

Commercial's

# AUDITING and ETHICS

CA INTER - Group-2, Paper-5 (NEW SYLLABUS)

Applicable for May 2024  
and onwards Examination



**CA Abhishek Bansal**  
(B.Com, FCA, CS, PGDFM)

10th Edition 2024

Commercial Law Publishers (India) Pvt. Ltd.

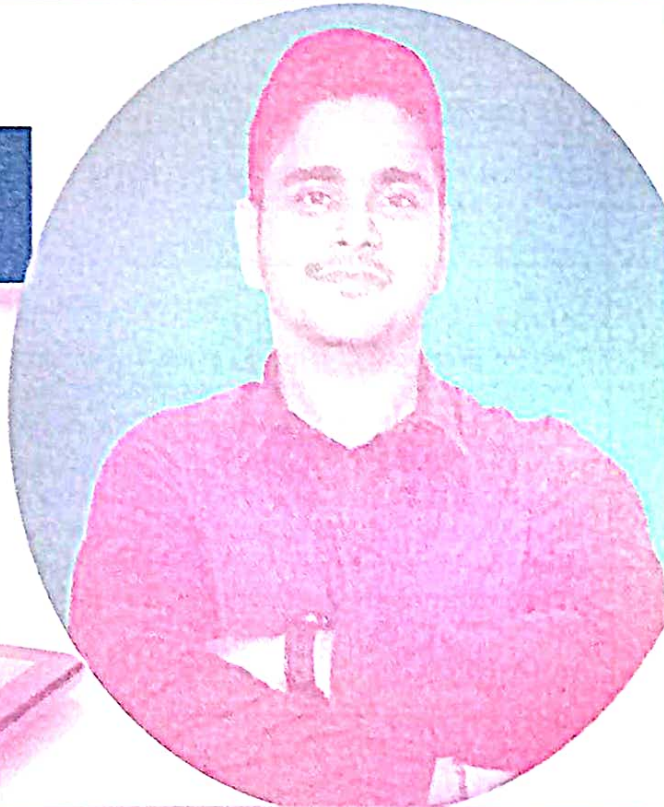
MAIN BOOK

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Phones: 43502007, 43502008, 43011562, 43452009

e-mail: commercialhouse@yahoo.co.in

naveen.commercialhouse@gmail.com

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## PREFACE

Dear Students,

It gives me immense pleasure in presenting the Hand book on "Auditing and Ethics".

The book has been written keeping in view the requirements of C.A. INTER examination of the Institute of Chartered Accountants of India.

My heartfelt and sincere thanks to publishers COMMERCIAL LAW PUBLISHERS INDIA PRIVATE LTD. for trusting me with this responsibility.

Salient Features:

- Strictly as per syllabus approved by ICAI.
- Upto date amendments including Companies Act, 2013.
- Handwritten font is used to have a feel of one's self notes.
- Mnemonics are made for descriptive answers.
- Covers all chapters for CA INTER Syllabus

Suggestions from all readers would be highly appreciated and acknowledged.

You can mail your suggestions, advice and comments on [abhibansal3@gmail.com](mailto:abhibansal3@gmail.com)

For latest updates / amendments, visit [www.letslearnindia.in](http://www.letslearnindia.in)

Finally, I hope that students will find this book beneficial from exam point of view.

My heartfelt thanks to my beloved wife Ria Teniwal for helping me in drafting this book.

Thanks to Ms. TANU MOURYA in formatting the book in the best possible way. Wishing every success to the readers.

Enjoy reading and all the best.



CA Abhishek Bansal

15<sup>th</sup> DECEMBER, 2023

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<u>CHAPTER 1</u> <u>NATURE, OBJECTIVE &amp; SCOPE OF AUDIT</u>	
I.	<u>INTRODUCTION</u>
	Financial Statements are the set of documents which show the result of the business operations during a particular period.
	A Financial Statement includes:
	♣ Profit and Loss Account
	♣ Balance Sheet
	♣ Cash Flow Statements
	♣ Notes to accounts
	♣ Statement of changes in equity
	The following entities are interested in financial statements for different purposes.
1.	Management: For managing the day-to-day affairs of the company and evaluating the performance.
2.	Shareholders: To analyses performance, profitability and financial position v
3.	Financial Institutions: To determine the financial position of the company.
4.	Suppliers: To determine the credit-worthiness of the company for the purpose of granting credit.

5. **Researchers:** For the purpose of study and analysis.
6. **Government:** To ensure prompt collection of direct and indirect tax revenues, to evaluate arrangements
7. **Customers:** To know the general business viability before entering into long-term contracts and arrangements.

## II. AUDIT AND AUDITOR

### A. DEFINITION OF AUDITING:

Auditing is defined as a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose.

