Skillshort

Self-Study Preparation Pack

CA INTERMEDIATE

Paper 5: Auditing and Ethics

Chapter-wise Detailed Notes

For January 2027 attempt · ICAI BoS study material (new scheme, 11 chapters) + RTP January 2027 · Standards on Auditing, Companies Act 2013, CARO 2020, Code of Ethics

100 marks · 3 hours | 30 MCQ + 70 descriptive | Q1 compulsory + any 4 of 5 | Case-study answers

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This subject pack has 6 parts

1 Chapter-wise notes

2 Important topics & weightage

3 Past papers: trends & links

4 Mock tests + solutions

5 Chapter practice questions

6 Last-week plan & strategy

Prepared by Skillshort for self-study. Original explanations and questions; not an official ICAI/ICMAI/ICSI publication. Items marked VERIFY should be checked against the latest official material.

How to use these notes

These notes follow the **ICAI new-scheme study material** for Paper 5 (11 chapters). Each chapter gives the **Standard on Auditing (SA)** or legal provision, the lists ICAI expects word-for-word, the **case-study angle** ICAI uses in its questions, and common traps. Items marked VERIFY should be checked against the latest study material or RTP before the exam.

File	Use it for
01 Chapter Notes (this file)	Concept building and first revision
02 Important Topics & Weightage	What to study first; frequency across 4 recent attempts
03 Past Papers – Trend Analysis & Links	How ICAI asks; official download links
04 Mock Tests 1–2 with Solutions	Full 3-hour practice in the exam pattern
05 Chapter-wise Practice Questions	MCQs + case-study practice after each chapter
06 Last-Week Plan & Exam Strategy	Final revision and exam-day plan

Paper at a glance

Item	Detail
Marks / time	100 marks, 3 hours (+15 minutes advance reading 1:45–2:00 pm)
Part I – MCQs (30 marks)	15 MCQs × 2 marks: one or two case scenarios of 5 MCQs + independent MCQs – mostly **application** of SAs
Part II – Descriptive (70 marks)	Q1 compulsory (14) + **any 4 of Q2–Q6** (14 marks each); sub-parts of 1–5 marks; Q6(c) usually has an OR
Skill-wise weightage	Comprehension & knowledge **40%–60%**; Analysis & application **40%–60%**

EXAM TIP **The answer format ICAI rewards**

Provision (name the SA/section/clause and state the rule) → **Facts** (apply to the case) → **Conclusion** (correct/not correct; what the auditor should do). Examiners repeatedly deduct marks when students write general audit points instead of the **specific requirement of the SA** asked.

SA map – the Standards you must know

Series	Area	SAs in your syllabus
200–299	General principles and responsibilities	200 objectives; 210 terms of engagement; 220 quality control for an audit; 230 documentation; 260 communication with TCWG (overview); 265 deficiencies in internal control (overview); 299 joint audit
300–499	Risk assessment and response	300 planning; 315 identifying and assessing RMM; 320 materiality; 330 responses to assessed risks (overview); 450 evaluation of misstatements (overview)
500–599	Audit evidence	500 audit evidence; 501 selected items; 505 external confirmations; 510 opening balances; 520 analytical procedures; 530 audit sampling; 550 related parties; 560 subsequent events; 570 going concern; 580 written representations
600–699	Using the work of others	610 using the work of internal auditors
700–799	Reporting	700 forming an opinion; 701 key audit matters; 705 modified opinions; 706 emphasis of matter and other matter; 710 comparative information
Quality	Firm-level	SQC 1 quality control for firms (overview) – ICAI has issued SQM 1/SQM 2 to replace it from a notified date VERIFY

Chapter 1: Nature, Objective and Scope of Audit

1.1 Meaning, objectives and scope

- **Audit** – an independent examination of financial information of an entity, whether profit-oriented or not, irrespective of its size or legal form, when such an examination is conducted with a view to expressing an **opinion** thereon.
- **SA 200 – overall objectives:** (a) to obtain **reasonable assurance** about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, so that the auditor can express an opinion on whether they are prepared, in all material respects, in accordance with the applicable financial reporting framework; and (b) to **report** on the financial statements and communicate as required by the SAs.
- Where reasonable assurance cannot be obtained and a qualified opinion is insufficient, the auditor **disclaims** an opinion or **withdraws** from the engagement where withdrawal is possible under law.
- **Scope of audit** (decided by the auditor, with reference to law, regulations and SAs): coverage of all aspects of the entity relevant to the financial statements; reliability and sufficiency of the financial information; proper disclosure. **Outside the scope:** the audit does not guarantee the future viability of the entity, nor the efficiency or effectiveness with which management conducted affairs; it is not an investigation of fraud.
- **Reasonable assurance** – a high, but not absolute, level of assurance. **Limited assurance** (review engagements, SRE 2400) – negative form of conclusion ("nothing has come to our attention...").

