II

*Self - study Book. Explains all Concepts.. Simplifies all Concepts...*



Notebook style multicoloured  
Book penned by CA SJ



Scientifically designed for conceptual  
understanding with minimum effort



Excellence in simplicity -  
A very neat and simple  
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Covers text tags and  
graphics for memorisation



A handy book for self study  
and last day revision



-Author-

CA. Sarthak Niraj Jain

## Index

**1**  
CHAPTER

Nature, Objective  
and  
Scope of Audit

VOLUME I

**2**  
CHAPTER

Audit Strategy, Audit  
Planning and Audit  
Programme

VOLUME I

**3**  
CHAPTER

Risk Assessment and  
Internal Control

VOLUME I

**4**  
CHAPTER

Audit  
Evidence

VOLUME I

**5**  
CHAPTER

Audit of Items of  
Financial Statements

(5.1 - 5.38)

**6**  
CHAPTER

Audit  
Documentation

VOLUME I

Completion and  
Review

7.1-7.28

**7**  
CHAPTER

Audit  
Report

8.1-8.50

**8**  
CHAPTER

Special Features of  
Audit of Different  
Type of Entities

9.1-9.46

**9**  
CHAPTER

Audit of  
Banks

10.0-10.24

**10**  
CHAPTER

Ethics and Terms  
of  
Audit Engagements

VOLUME I

**11**  
CHAPTER

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## Chapter 01

## NATURE, OBJECTIVE AND SCOPE OF AUDIT

## 1 ORIGIN OF AUDITING

01

**Kautilya's Arthshastra (4th century BC)** - Reference to auditing is found where it talks about fixed accounting year, a process for closure of accounts and audit for the same. Even there are references to misstatements in financial statements (FS) due to abuse of power.

02

**Origin of word "AUDIT"** (Medieval times - 1100 to 1500 AD)

Auditors used to hear the accounts read out to them to check that employees were not careless and negligent. This led to use of word audit originating from Latin word "audire" meaning "to hear".

03

**Industrial revolution in Europe (Late 18th / Early 19th Century)**

Led to astronomical expansion in volume of trade and consequently demand of auditors.

04

**Auditor of Government Entities in India (1860)**

The first Auditor General of India was appointed in British India in 1860 having both accounting and auditing functions. Later on, office of Auditor General was given statutory recognition. Presently, Comptroller and Auditor General of India (C&AG) is an independent constitutional authority responsible for auditing government receipts and expenditures.

05

**Institute of Chartered Accountants of India (1949)**

It was established as a statutory body under an Act of Parliament in 1949 for regulating the profession of Chartered Accountancy in the country.

## 2 MEANING AND NATURE OF AUDITING

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


**Analysis**
**A** *Audit is an independent examination of financial information*

- ⇒ Meaning of Independence - Judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.
- ⇒ The auditor should be independent of entity under audit to form opinion without any influence.
- ⇒ Independence increases its ability to act objectively without any biases.
- ⇒ Example, Auditor appointed by a company which is owned managed by his brother or company where he has invested in shares of the company, auditor should not accept as his own self-interest gets involved.

**B** *Audit can be of entity that is a*

- ⇒ Business or a non-profit organization like an NGO or a charitable trust.
- ⇒ Small, medium or large organisation.
- ⇒ Any entity with any legal structure i.e. proprietary concern, a partnership firm, a LLP, a private company, a public company, a society or a trust.

**C** *The purpose of audit is to express an opinion on the FS.*

- ⇒ Preparation and presentation of FS of an entity is responsibility of management.
- ⇒ The auditor expresses an opinion on FS by means of written audit report.

**D** *Auditor to check that FS are not misleading anybody*

**He ensures that** - (FS as per books → Supported by evidences → Nothing Omit → Clearly → Class, disclosure, description as per AS → T&F View)

- ✦ the accounts have been drawn up with reference to entries in the books of account;
- ✦ the entries in the books of account are adequately supported by sufficient and appropriate evidence;
- ✦ none of the entries in the books of account has been omitted in the process of compilation;
- ✦ the information conveyed by the statements is clear and unambiguous;
- ✦ FS amounts are properly classified, described and disclosed in conformity with accounting standards; and
- ✦ the statement of accounts presents a true and fair picture of the operational results and of the assets and liabilities.

Auditing provides assurance. Its basic nature lies in providing assurance to users - providing confidence to users of FS. Such an assurance lends credibility to FS.

### 3 AUDITING- RELATIONSHIP WITH OTHER DISCIPLINES

Auditing is interdisciplinary in nature and draws as well as make use of different subjects. An auditor is required to have sound understanding of:

#### Accounting

Auditing reviews the FS which are nothing but a result of the overall accounting process hence a sound knowledge of accounting principles is required.

#### Law

An auditor should have a good knowledge of business laws and taxation laws affecting the entity.

#### Economics

Auditor is expected to be familiar with the overall economic environment of the client in which the business is operating.

#### Behavioural Science

Knowledge of human behaviour as auditor has to interact with people for seeking information and making inquiries.

#### Statistics

Knowledge of statistical sampling for meaningful conclusions. Auditors uses statistical methods to draw samples in a scientific manner. It is not possible for an auditor to check each and every transaction. So, use of statistical methods to draw samples for conducting audit is made.

#### Financial Management

Auditor is expected to have knowledge about various financial techniques such as working capital management, funds flow, ratio analysis, capital budgeting etc. These also assist in applying some audit procedures effectively. Knowledge of financial market is also expected from auditor.

#### Mathematics

For verification of inventories and other checks.

#### Data Processing

EDP auditing in itself is developing as a discipline in itself.

#### Production

Good auditor is one who understands the client and his business functions such as production, cost system, marketing etc.

### SA-200 "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing"

In conducting audit of FS, objectives of auditor are: -

- (a) To obtain reasonable assurance about whether the FS as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the FS are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- (b) To report on the FS, and communicate as required by the SAs, in accordance with the auditor's findings.

### Analysis

- ⇒ **Reasonable assurance** is to be distinguished from absolute assurance. Absolute assurance is a complete assurance or a guarantee that FS are free from material misstatements. However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance but it is not complete assurance.
- ⇒ Audit is carried out with professional competence and skills in accordance with **Standards on Auditing**. Audit procedures are applied in accordance with SAs, audit evidence is obtained and evaluated. On basis of that, conclusions are drawn and opinion is formed. It leads to high level of assurance which is called as reasonable assurance but it is not absolute assurance.
- ⇒ **Misstatements in FS can occur due to fraud or error or both**. The auditor seeks to obtain reasonable assurance whether FS as a whole are free from material misstatements caused by fraud or error. He has to see effect of misstatements on FS as a whole, in totality.
- ⇒ **Opinion - FS as per applicable FRFW**. Obtaining reasonable assurance that FS as a whole are free from material misstatements enables the auditor to express an opinion on whether the FS are prepared, in all material respects, in accordance with an applicable financial reporting framework.
- ⇒ **Audit Report - As per findings**. The opinion is reported and communicated in accordance with audit findings through a written report as required by SAs.

## 5 SCOPE OF AUDIT

(Scope refers to range or reach of something)

### Purpose of an audit

To enhance the degree of confidence of intended users in the FS. It is achieved by the expression of an opinion by the auditor on whether the FS are prepared, in all material respects, in accordance with an applicable financial reporting framework.

### Users of FS

May be shareholders, employees, customers, government and regulatory authorities, bankers etc.

### Applicable financial reporting framework

Framework adopted in the preparation and presentation of the FS, acceptable in view of the nature of the entity and the objective of the FS, or that is required by law or regulation.

**Example**, in case of companies in India, financial reporting framework is provided under Schedule III of Companies Act, 2013.

## A SCOPE OF AUDIT- WHAT IT INCLUDES

Scope of audit of FS:

- (1) **Coverage of all aspects of entity**  
All aspects of the entity relevant to the FS being audited are covered under audit.
- (2) **Reliability and sufficiency of financial information**  
By study and assessment of accounting systems and internal controls and by carrying out appropriate tests, enquiries and procedures auditor verifies information contained in underlying accounting records and other source data (like bills, vouchers, documents etc.) is reliable and sufficient basis for preparation of FS.
- (3) **Proper disclosure of financial information**  
FS should properly summarize transactions and events recorded therein. FS to consider the judgments made by management in preparation of FS. For example, choosing of appropriate accounting policies in relation to various accounting issues like choosing method for valuation of inventories.
- (4) **Expression of Opinion on historical financial information**  
Auditor evaluates selection and consistent application of accounting policies by



management. FS of an entity are prepared on historical financial information basis hence audit is also based on historical financial information.

“Historical financial information” means information expressed in financial terms in relation to a particular entity, derived primarily from that entity’s accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

### **B SCOPE OF AUDIT- WHAT IT DOES NOT INCLUDES**

- ⇒ Responsibility of preparation and presentation of FS – Lies with Management
- ⇒ Duties outside scope of competence of auditor - Auditor is not expected to perform duties which fall outside domain of his competence, like:
  - ✦ Physical condition of certain assets like that of sophisticated machinery
  - ✦ Suitability and life of civil structures like buildings
- ⇒ Expertise in authentication of documents - The genuineness of documents cannot be authenticated by him because he is not an expert in this field.
- ⇒ Investigation - Audit is distinct from investigation.