In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report.

According to SA-200 on "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing",

"An audit is an independent examination of the 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."



	<b>B. AUDITOR:</b>		
1.	The person conducting an audit is known as the Auditor.		
2.	He makes a report to the person appointing him after due examination of the accounting records and the accounting statement in the form of an opinion on the financial statements. The opinion that he is called upon to express is whether the financial statement reflects a true and fair view.		
3.	In India, under the authority of the company's act, 2013, only chartered accountants are professionally qualified for the audit of the accounts of the companies.		
4.	By and large, it is chartered accountants or a firm, majority of the partners of which are chartered accountants, who acts as auditors in India.		
<b>III.</b>	<b><u>DISTINCTION BETWEEN INTERNAL &amp; EXTERNAL AUDIT:</u></b>		
	<b>BASIS FOR COMPARISON</b>	<b>INTERNAL AUDIT</b>	<b>EXTERNAL AUDIT</b>
	Meaning	Internal Audit refers to an ongoing audit function performed within an organization by a separate internal auditing department.	External Audit is an audit function performed by the independent body which is not a part of the organization.

Objective	To review the routine activities and provide suggestion for the improvement.	To analyze and verify the financial statement of the company.
Conducted by	Employees	Third Party
Auditor is appointed by	Management	Members
Users of Report	Management	Stakeholders
Opinion	Opinion is provided on the effectiveness of the operational activities of the organization.	Opinion is provided on the truthfulness and fairness of the financial statement of the company.
Scope	Decided by the management of the entity.	Decided by the statute.

IV. QUALITIES OF AN AUDITOR

The auditor should have adequate knowledge of the following:

- General principles of law, contracts, partnerships, etc.
- Statutes and provision applicable to entity. For instance, Companies Act, 2013, etc.
- Direct and Indirect Tax Laws.
- General Economic Trends.
- Nature of client's business and its characteristics.
- Accountancy principles, policies, standards, techniques, practices, etc.

	<ul style="list-style-type: none"> <li>• Auditing principles, standards, techniques, practices, etc</li> </ul>
	<p>The auditor should possess personal qualities like tact, caution, firmness, good temper, integrity, objectivity, independence, discretion, patience, clear headedness, common sense, reliability and trust.</p>
V.	<p><u>OBJECTIVES OF AN AUDIT</u></p>
	<p>As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:</p>
✚	<p>To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and</p>
✚	<p>To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.</p>
	<p><u>Explain Reasonable Assurance v/s Absolute Assurance</u></p>
	<p>Reasonable assurance is to be distinguished from absolute assurance. Absolute assurance is a complete assurance or a guarantee that financial statements 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.</p>
	<p>Audit of financial statements is carried out by the auditor with professional competence and skills in accordance with Standards on Auditing. Audit procedures are applied in accordance with SAs, audit evidence is obtained and</p>

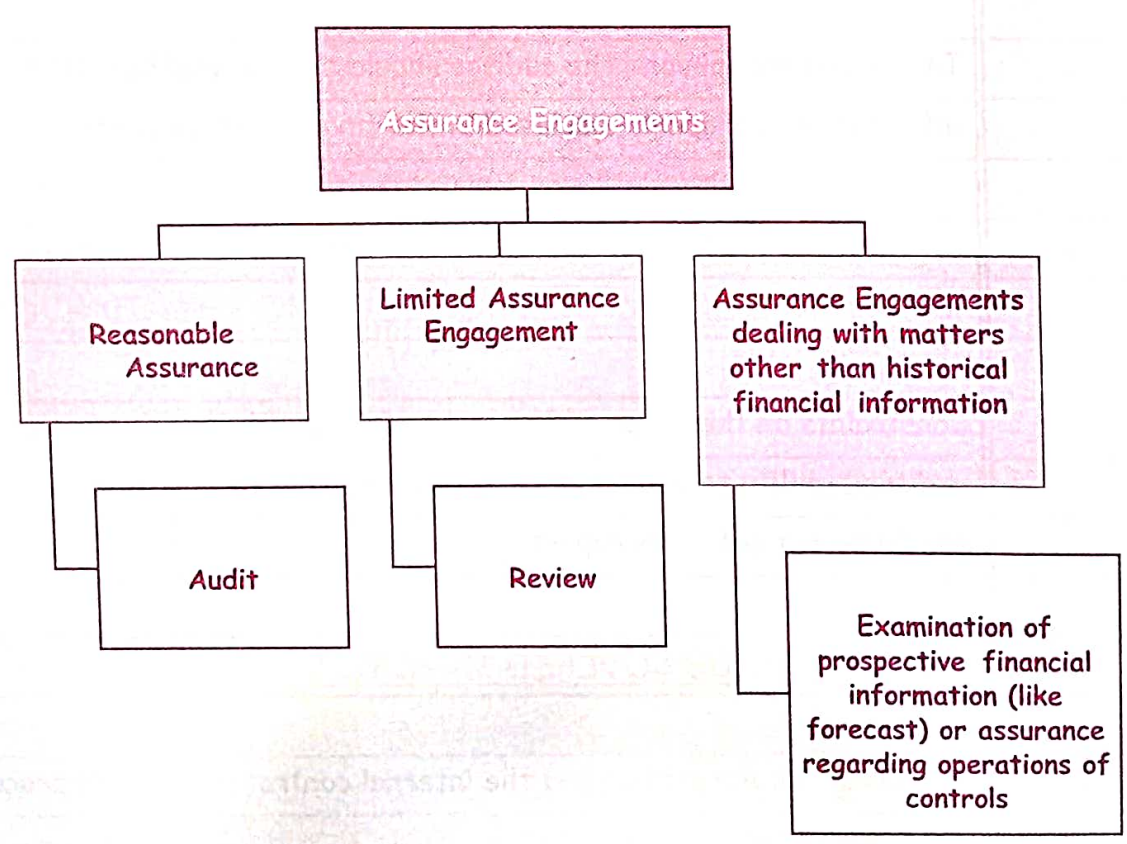
evaluated. On basis of that, conclusions are drawn and opinion is formed. It leads to high level of assurance which is called as reasonable assurance but it is not absolute assurance.