1.2 Inherent limitations of an audit (SA 200)

Limitation	Explanation
Nature of financial reporting	Judgements and estimates; some items are inherently subjective (e.g. fair values, provisions)
Nature of audit procedures	Management may not provide complete information; fraud may involve collusion or forgery; the auditor has no legal power of search
Timeliness and cost-benefit	Information must be reported in a reasonable period at a reasonable cost; the auditor tests on a sample basis
Other matters	Fraud involving senior management, related-party relationships, non-compliance with laws, future events (going concern)

1.3 Assurance engagements and engagement standards

- **Elements of an assurance engagement:** (i) **three-party relationship** – practitioner, responsible party, intended users; (ii) appropriate **subject matter**; (iii) suitable **criteria**; (iv) sufficient appropriate **evidence**; (v) written **assurance report**.
- **Engagement standards issued by ICAI:** SAs (audit of historical financial information); **SREs** (review of historical financial information – SRE 2400, 2410); **SAEs** (assurance other than audits/reviews – e.g. SAE 3400 examination of **prospective financial information**); **SRSs** (related services – SRS 4400 agreed-upon procedures, **SRS 4410 compilation engagements**).
- **Qualities of an auditor:** integrity, objectivity, independence, professional competence, tact, patience, curiosity, **professional skepticism** (questioning mind, alert to contradictory evidence) and **professional judgement**.
- **Relationship with other disciplines:** accounting, law, economics, behavioural science, statistics and mathematics (sampling), data processing/IT.

Chapter 2: Audit Strategy, Audit Planning and Audit Programme

2.1 SA 300 – Planning an audit

- **Planning** involves establishing the **overall audit strategy** and developing an **audit plan**. It is a **continual and iterative** process – not a discrete phase.
- **Benefits of planning:** attention to important areas; identifying and resolving problems on time; organising and managing the engagement effectively; selecting team members with appropriate capability and assigning work; facilitating **direction, supervision and review**; coordinating work of auditors of components and experts.
- **Preliminary engagement activities:** (i) procedures on **continuance** of the client relationship (SA 220); (ii) evaluating compliance with **ethical requirements including independence**; (iii) establishing an **understanding of the terms of the engagement** (SA 210).
- **Key engagement team members** (and the engagement partner) are involved in planning, including the discussion among team members.
- **Discussing elements of planning with management** is permitted and helps coordination, but the overall audit strategy and audit plan **remain the auditor's responsibility**. Care is needed not to compromise effectiveness (e.g. by making procedures too predictable).

2.2 Overall audit strategy vs audit plan

Overall audit strategy (scope, timing, direction)	Audit plan (detailed)
Characteristics of the engagement (framework, industry reporting, locations, components)	Nature, timing and extent of **risk assessment procedures** (SA 315)
Reporting objectives, timing and nature of communications	Nature, timing and extent of **further audit procedures** at assertion level (SA 330)
Factors significant in directing the team's efforts (materiality, high-risk areas, internal control, significant business developments)	Other planned procedures required by SAs
Results of preliminary activities and knowledge from other engagements	
Nature, timing and extent of **resources** (who, when, how many hours)	

- **Factors for direction, supervision and review of team members:** size and complexity of the entity; area of the audit; assessed risks of material misstatement; capabilities and competence of the individual team members.
- **Changes during the audit:** if unexpected events occur, conditions change or audit evidence contradicts earlier assessments, the auditor **updates and changes the overall audit strategy and audit plan** and the resulting planned procedures – and documents the significant changes and reasons.
- **Documentation:** overall audit strategy, audit plan, and significant changes during the engagement with reasons.