### **INVESTIGATION Vs AUDIT**

- ⇒ An audit is not an official investigation into alleged wrong doing.
- ⇒ Auditors do not have any specific legal powers of search or recording statements of witness on oath necessary for carrying out an official investigation.
- ⇒ Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.
- ⇒ The objective of audit, is to obtain reasonable assurance about whether the FS as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.
- ⇒ The scope of audit is general and broad whereas scope of investigation is specific and narrow

### **6 INHERENT LIMITATIONS OF AUDIT**

Certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that FS are free from misstatement due to fraud or error. These fundamental limitations arise due to the following factors:

**A Nature of financial reporting**

- ⇒ Preparation of FS involves making many **judgments** by management.
- ⇒ Management prepared FS free from material misstatements and devises internal controls. Such **controls** also suffer from **own limitations** like lapse of control due to collusion of employees.

**B Nature of Audit procedures**

- ⇒ The auditor carries out his work by obtaining audit evidence through performance of audit procedures.
- ⇒ However, there are practical and legal limitations to obtain audit evidence like use of sample testing or sometimes management may not provide complete information as requested by auditor and auditor cannot force them, an example of legal limitation.
- ⇒ The management may indulge in frauds and conceal it to make it hard to detect by the auditor. It may produce fabricated documents to auditor. An auditor may not be an expert to detect unauthenticated documents
- ⇒ Entity may have entered into some transactions with related parties only paper and auditor may not be able to detect probable wrong doings in such transactions.

**C Not in nature of investigation**

- ⇒ Audit is not an official investigation. Hence, auditor cannot obtain absolute assurance that FS are free from material misstatements due to frauds or errors.

**D Timeliness of financial reporting and decrease in relevance of information over time**

- ⇒ The relevance of information decreases over time and auditors cannot verify each and every matter.

**E Future events**

The business may cease to exist in future due to changes in market conditions, emergence of new business models or products or due to onset of some adverse events. In view of the above factors, an auditor cannot provide a guarantee that FS are free from material misstatements due to frauds or errors.

**7 WHAT IS AN ENGAGEMENT?**

- ⇒ Engagement means an arrangement to do something.

Chapter 05

# AUDIT OF ITEMS OF FINANCIAL STATEMENTS

## 1 INTRODUCTION

Companies prepare their FSs in accordance with the framework of **generally accepted accounting principles (Indian GAAP)**, also commonly referred to as **accounting standards (AS)**.

Each FS purports to **present something as a whole in addition to its component details**. For example, an income statement purports to present “the results of operations” a BS purports to present “financial position”.

A **FS audit** comprises the examination of an entity’s **FSs** and accompanying disclosures by an independent **auditor** and attesting the truth and fairness of preparation and presentation of the **FSs** and related disclosures.

**Auditor’s opinion** is typically directed to these overall representations.

**But to formulate** an opinion on the overall truth of these statements he has **first to inquire into the truth of many specific assertions** that makes up each of these statements.

Out of his individual judgements of these specific assertions **he then arrives at a judgement on the FS as a whole**.

This chapter covers **AUDIT PROCEDURES TO VERIFY THE VARIOUS ASSERTIONS** appearing in the FSs.

### A DEFINITION OF ASSERTION:

It refers to the representations by management, explicit or otherwise, that are embodied in the FSS, as used by the auditor to consider the different types of potential misstatements that may occur.

In preparing FSs, company’s management makes various implicit or explicit claims (i.e. assertions) regarding:

- ◆ completeness;
- ◆ cut-off;
- ◆ existence/ occurrence;
- ◆ valuation/ measurement;
- ◆ rights and obligations; and
- ◆ P&D

of **Assets, Liabilities, Equity, Income, Expenses and Disclosures**

### Example

Building with carrying amount of 50 lakh, asserts:

- The building exists as at the period end (existence assertion);
- Company X owns and controls it (Rights and obligations assertion);
- Its valued accurately as per measurement principles (Valuation assertion);
- All buildings owned and controlled by Company X are included in CA of 50 lakh (Completeness assertion).

Income statement captions comprising **revenue and expense balances**

**ASSERTIONS MAY BE BROADLY CLASSIFIED INTO THE FOLLOWING TYPES:**

BS captions comprising **ALE**

## B INCOME STATEMENT CAPTIONS COMPRISING REVENUE AND EXPENSE BALANCES

Assertions	Explanation
<b>Occurrence</b>	Transactions have occurred and relate to the entity.
<b>Completeness</b>	All transactions have been recognized in the FS + none omitted.
<b>Cut-off</b>	<ul style="list-style-type: none"> <li>• All I&amp;E are reported in correct accounting period.</li> <li>• Cut-off is a separate assertion as substantive procedures to verify it are typically different from assertion of completeness</li> </ul>
<b>Measurement</b>	<ul style="list-style-type: none"> <li>• Transactions recorded accurately + appropriate amounts.</li> <li>• No errors in preparing documents or ledger postings.</li> <li>• The figures and explanations are not misstated.</li> </ul>
<b>P&amp;D (P&amp;D)</b>	<ul style="list-style-type: none"> <li>• Transactions and events have been: Classified and presented <b>fairly</b> in the FSs.</li> <li>• Appropriately segregated or disaggregated.</li> <li>• Disclosures are <b>complete and accurate</b>.</li> <li>• <b>Significant judgement and qualitative assessments</b> disclosures are more susceptible to MM.</li> <li>• No material information is omitted, distorted or misleading + is relevant and easy to understand.</li> </ul>

### Audit Procedure

A

Employee Benefit Expense - EBE

B

Sales

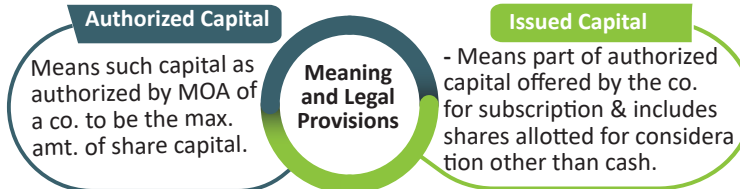
Incurring for personnel employed by entity during the period. No cost of any unauthorized personnel.	<b>Occurrence</b>	Sales recorded only for goods ordered by valid customers and despatched & invoiced in the period.
EBE of all personnel - fully accounted.	<b>Completeness</b>	All genuine sales recorded.
Expense recognized related to current period only	<b>Cut-off</b>	Sales to include despatch of goods made at the year end as well.
EBE calculated accurately. Deductions of TDS etc correctly accounted for.	<b>Measurement</b>	Sales recorded correctly as per invoice, discounts properly adjusted.
As per Schedule 3 disclose in EBE separately (i) salaries and wages, (ii) contribution to PF etc, (iii) ESOP, ESPP expenses (iv) staff welfare expenses	<b>P&amp;D</b>	<b>As per Schedule 3</b> - Other than finance company - Revenue from operations to disclose separately in notes revenue from (a) Sale of products; (b) Sale of services; (ba) Grants or donations (Section 8 companies only) , (c) Other operating revenue less excise duty

**C BALANCE SHEET CAPTIONS COMPRISING ASSET - LIABILITY - EQUITY (ALE)**

Explanation	Assertions	Example: Inventory balance
ALE exist as at period end.	<b>Existence</b>	Inventory actually existed as at the period end.
All ALE are recognized	<b>Completeness</b>	All inventory held is recorded in FS + Inventory with 3 <sup>rd</sup> party included + Inventory held as 3 <sup>rd</sup> party (Consignee) not included
Reported in appropriate period.	<b>Cut-off</b>	No balance of next year included. All location stock of current period recorded
Recorded at appropriate amount with no overstatement or understatement.	<b>Valuation</b>	Recognised at lower of Cost or NRV (AS-2) + Acceptable valuation FIFO, etc + Unallocable costs not added to cost of inventory
Entity has ownership and legal title to assets and liabilities recognized represent entity's obligations to repayment as at a given date.	<b>Rights &amp; Obligations</b>	Entity owns the inventory, invoices made in its name. Verify consignment stocks
<ul style="list-style-type: none"> <li>Properly <b>classified, described and disclosed</b>.</li> <li>Significant judgement and qualitative assessments disclosures are have more RoM</li> <li>Information not materially distorted, omitted or misleading</li> <li>Balances appropriately segregated &amp; disaggregated</li> <li>As per applicable FRFW</li> </ul>	<b>P&amp;D</b>	<ul style="list-style-type: none"> <li>Refer Schedule 3 requiring inventory classification as RM, WIP, FG, Stock-in-trade, Stores &amp; Spares, Loose Tools, Others.</li> <li>Separate disclosure for goods in transit.</li> <li>Mode of valuation disclosed</li> </ul>
<b>Example</b> Share capital – P&D assertion Reconciliation of the no. of shares outstanding at beginning & end is to be disclosed in notes.		