<u>Reasonable assurance engagement</u>	<u>Limited assurance engagement</u>
Reasonable assurance engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement.
It draws reasonable conclusions on the basis of sufficient appropriate evidence.	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
Example of reasonable assurance engagement is an audit engagement.	Example of limited assurance engagement is review engagement.

Examples of assurance engagements

Checkbox	Example of assurance engagement	Type of assurance engagement
✓	Audit of financial statements	Reasonable assurance engagement

✓	Review of financial statements	Limited assurance engagement
✓	Examination of Prospective financial information	Provides assurance regarding reasonability of assumptions forming basis of projections and related matters
✓	Report on controls operating at an organization	Provides assurance regarding design and operation of controls



VI.	<u>SCOPE OF AUDIT</u>
	The principal aspects to be covered in an audit concerning final statements of account are the following:
•	To form an opinion the auditor should be satisfied as to whether the information contained in the underlying accounting records and other source data is reliable and sufficient as the basis for the preparation of the financial statements
•	All aspects of the enterprise to be covered in audit
•	In forming his opinion, the auditor should decide whether the relevant information is properly disclosed in the financial statements
•	The auditor is not expected to perform duties which fall outside the scope of his competence
•	Constraints on the scope of the audit of financial statements that impair the auditor's ability to express an unqualified opinion on such financial statement should be set out in his report.
VII.	<u>ASPECTS TO BE COVERED IN AUDIT</u>
φ	Examining the Accounting and the internal control system and procedures of the organization.

φ	Confirming the validity, reliability and authenticity of transactions.
φ	Scrutinizing the vouchers and supporting documents. ■ Checking arithmetic accuracy of the accounts.
φ	Determining whether distinction has been made between capital and revenue natured items.
φ	Making a comparison of the items covered in the financial statement with those of the account books.
φ	Verifying the assets and liabilities.
φ	Confirming the statutory requirements of the body corporate
φ	Reporting to the requisite authority
<b>VIII.</b>	<b><u>ADVANTAGES OF AUDIT OF FINANCIAL STATEMENTS</u></b>
φ	It safeguards the financial interest of persons who are not associated with the management of the entity, whether they are partners or shareholders, bankers, FI's, public at large etc.
φ	It acts as a moral check on the employees from committing defalcations or embezzlement.
φ	Audited statements of account are helpful in settling liability for taxes, negotiating loans and for determining the purchase consideration for a

	business.
φ	These are also useful for settling trade disputes for higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.
φ	An audit can also help in the detection of wastages and losses to show the different ways by which these might be checked, especially those that occur due to the absence or inadequacy of internal checks or internal control measures.
φ	Audit ascertains whether the necessary books of account and allied records have been properly kept and helps the client in making good deficiencies or inadequacies in this respect.
φ	As an appraisal function, audit reviews the existence and operations of various controls in the organisations and reports weaknesses, inadequacies, etc., in them.
φ	Audited accounts are of great help in the settlement of accounts at the time of admission or death of partner.
φ	Government may require audited and certified statement before it gives assistance or issues a license for a particular trade.
IX.	<u>DISTINCTION BETWEEN AUDITING &amp; INVESTIGATION</u>