2.3 Audit programme

- A detailed list of **audit procedures** to be applied to each area, with columns for the person performing, date and reference to working papers. It provides **instructions** to assistants, a **basis for allocating work**, a means of **controlling** progress and evidence of work done.
- **Developing an audit programme:** objectives of the audit; understanding of the business and internal control; assertions; the **most appropriate audit evidence** (the evidence that gives the highest satisfaction about the assertion – e.g. physical verification for cash in hand; **confirmation from the bank** for investments pledged with the bank).
- **Advantages:** clear set of instructions, uniformity, evidence of work done, fixing responsibility. **Disadvantages:** mechanical work, initiative of staff killed, rigidity – minimised by periodic review and encouraging staff to report unusual matters.

Chapter 3: Risk Assessment and Internal Control

3.1 Audit risk model

Audit risk = Risk of material misstatement (inherent risk × control risk) × Detection risk

- **Inherent risk** – susceptibility of an assertion to misstatement before considering controls (complex calculations, estimates, cash, high-value items, new products).
- **Control risk** – risk that a misstatement will not be prevented, or detected and corrected, by the entity's internal control.
- **Detection risk** – risk that the auditor's procedures will not detect a material misstatement. It is the only component the auditor **controls**, by changing the nature, timing and extent of procedures. RMM and detection risk move **inversely**: higher RMM → lower acceptable detection risk → more and better substantive work.
- **Detection risk** has two parts: **sampling risk** (the sample conclusion differs from the population) and **non-sampling risk** (wrong procedures, misinterpreting evidence).

3.2 SA 320 – Materiality

- Misstatements are material if they, individually or in aggregate, could reasonably be expected to **influence the economic decisions** of users. Materiality is a matter of **professional judgement** and is affected by **size and nature**.
- **Benchmarks:** profit before tax from continuing operations (profit-oriented entities – often ~5%); total revenue (~1%) or total expenses for loss-making or not-for-profit entities; total equity or net asset value (asset-based entities). Percentages are illustrative only, not prescribed VERIFY.
- **Performance materiality** – an amount set **below** materiality for the financial statements as a whole, to reduce to an appropriately low level the probability that aggregate uncorrected and undetected misstatements exceed materiality.
- **Specific materiality** – lower levels for particular classes of transactions, balances or disclosures (e.g. related-party transactions, directors' remuneration).
- **Revision** – materiality is revised when new information becomes available (e.g. actual results differ substantially from forecasts). **Documentation:** materiality, performance materiality, specific levels and any revisions.

3.3 SA 315 – Identifying and assessing RMM

- **Objective:** to identify and assess the risks of material misstatement, whether due to fraud or error, at the **financial statement and assertion levels**, through understanding the entity and its environment, including internal control, thereby providing a basis for designing and implementing responses.
- **Risk assessment procedures:** (i) **inquiries** of management and others (internal audit, in-house legal counsel, marketing staff); (ii) **analytical procedures**; (iii) **observation and inspection**. Plus discussion among the engagement team.
- **Understanding the entity:** industry, regulatory and external factors; nature of the entity (operations, ownership, investments, financing); accounting policies; objectives, strategies and business risks; measurement and review of financial performance; internal control.
- **Components of internal control:** (i) **control environment** (integrity and ethical values, commitment to competence, participation of TCWG, management's philosophy, organisational structure, HR policies); (ii) the **entity's risk assessment process**; (iii) **information system and communication**; (iv) **control activities** (authorisation, performance reviews, information processing, physical controls, segregation of duties); (v) **monitoring of controls**.
- **Significant risk** – an identified risk that requires special audit consideration (fraud risk, significant non-routine transactions, related parties, complex estimates).

3.4 Internal control – evaluation and testing

- **Inherent limitations of internal control:** cost-benefit; routine transactions only; human error; collusion; management override; changes in conditions.

- **Tools for evaluation:** narrative records, **internal control questionnaire (ICQ)**, checklists, flow charts; **walk-through** test to confirm understanding.
- **Tests of controls** – to evaluate **operating effectiveness** (inquiry with observation, inspection, re-performance). If controls are expected to operate effectively, the auditor may rely on them and reduce substantive testing.
- **SA 265** – **Deficiency in internal control:** a control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements on a timely basis; or a necessary control is missing. **Significant deficiency:** a deficiency or combination of deficiencies that, in the auditor's **professional judgement**, is of sufficient importance to merit the attention of **those charged with governance**. Significant deficiencies are communicated **in writing** to TCWG on a timely basis, and also to management at an appropriate level.
- **Indicators of significant deficiencies:** evidence of ineffective control environment (fraud by senior management, management failing to remedy previously communicated deficiencies); absence of a risk assessment process where one is expected; material misstatements detected by the auditor that controls did not prevent; restatement of prior-period financial statements to correct a material misstatement.