**2 BS CAPTION**

**A SHARE CAPITAL**



Assertions	Explanation
<b>Existence</b>	To establish <b>existence</b> of share capital
<b>Completeness</b>	Equity balances have been <b>recognized</b> in the FS or not?
<b>Valuation</b>	Equity balances have been <b>valued appropriately</b>

**Audit Procedure**

- Tally the period-end share capital with PY audited FS
- In case there is no change, obtain a **WR from CS**
- In case there is any change:
  - Verify paid up capital ≤ authorised SC from MOA
  - Obtain certified copies of **resolutions passed to increase authorised SC**.
- Fresh issue made in CY, check:**
  - Compliance of Companies Act 2013 for - Return of Allotment, Minimum Subscription, Minimum application money to be collected, maintenance of separate Bank account, payment of underwriting commission as per Sec 40 etc.
  - No shares issued at **Discount** (Sec. 53)
  - Shares issued **for cash or other than cash**. (Eg: Promoters / Underwriter for their services)
  - Compliance with **SEBI Regulations and Guidelines**.
  - Verify copies of **forms filed with MCA**: Form SH-7, Alteration of share capital, PAS 3 Return of allotment
  - Forms with RBI** - Form FCGPR - In case of FDI by NR shareholder
  - Verify number of securities issued with **issue price**
- In case there increase in authorized capital:**
  - Verify the fee and stamp duty payable to MCA **calculated**
  - Obtain a copy of the **receipt** in support

**Presentation and Disclosure** Refer Sch – III disclosures given at the end of the chapter notes.

- (a) Shares issued at Premium**
- (i) Meaning and Legal Provisions**
- Amount in **excess** of the **nominal value** of the shares
  - Section 52** - Company shall transfer the amount received by it as securities premium to **securities premium account & state the means** in which the amount in the account can be applied
- (ii) Application**
- Towards fully paid **bonus shares**
  - Writing off the **preliminary expenses**
  - Writing off the **expenses or commission paid or discount allowed** of shares or debentures
  - For **premium payable** on the redemption of PSC or Deb.
  - Purchase of its own shares** u/s 68
    - For Specified companies u/s 133 only a, e and c (equity only) is allowed
- (iii) Audit procedure**
- Verify whether premium **transferred** to a “securities premium account”
  - Whether **application** is only for the purposes mentioned

Contd...

**A SHARE CAPITAL**

(b) **Shares issued at Discount**

(i) **Meaning and Legal Provisions**

**Section 53**

- Company shall not issue shares at a discount
- Except in the case of an issue of **sweat equity shares** given under **section 54**
- May be issued to creditors at discount to convert debt under a statutory resolution or restructuring plan.
- Any share issued at discounted price shall be **void**
- Where company fails to comply the provisions penalty equal to amount raised or ₹ 5 lakh, whichever is **less & refund all monies with interest** at the rate of **12% p.a.**

(ii) **Audit procedure**

- Whether any movement in SC during the year
- Verify that Company has **not issued** any of its shares at a discount by seeing minutes, share issued price.
- Debt resolution plan, if any

(c) **Issue of Sweat Equity Shares**

(i) **Meaning and Legal Provisions**

**Section 54**

“Sweat Equity Shares” means equity shares issued by the company to **employees or directors** at a **discount** or for **consideration other than cash** for providing **know-how** or making available right in the nature of **intellectual property rights or value additions**, by whatever name called.

(ii) **Audit procedure**

- Verify that class of shares already issued &
  - Issue is authorized by a **special resolution**
  - Resolution specifies** number of shares, current market price, consideration
  - Issued in accordance with the **regulations made** by the SEBI
  - Pari-passu rights, limitations & restrictions with other ESH.
- Whether provisions of CA13 complied

(e) **Disclosure for Equity**

**Audit procedure**

Refer Sch III

(d) **Reduction of Capital**

(i) **Meaning and Legal Provisions**

- Company may reduce capital by reduction in unpaid capital or cancellation of lost capital or paying off excess paid up capital as per **Section 66 of the Act**
- S. 66 (6) - **Buy-back of own securities u/s 68** will not attract S.66 reduction of capital provisions.

(ii) **Audit procedure**

**Section 66, Compliance to be checked:**

- Verify that the **special resolution** passed after convening the meeting properly with advance notice
- Verify whether **AOA authorizes reduction**
- Verify there is no default in **repayment of deposit** on its interest
- Examine the order of the **Tribunal** confirming the reduction & filling it with ROC
- Inspect the **Registrar’s Certificate on reduction of capital**
- Vouch the **accounting entries** to write down assets as per resolution of SH and presentation as per S III.
- Confirm **revaluation of assets** properly disclosed
- Verify the **adjustment** made in the **members’ a/c in RoM and share certificates** amended to new issued
- Confirm that the words **“and reduced”** have been added
- Verify that **MOA has been suitably amended**
- Check **Tribunal terms** compliance

**B RESERVE AND SURPLUS**

(a) **Meaning**

**Reserves**  
Amounts appropriated out of profits not intended to meet any liability, contingency, commitment or diminution

**Provisions**  
Amounts charged against revenue to provide for:

- Renewal or diminution in assets
- Known liability
- Disputed claim

(b) **Difference between Reserves and Provisions**

(c) **Reserves segregated as Revenue or Capital**

**Revenue Reserves**

- Represent profits available for distribution
- Used to :
 

distribute profit in lean years,	finance business extension,	augment working capital or	strengthen financial position.
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**Capital Reserve**

- Not regarded as free for distribution. Limited use permitted.
- Revenue profit appropriated for asset replacement reserve also in nature of capital reserve.
- Capital Reserve is created from capital profits as well (earned through sale of capital assets like PPE, investments).
- Uses:**
  - Generally for writing down fictitious assets or losses or issuing bonus shares if it is realized and AOA permits.
  - Securities premium or Capital Redemption Reserve use restricted as u/s 52&55.

(d) **Assertions**

- Existence**  
Establish the existence of R & S at period-end.
- Completeness**  
R&S balances have been recognised
- Valuation**  
Reserves and Surplus balances have been valued appropriately.
- Presentation and Disclosure**  
Refer Sch-III

**Audit procedure**

Tally the opening balance with PY. → For addition/ utilization CY:

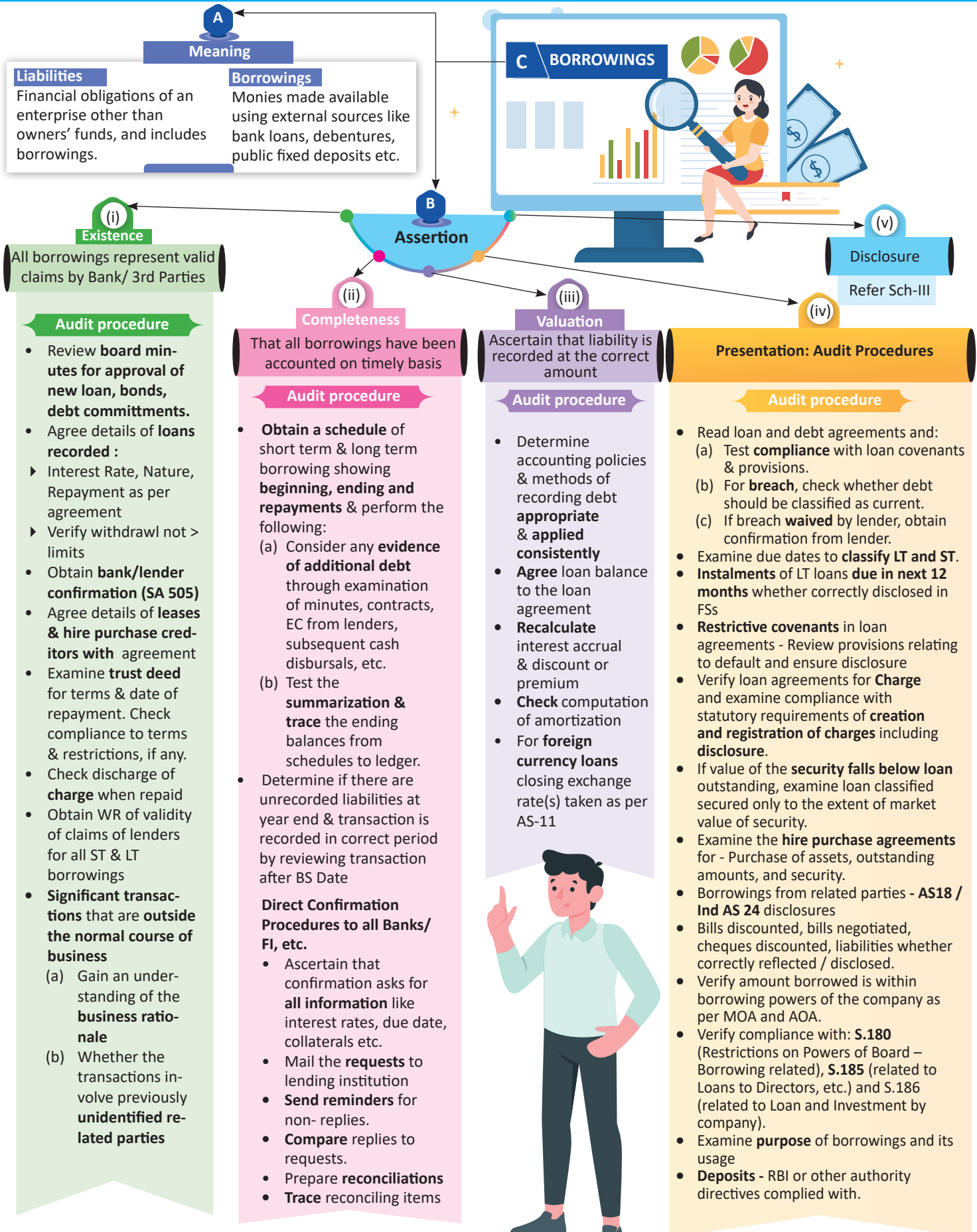
**Profit and Loss balance**

- Trace the movement as disclosed in **statement of changes in equity & SPL.**
- For **adjustment** related to dividend payment **verify** the resolution passed
- If dividends declared **after the BS date** should not recognize as a liability, only disclosed