	<u>BASIS FOR COMPARISON</u>	<u>AUDITING</u>	<u>INVESTIGATION</u>
	Meaning	The process of inspecting the books of accounts of an entity and reporting on it, is known as Auditing.	An inquiry conducted, for establishing a specific fact or truth is known as Investigation.
	Nature	General Examination	Critical and in depth examination.
	Evidences	The evidences are persuasive in nature.	The evidences are unquestionable, therefore, its
	Time Horizon	Annually	As per requirement
	Performed by	Chartered Accountant	Experts
	Reporting	General Purpose	Confidential
	Obligatory	Yes	No
	Appointment	an auditor is appointed by the shareholders of the company.	The management or shareholders or one- third party can appoint investigator.
X.	<u>AUDIT REQUIRED UNDER LAWS</u>		
	The organizations which require audit under law are the following:		
φ	Companies governed by the Companies Act, 2013;		
φ	Banking companies governed by the Banking Regulation Act, 1949;		
φ	Electricity supply companies governed by the Electricity Supply Act, 1948;		
φ	Co-operative societies registered under the Co-operative Societies Act, 1912;		
φ	Public and charitable trusts registered under various Religious and Endowment		

	Acts:
◊	Corporations set up under an Act of Parliament or State Legislature such as Life Insurance Corporation of India.
◊	GST Audit under GST Act
◊	Specified entities under various sections of the Income-tax Act, 1961.
XI.	<u>IMPORTANCE OF AUDITING AS A TOOL</u>
	<u>Relationship between Auditing and Accounting</u>
◊	Accounting and auditing are closely related with each other. Auditing reviews, the financing and the statements which are nothing but a result of the overall accounting process.
◊	It naturally calls on the part of the auditor to have a thorough and sound knowledge of general accepted principles of accounting before he can review the financial statements.
	<u>Relationship between Auditing and Law</u>
◊	The relationship between auditing and law is a very close one.
◊	Auditing involves examination of various transaction with a view to ascertain whether or not the transactions have been properly entered into.
◊	It necessitates that an auditor should have a good knowledge of business laws affecting the entity.

ϕ	He should be familiar with the law of contracts, negotiable instruments etc.
ϕ	The knowledge of taxation laws is also inevitable as an entity is required to prepare its financial statements taking into account various provisions affected by various tax laws.
ϕ	In analyzing the impact of various transactions particularly from the accounting aspect an auditor ought to have a good knowledge about the direct as well as indirect tax laws.
<u>Relationship between Auditing and Economics</u>	
ϕ	As is well known, accounting is concerned with the accumulation and presentation of data relating economic activity.
ϕ	The auditors are more concerned with micro-economic rather than with the macro-economics.
ϕ	The knowledge of macro-economic should include the nature of economic forces that affect the firm relationship of price, productivity it and the role of government and government regulations.
ϕ	An auditor is expected to be familiar with the overall economic environment in which his client is operating
<u>Relationship between Auditing and Behavioral Science</u>	
ϕ	[The discipline of behavioral science is closely linked with the subject of

	auditing]
ϕ	The field of auditing as a discipline involves review of various assertions both in finance as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same.
ϕ	Thus, it is quite logical and natural that the function of audit can be performed if only if the person also possesses a good knowledge about the fields in respect of which he is conducting such a review.
ϕ	The discipline of behavioral science is also closely linked with the subject of auditing.
ϕ	While it may be said that an auditor, particularly the financial auditor, deals basically with the figure contained in the financial statements. He shall also be required to interact with a lot of people in the organization.
ϕ	The knowledge of human behavior is indeed very essential for an audit discharge his duties.
ϕ	Hence, he should have the knack of getting along with the personnel of the entity under the audit.
	<u>Relationship between Auditing and Statistics-Mathematics</u>
ϕ	With the emergence of test check procedures, the discipline of statistic has come quite close to, auditing as the auditor is also expected to have the knowledge of statistical sampling so as to arrive so as to arrive at meaningful

conclusions.

φ The knowledge of mathematics is also required on the part of the particularly at the time of verification of inventories.

Relationship between auditing and data processing

⊕ Many organizations are carrying out their financial accounting activities with the help of computers which can document, record, collate, allocate and value accounting data and information in very large quantities at very high speed.

⊕ With the dependence on the accuracy of the programmed instructions today, the computer is able to carry out each of these activities with complete accuracy

⊕ With such a phenomenal growth in the field of computer science, the auditor should have good knowledge of the components, general capability of the system and the related terms

⊕ In fact, data processing and auditing both are developing as a discipline in itself

Relationship between auditing and financial management

⊕ Auditing is also closely related with other functional fields of business such as finance, production, marketing, personnel and other general areas of business management.

⊕ With the overgrowing field of auditing, the financial services sector occupies a