3.5 Digital audit and internal financial controls

- **IT environment risks:** unauthorised access, unauthorised changes to master data, inappropriate manual intervention, loss of data, reliance on systems that process data inaccurately, lack of segregation of duties in IT.
- **Types of IT controls: general IT controls** (access security, program change management, data centre and network operations, system development) and **application controls** (input, processing, output – e.g. edit checks, validation, three-way match). Plus **IT-dependent manual controls**.
- **Audit approach:** understand and document the automated environment; identify the significant applications, interfaces and reports used; test **ITGCs** first, then automated controls (a test of one instance may suffice if ITGCs are effective). **Testing methods:** inquiry, observation, inspection, re-performance; **data analytics** (100% testing of journals, duplicate payments, unusual entries).
- **Assessing and reporting IT findings:** identify the root cause; consider whether a deficiency affects other controls; check whether compensating controls exist; assess the impact on financial statements and substantive procedures; and communicate significant deficiencies to TCWG (SA 265).
- **Internal financial controls (IFC)** – s. 134(5)(e) (directors' responsibility for listed companies) and **s. 143(3)(i)** – the auditor reports on the **adequacy and operating effectiveness of IFC with reference to financial statements**. IFC is wider (orderly and efficient conduct of business, safeguarding assets, fraud prevention, accuracy and timely preparation of reliable financial information). **ICFR** (internal control over financial reporting) is the part relevant to financial statements.

REMEMBER **IFC reporting exemption for private companies**

Reporting u/s 143(3)(i) does **not** apply to a **private company** that is a one person company or a small company, **or** that has turnover **less than ₹50 crore** as per the latest audited financial statements **and** aggregate borrowings from banks, financial institutions or any body corporate **less than ₹25 crore** at any point of time during the financial year (MCA notification, June/July 2017). It also must not have defaulted in filing financial statements u/s 137 or the annual return u/s 92.

3.6 SA 330 – Responses to assessed risks (overview)

- **Overall responses** at financial statement level: emphasising professional skepticism, assigning more experienced staff, more supervision, unpredictability in procedures, changes to timing.
- **Further audit procedures** at assertion level: **tests of controls** (when relying on controls, or when substantive procedures alone cannot give sufficient evidence) and **substantive procedures** (tests of details and substantive analytical procedures). Irrespective of assessed risks, the auditor performs **substantive procedures for each material class of transactions, account balance and disclosure**.

Chapter 4: Audit Evidence

4.1 SA 500 – Audit evidence

- **Sufficiency** is the measure of quantity, and **appropriateness** is the measure of quality (relevance and reliability). The quantity needed is affected by the assessed risks (higher risk needs more evidence) and by quality (better evidence means less is needed). More evidence does **not** make up for poor quality.
- **Reliability generalisations:** evidence from **independent external sources** is more reliable; internally generated evidence is more reliable when **related controls are effective**; evidence obtained **directly by the auditor** (observation of a control) is more reliable than evidence obtained indirectly or by inference (inquiry); **documentary** evidence is more reliable than oral; **original documents** are more reliable than photocopies or facsimiles.
- **Audit procedures: inspection** (records, documents, physical assets), **observation**, **external confirmation**, **recalculation**, **re-performance**, **analytical procedures**, **inquiry** (alone not sufficient).
- **Sources:** accounting records, minutes, confirmations from third parties, analysts' reports, information prepared using a **management's expert** (evaluate competence, capabilities and objectivity of the expert).

4.2 Assertions

About classes of transactions and events (income statement)	About account balances (balance sheet)	About presentation and disclosure
Occurrence – transactions occurred and pertain to the entity	**Existence** – assets and liabilities exist	Occurrence and rights and obligations of disclosed events
Completeness – all transactions recorded	**Rights and obligations** – entity holds rights to assets; liabilities are obligations	Completeness of disclosures
Accuracy – amounts recorded appropriately	**Completeness** – all assets and liabilities recorded	Classification and understandability
Cut-off – recorded in the correct period	**Valuation and allocation** – recorded at appropriate amounts	Accuracy and valuation
Classification – recorded in the proper accounts		

- Example: subsequent realisation of receivables after year-end tests **existence** and **valuation**; tracing despatch notes to sales invoices tests **completeness**; vouching invoices to despatch notes tests **occurrence**.