**Other Equity**  
Understand the underlying reason for the transaction

**Share Premium**

- Confirmed that company has issued shares in **excess** of nominal value
- Verify **BOD resolution** passed
- Withdrawal could be done only for **limited purposes**



**D TRADE PAYABLES AND OTHER CURRENT LIABILITIES**

(a)

**Meaning**  
A liability is classified as current if it satisfies any of the following criteria:

expected to be settled in **normal operating cycle**

held primarily for purpose of being **traded**

due to be settled within **twelve months**

entity does not have an unconditional right to **defer settlement**

(b)  
**Assertion**

(i)  
**Existence**

**Audit procedure**

- Check whether there are **controls in place to avoid duplicate entries and recording payable as expense is recognised.**
- Ask for a period-end accounts payable **ageing report.**
- **Calculate** the accounts payable report total.
- Verify that the total traced to the general ledger is **correct.**
- **Investigate** reconciling items, large JE.

**Direct Confirmation Procedures**  
Refer Receivables  
Contact vendors directly/ independently and ask confirm balance at end of reporting period. Seek confirmation for:  
(a) all significant account payable balances and  
(b) material suppliers of the year even if period-end balance is not significant.

(iii)  
**Valuation**

**Audit procedure**

**Assess old outstanding liability balances:**

- (a) Whether the method is used is consistent and **appropriate** for the underlying business environment for ageing & write back analysis
- (b) Obtain the ageing of payable balances
- (c) Obtain the **list of vendors with disputes or litigations**
- (d) Check that **write-backs** in the liability balances approved by senior management.
- Check that the **restatement** of foreign currency trade payables
- Understand management's process to identify the **principal amount** and the **interest due** to MSME and **test check** the management process to identify such balances

(ii)  
**Completeness**

**Audit procedure**

**Test purchase/ expense vouchers listed in account payable report.**

- **Select** few purchase/ expense with supportings.
- See if the purchases were **recorded** with correct amounts, correct vendors & on the correct dates.
- **Match purchase/ expense vouchers to gate entry (inward) register/ log**
- See if purchases are being recorded in the **correct accounting period.**

**Search for unrecorded liability**

- Review all **material expense** vouchers recorded post BS.

**The auditor needs to satisfy himself of correct and proper cut-offs. Need to perform the following cut off tests:**

- For the last 5 invoices **received/ recorded** the goods should have been received/ risk and rewards of ownership in goods should have been **transferred** in favour of the entity;
- All good received prior to the period/ year- end should have been **booked** in the form of purchases & included in trade creditors;

(iv)

**Presentation and**

**Refer Sch – III**

**For advance received from customers/ revenue received in advance,**

- Obtain the **customer-wise listing.**
- Verify **ageing**
- **Enquire** from the entity's management if any dispute with the customer.
- Verify the underlying **documentation.**
- Verify if advances have been **adjusted** subsequently.

**In relation to statutory dues liability**

- Prepare a **reasonability** with respect to sales/ purchases etc.
- Reasons for **variance** if any between O/s liability and amount paid after BS date
- Verify the **challans** for deposits made
- Analyse the **reasons** for any variance
- Consider CARO reporting



**E PROVISIONS AND CONTINGENT LIABILITIES**

**(a) Meaning**

**Provisions**

A provision is a liability which can be measured only by using a substantial degree of estimation.

**Recognised when:**

- (i) Entity has a present obligation as a result of a past event;
- (ii) outflow of resources embodying economic benefits is probable
- (iii) reliable estimate can be made

**A contingent liability is:**

- a **possible obligation** arises from past events confirmed only by **uncertain future events** not wholly within the control of the entity
- a **present obligation** arises from past events but is **not recognized** because:
  - ▶ it is **not probable** that an outflow of economic benefits will be required to settle the obligation, or
  - ▶ amount **cannot be measured** with sufficient reliability

**Accounting Treatment of Contingent Liabilities**

	Likelihood of Occurring	Measurement	Accounting Treatment
Contingency	Probable	Estimable	Record and Disclose Provision
		Not Estimable	Disclose C. Liab
	Reasonably Possible		Disclose C. Liab.
	Remote		None

**(b) Assertions**

- (i) Existence → Establish the existence at the period- end
- (ii) Completeness → Provisions have been recognized in the FS
- (iii) Valuation → Provision valued appropriately
- (iv) Presentation and Disclosure → Refer Sch. III

**Audit procedure**

- 01 Obtain a list of all provisions & compare them with balances in ledger
- 03 Inspect the underlying arrangements with customers, litigations etc.
- 03 Obtain & evaluate the underlying working & basis for each of the provisions made
- 04 Obtain WR that all provision, as required, are recognised
- 05 Obtain experts report, calculation workings and verify underlying assumptions, data.

As per SA 500- when using the work of a management's Expert, audit evidence that the auditor should obtain include:

**A Evaluate the competence, capabilities and objectivity of that expert:**

- Whether employed by the entity
- Extent management can exercise influence or control over the expert
- Auditor's previous experience
- Knowledge of the expert's

**B Obtain an understanding of the work of that expert:**

- Evaluate the work of the expert
- Whether any professional or other regulatory requirements apply
- Evaluating the assumptions & methods
- Evaluating the nature of internal or external data

**C Evaluate the appropriateness of his work as audit evidence for the relevant assertion**

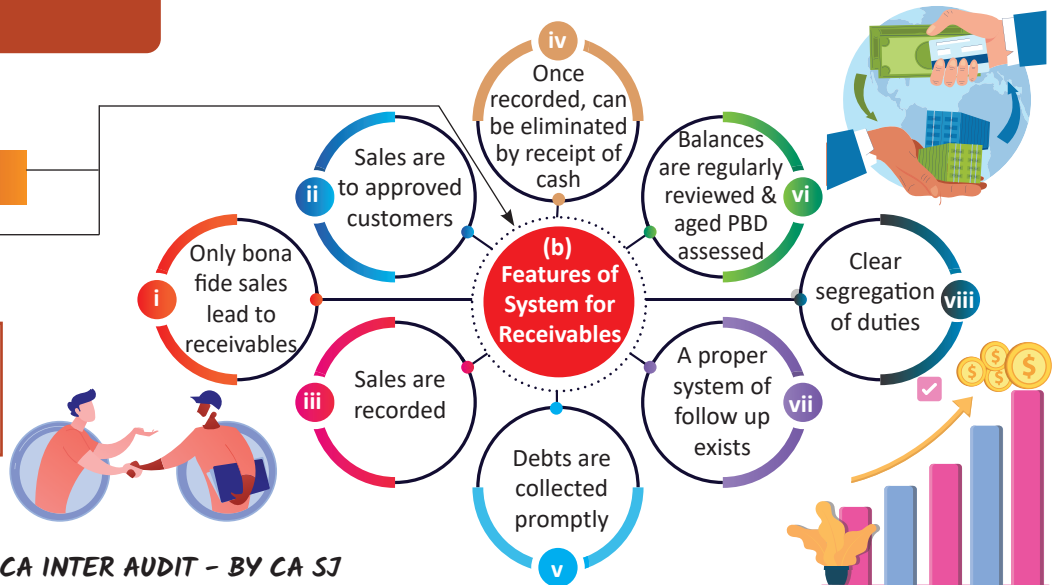
- Relevance and reasonableness
- Relevance, completeness and accuracy

**3 ASSETS**

**A TRADE RECEIVABLES**

**(a) Meaning**

These are monies which are owed to an organisation by a customer





**(c) Assertion** → **(i) Existence**  
Establish the existence at the period end.

**1. Audit procedure**

- Check whether **controls in place to avoid duplicate billings**
- Ensure that trace receivables ledger **reconciles** to general ledger at year end.
- Ask for **ageing report**
- Calculate** the receivable report total.
- Verify that the total **traced** to the general ledger is correct.
- Investigate reconciling items.
  - If there are journal entries, review the justification for larger amounts.
- Journal entries should be fully **documented**. See whether **realization** is recorded invoice wise or not.
  - If not, check debtors is **adjusted** chronologically invoice wise & on FIFO basis.
  - If realization is made on account, verify if the company has obtained **confirmations** from debtors.

**2. Direct Confirmation Procedures**

A significant and important audit activity is to **contact customers directly & ask to confirm** the amounts of unpaid accounts receivable.

- Auditor to employ with the **consent of entity**
- If management request the auditor to **not to seek direct confirmation**, auditor to consider **valid grounds** for such request and reconsider NTE of AP.
- The trade receivables may be requested to **confirm the balances either**:
  - as at the **date of the balance sheet**
  - any **other selected date**. Decide in consultation with entity.
- The **form of confirmation** may be either **positive or negative**, or blank (preferred).
- If the **negative rather than positive** form of confirmation is used, the number of requests sent and the extent of the other auditing procedures to be performed should normally be greater
- Method of selection** of trade receivables should not be disclosed to the company
- Undelivered letters** should return to auditor not client.
- Maintain strict control** to ensure correctness & proper dispatch of letters
- May **mail the letters** directly or share list with entity and control / oversee dispatch
- Auditor should also consider what **further tests** he can carry out in order to satisfy himself as to the correctness of the amount of trade receivables taken as a whole
- Check that receivables for **other than sales** or services are not included in the list
- Ensure related party receivables** are collectable, properly authorized, reasonable & done at **arm's length price**
- Trend analysis**:
  - See if there are any unusual trends.
  - Measure the average collection period.
  - Inquiries about reasons for changes in trends.

**2A. When discrepancies revealed in confirmations received**

- Ask entity to investigate and reconcile.
- Consider further tests to satisfy correctness of amount of the trade receivable taken as a whole.

**2B. Additional tests where no reply is received on direct confirmation request**

Where no reply is received, auditor should perform additional testing, include:

- Agreeing the balance to cash received subsequently
- Agreeing customer's remittance advice or balance with underlying invoice
- Preparing a detailed analysis of the identifiable transactions to check if real (examination in depth)
- Prepare a final summary

**(ii) Completeness Audit Procedures**

**Satisfy himself of correct and proper cut-offs.**

**For the invoices issued closer to the reporting date (last 5 days)**

- The goods should have been **dispatched** & not lying with the Company & included in closing stock
- All good dispatched prior to the period/ year-end have been **invoiced** and included in debtors
- No goods dispatched after the year- end have been invoiced & included in debtors for the period under audit

**Test invoices listed in receivable report:**

Select few invoices compare them to supporting documentation	See <b>billed with</b> correct amounts, correct customers & correct dates
--	---

**Match invoices to shipping/ dispatch log:**

For those items in the shipping/ dispatch log	See if sales are being <b>recorded</b> in the correct accounting period	Examination of <b>invoices issued</b> subsequent to the period being audited
---	---	--

**Assess bill and hold sales:**

- Where the company billing customers for sales despite **still retaining** the goods on-site
- Examine **supporting documentation**

**Review receiving log:**

If company has recorded an inordinately **large amount** of customer returns after audit period indicating dummy sales

**Study the system of giving discounts and check the following:**

- Company **policy/** general industry trends
- Realization** of cheque or receipt of cheque
- Verify that the cheque has been realized within a **reasonable time**

**Review credit memos:**

- Properly authorized
- Issued in the correct eriod
- Circumstances of their issuance
- Issued after the period
- Any deduction has been made against a bill, check the reason & correspondence for the same

**(iii) Valuation Audit Procedures**

- Assess the allowance for doubtful accounts:**
  - Review** the process followed
  - Method used** in the last year & is **appropriate** for the underlying business environment
- Obtain the ageing report of accounts receivable and both Dr/ Cr Balances**
- Obtain the list of **debtors** under litigation
- Scrutinize the analysis and identify those debts which **appear doubtful**
- Assess bad debt write-offs**
- Check that write-offs **approved** by an appropriate & authorised member

**(iv) Valuation Presentation and Disclosure**

Refer Sch. - III

**B**

**CASH & CASH EQUIVALENTS**

(a)

**Meaning**

**Cash & Cash Equivalents includes:**

- (1) Cash in hand
- (2) Stamps in hand
- (3) Balances with bank

(b)

**Assertions**

(i) **Existence**

Establish the existence as at the period end

(iii)

**Valuation**

Ensure that Cash and cash equivalent balances have been valued appropriately including correct forex rate for foreign currency balances.

(ii) **Completeness**

Cash and C.E. balances have been recognized in the FS or not?

(iv)

**Presentation and Disclosure** Refer Sch – III

**Audit procedure**

**Surprise Check:**

- Cash Verification **without giving notice**
- On the **last day** but also again sometimes after close of the year
- All cash balances should be checked **simultaneously**
- **Cashier** to be present while cash is being counted

**Checking of Rough Cash Book:**

- Auditor should **test entries** from the rough cash book with those in the cash book
- Temporary advances paid to the employees are initialled by a **responsible official** & debited to **appropriate accounts if included in C&CE as slips, chits or I.O.U.**

**Direct Confirmation Procedures:**

- **Contact banks/** financial institutions directly
- Done for all account balances at year end
- Company should be asked to **investigate** and reconcile the discrepancies
- **Emphasize** for confirmation of 100% of bank account
- In remote situations where no reply is received, auditor should perform **additional testing** regarding the balances like down loading online statement, or sending team member to Bank Branch for confirmation

**Verification of BRS:**

- **Understanding process & frequency of making BRS verification of BRS includes:**
- **Tallying** the balance as per books and bank book
- **Checking of all material reconciling items**
  - Verify **cheques issued have subsequently been cleared by bank**
  - For all cases where cheques have become stale same should not appear in the BRS
- **Checking of all material reconciling items included under "cheques de-posited but not credited by bank"**
  - **Verify** if the balances were credited by bank subsequently
  - Seek **explanations** from the man-agreement &
  - Verify of the **revenue recognition** related to such parties
- **Checking of all material reconciling items included under "amounts/ charges debited/ credited by bank but not accounted for"**
  - Auditor should insist the management to record **adjustments**
  - Auditor should **qualify** his opinion

**Sensitivity Analysis:**

Perform a cash sensitivity analysis by compiling a **summary of cash receipts & payments**

**Analyse** the trends, see variations, seek explanations.

**C**

**INVENTORIES**

**A Meaning**

Inventories are a **form of current asset** held for sale in the ordinary course of business or in the **process of production** for such sale or for consumption in the production of goods or service for sale or in the form of **materials or supplies** to be consumed in the **production process** or in the **rendering of services**.

**B Assertions**

(i) **Existence** Establish year end balance

(ii) **Completeness**

**Audit procedures**

Review client's plan for performing **inventory count**

Ensure consigned goods segregated

Appropriate supervision those performing count

Personally perform test counts to verify counts

**Test counts by auditor should include:**

- Observing employees
- Observing there is supervision
- All items are properly tagged
- Proper amounts are shown on tags
- Tags and summary are controlled & reconciled & discrepancies agreed with client
- Reconciliation of test counts with tags
- Staying alert at all times
- Establishing cut off, review last 5-10 shipping documents
- Ensuring exclusion of third party stock
- Ensuring accounting of all stock sheets
- Investigating any significant differences between the physical stock and stock records. Ask client to sign all stock sheets.
- Inventory count should be undertaken at end of period
- If client uses perpetual system, inventory may be counted at interim dates
- Confirm or investigate public warehouse inventory, job worker stock.

**1 Perform analytical procedures**

- a. Compute inventory turn-over ratio
- b. Perform vertical analysis
- c. Compare budgetary expectations

**2 Examine non-financial information**

**3 Perform purchase & sales cut-off tests. Trace shipping docs to books**

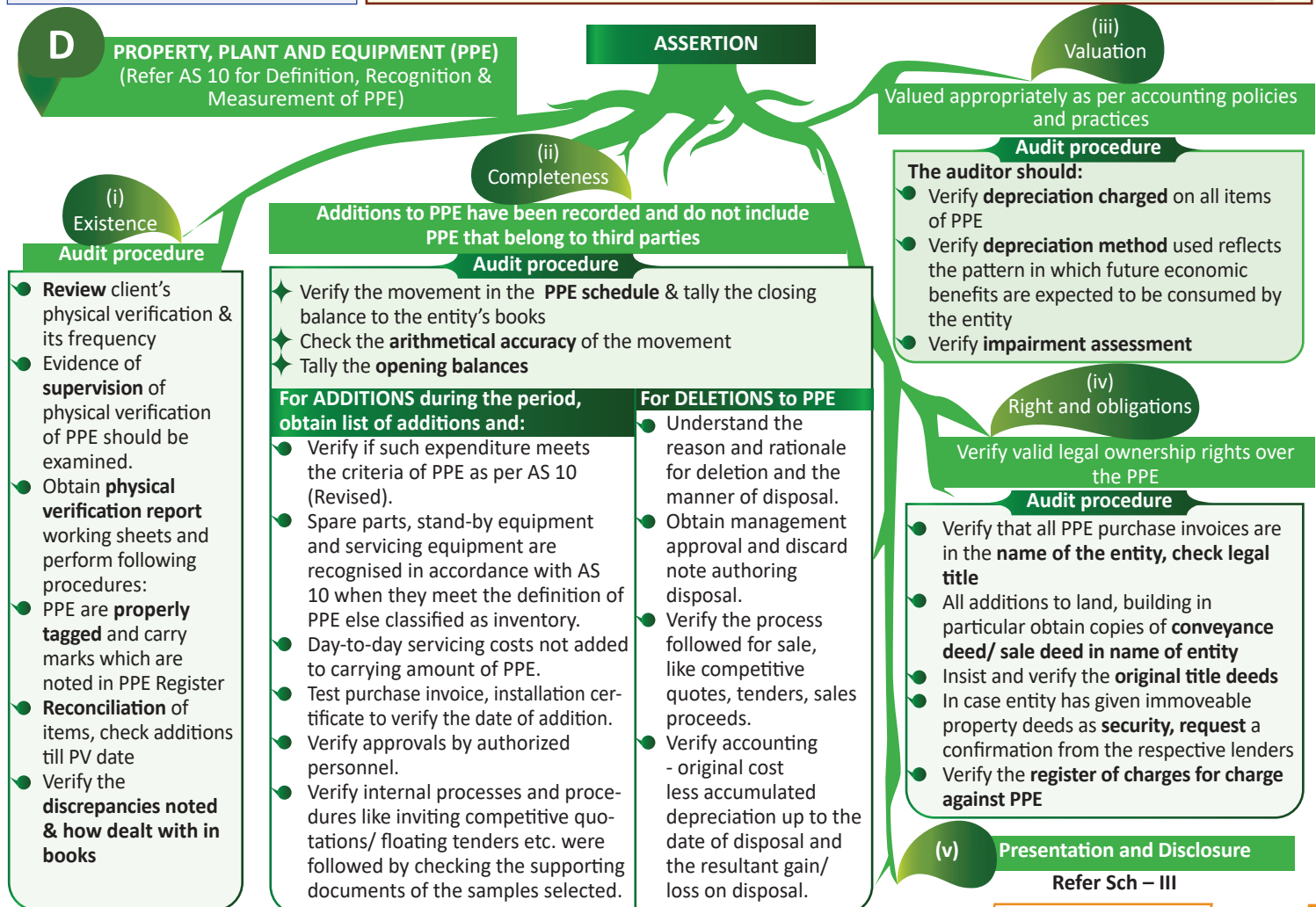
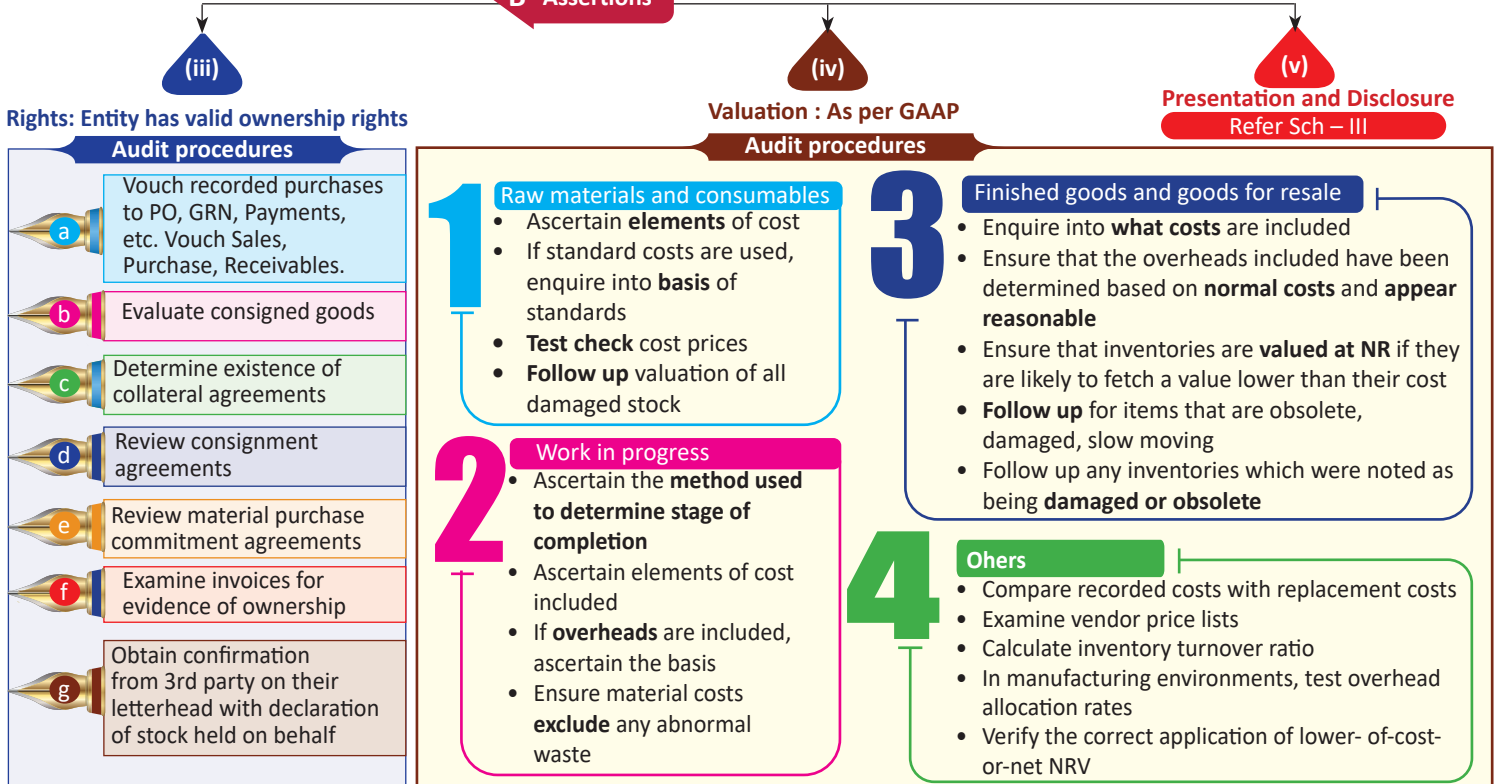
**4 Verify the clerical & arithmetical accuracy**

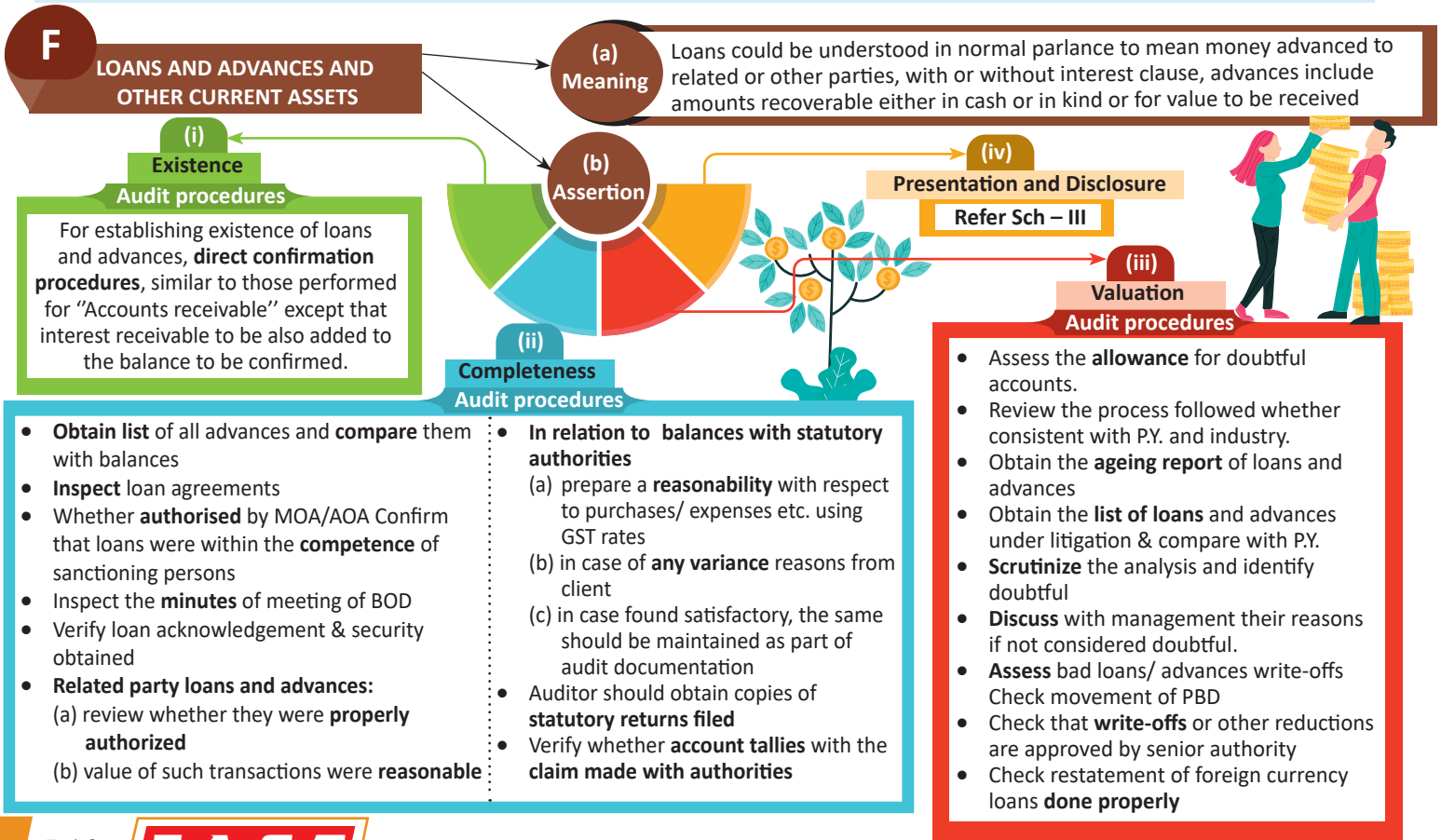
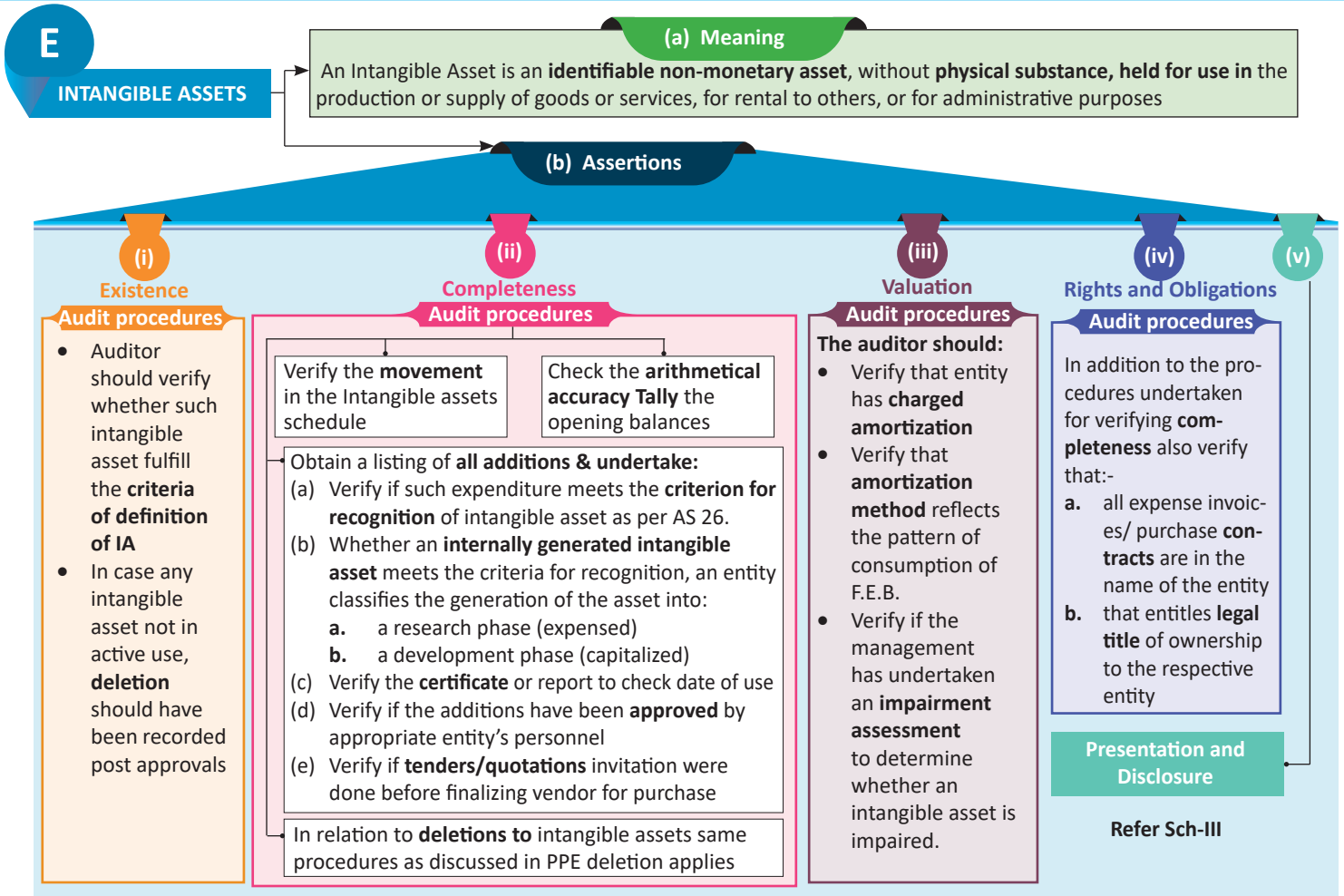
**5 Reconcile physical inventory with perpetual records.**

**6 Reconcile physical counts with general ledger control totals.**

**7 Verify our stock with 3<sup>rd</sup> party & 3<sup>rd</sup> party stock with us**

Contd.. **B Assertions**





# 4 INCOME STATEMENT CAPTIONS

## A SALE OF PRODUCTS AND SERVICES

**Meaning** The sales and collections cycle in a business refers to the **set of processes** that begin when a customer **purchases goods** or services & ends when the entity **receives complete payment** for the purchase. Sales generally attracts higher RoMM:

**1** Revenue Cycle involves Sales Service to Sales Journal and Deposit Slip, Cash Receipt both recorded to Accounts Receivable Listing

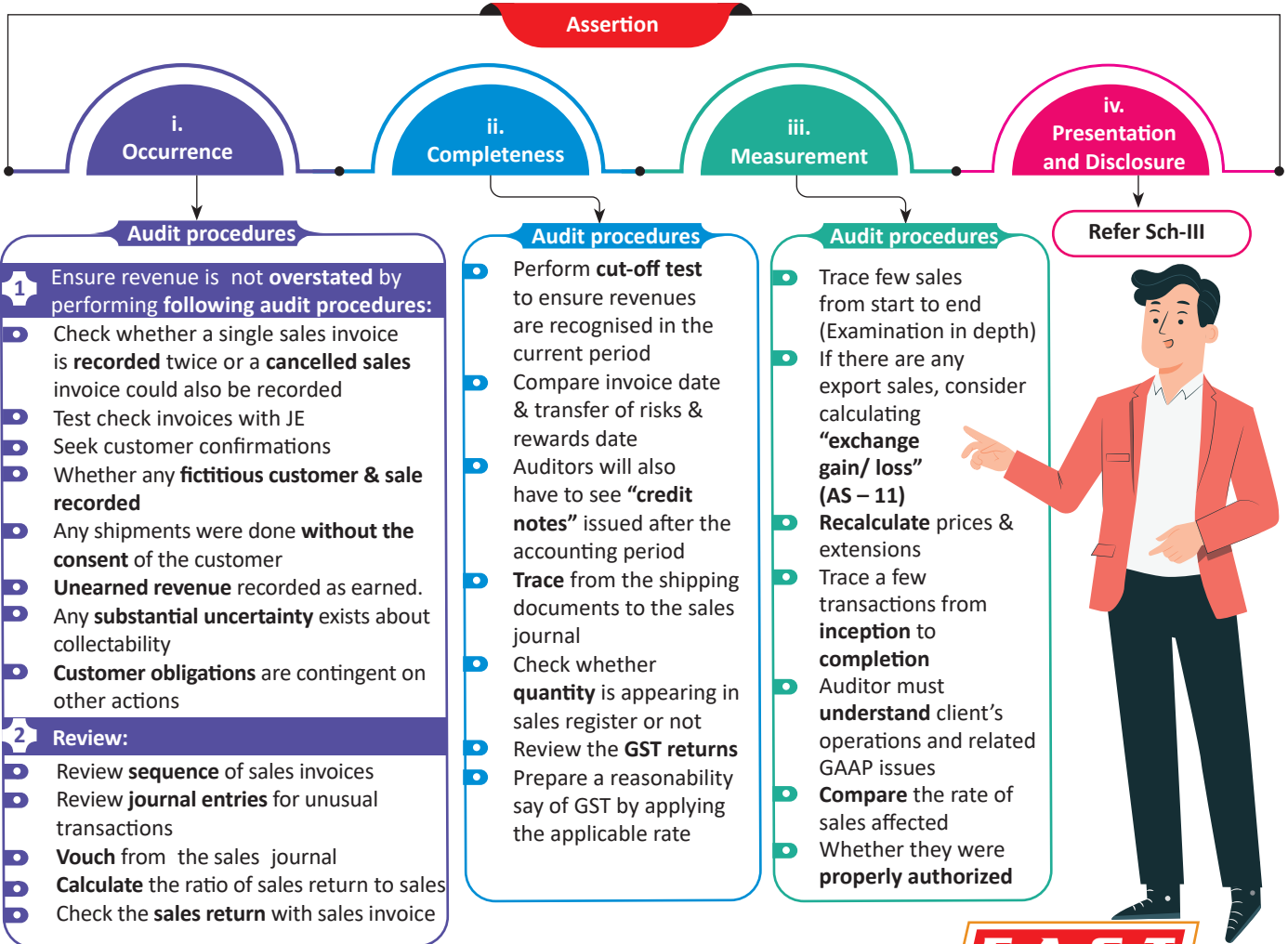
**3** **Tests the controls** – If effective, reduce substantive testing. If deficient communicate as per SA265.  
(**Example of controls** - Pre-numbered sales invoices, Authority for : Approval/Execution /Credit limit and Write-offs. **Example of Test of Controls** – Check if invoice serially numbered in a sample,)

**4** **Substantive analytical procedures** – (**Example** - Sales trend analysis, PY – CY comparisons, category-wise sales analysis, etc. Auditor can compute expected Sales value and compare with sales records. For this needs to know average SP, discounts, etc. during the year)

**2** As part of the year-end audit procedures, auditors test sales transactions and its ICs to assess whether entity is materially misstating revenues. This involves:

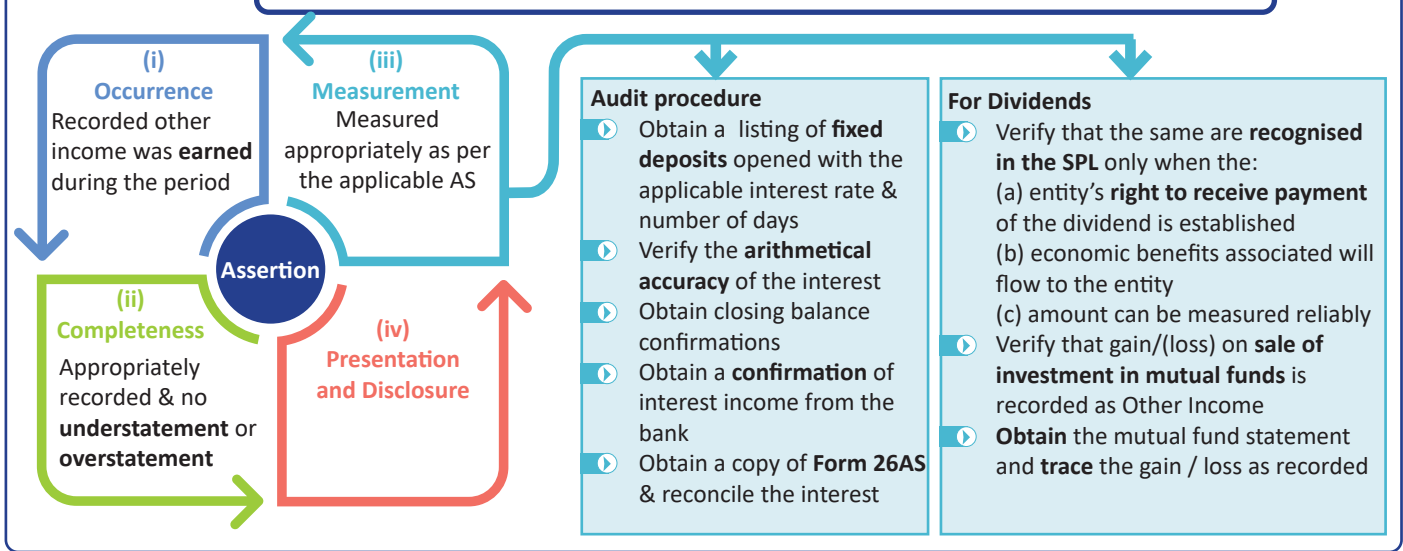
**Understanding Sales Process IC**  
(Example SoD between person determining Credit limit Vs Authorising Sales Orders Vs Raising Invoices Vs Despatch Vs Collections, when to record sales)

**Understanding revenue centres**  
(Example Types of products/ services, major customer, returns)



**B OTHER INCOME COMPRISING INTEREST INCOME, DIVIDEND INCOME, GAIN/ LOSS ON SALE OF INVESTMENTS ETC.**

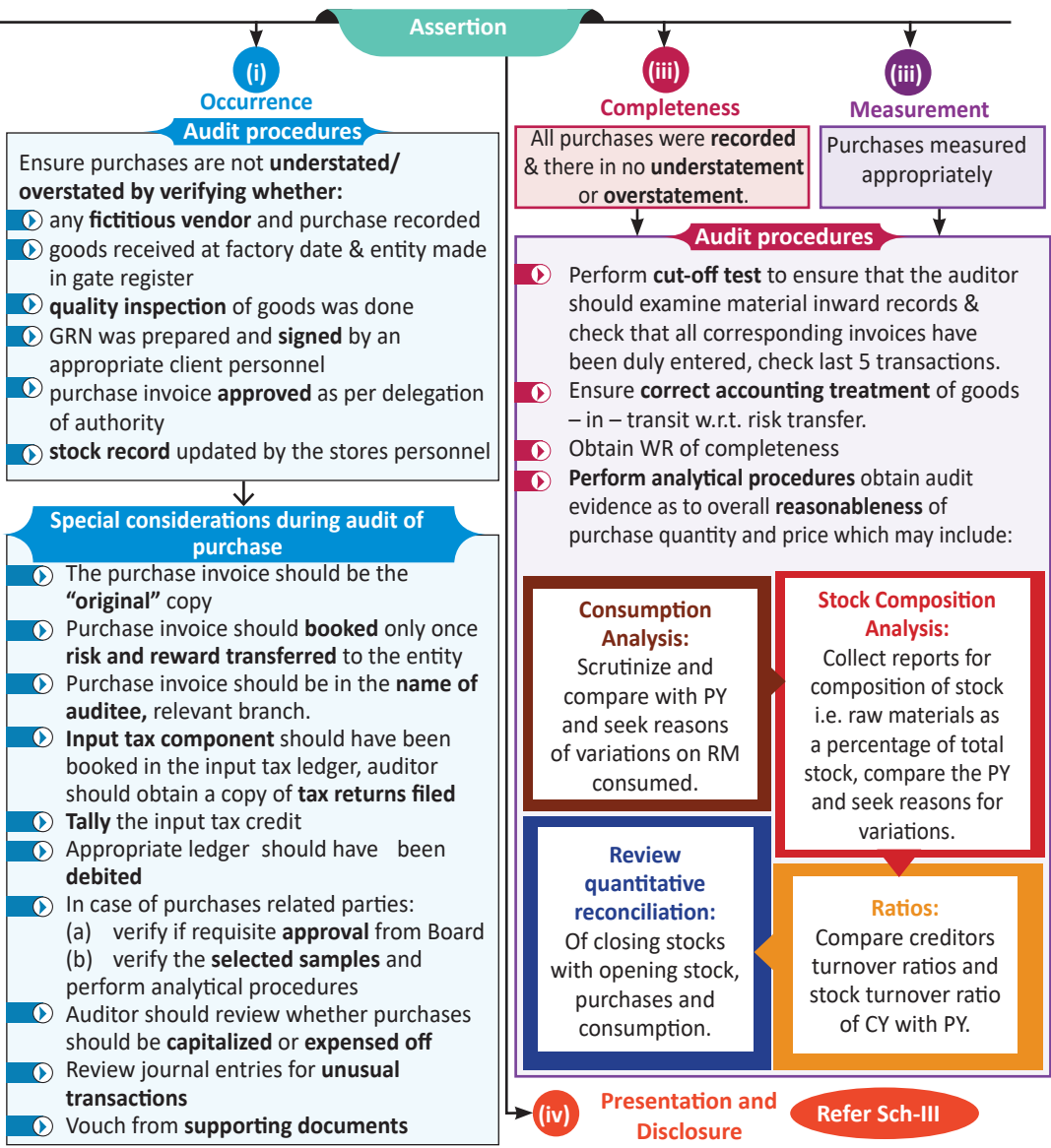
**Meaning :** Any form of income earned by an entity which is not linked to the entity's core business operations is generally classified as other income



**C PURCHASES**

**What are the factors auditor need to understand while auditing purchases -**


- An auditor needs to identify the control points over purchases whether:
  - i segregation of duties exist,
  - ii competitive quotes are invited,
  - iii a purchase committee exists
- Tests the controls the entity has set up for the purchase cycle
- Selects a **random sample** of transactions & examines the related purchase orders
- Performing **substantive audit procedures** is must & it will consist of:
  - i purchase trend analysis, comparison with previous accounting period
  - ii category wise purchases,
  - iii any analysis auditor may find relevant
  - iv the auditor would need to know the purchase prices of the products or services



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