4.3 SA 501 – Specific considerations for selected items

- **Inventory – attendance at physical count** (where inventory is material): evaluate management's instructions and procedures; **observe** the count; **inspect** inventory; perform **test counts** (floor to sheet and sheet to floor); check cut-off; obtain evidence of condition (damaged, obsolete).
- **Count on a date other than the date of the financial statements:** perform audit procedures to obtain evidence on whether **changes in inventory between the count date and the year-end date are properly recorded** (roll-forward or roll-back using purchase, sales and production records; check the reliability of the perpetual records).
- **Attendance impracticable** (e.g. location remote, safety): perform **alternative procedures** (inspection of documentation of subsequent sales). If not possible, **modify the opinion** (SA 705). Inconvenience is not a reason.
- **Inventory with third parties:** request **confirmation** from the third party, or inspect/perform other procedures (attend their count, obtain an auditor's report on their controls).
- **Litigation and claims:** inquiry of management and in-house legal counsel; review **minutes** of TCWG and correspondence with external legal counsel; review **legal expense** accounts. If there is a material risk – seek **direct communication with the entity's external legal counsel** through a **letter of general inquiry** prepared by management and sent by the auditor. If management **refuses** to permit communication or meeting, or the counsel refuses to respond, and alternative procedures fail → **modify the opinion** (SA 705).

- **Segment information:** obtain understanding of the methods used by management to determine segment information, evaluate whether they result in disclosure in accordance with the framework, test their application; perform **analytical procedures**.

4.4 SA 505 – External confirmations

- The auditor maintains **control** over confirmation requests (selecting parties, designing and sending requests, receiving responses directly).
- **Positive confirmation** – the confirming party responds in all cases (agreeing or giving the information). **Negative confirmation** – responds only if it **disagrees**; it gives less persuasive evidence and is used as the **sole** substantive procedure only if **all** of these hold: RMM assessed as **low** and controls tested; population of a **large number of small, homogeneous** balances; a **very low exception rate** is expected; and the auditor is not aware of circumstances that would cause recipients to disregard requests.
- **Management refuses** to allow a request to be sent: inquire into the **reasons** and seek evidence of their validity; evaluate the implications for risk assessment (including fraud); perform **alternative procedures**. If the refusal is unreasonable or alternative evidence cannot be obtained, **communicate with TCWG** (SA 260) and determine implications for the opinion (SA 705).
- **Non-responses:** perform alternative procedures (for receivables: examine subsequent cash receipts, despatch documents, sales near year-end). **Exceptions** must be investigated (they may indicate misstatement or control deficiency).

4.5 SA 510 – Initial audit engagements: opening balances

- **Objective:** sufficient appropriate evidence about whether opening balances contain misstatements that materially affect the current financial statements, and whether accounting policies are consistently applied.
- **Procedures:** check that prior-period closing balances are **correctly brought forward** (or restated); that opening balances reflect appropriate policies; **review the predecessor auditor's working papers** (if possible); evaluate whether current-period procedures provide evidence (e.g. collection of opening receivables); perform specific procedures.
- **Reporting:** cannot obtain evidence → **qualified opinion or disclaimer** (where law permits, opinion on results and cash flows may be disclaimed while unmodified on financial position); opening balances misstated and not corrected → **qualified or adverse**; accounting policies not consistently applied → **qualified or adverse**; predecessor's modified opinion still relevant and material → modify the current opinion.

4.6 SA 520 – Analytical procedures

- Evaluations of financial information through analysis of **plausible relationships** among financial and non-financial data; includes investigation of **fluctuations** inconsistent with other information or expected values.
- **Substantive analytical procedures** – suitable for large volumes of transactions that tend to be **predictable over time**. The auditor considers the suitability for given assertions; the **reliability of data** (source, comparability, nature and relevance, controls over preparation); develops an **expectation** precise enough; and determines the acceptable difference.
- Also required **near the end of the audit** to form an overall conclusion. Significant unexplained differences → inquire of management and perform other procedures.
- **Types:** trend analysis, ratio analysis, reasonableness tests (e.g. interest = average loan × rate), regression analysis.

4.7 SA 530 – Audit sampling

- **Audit sampling** – applying procedures to **less than 100%** of items in a population such that all sampling units have a **chance of selection**.
- **Statistical sampling** – random selection **and** probability theory to evaluate results (including measuring sampling risk). It is "more scientific": free from personal bias; sample size and results can be measured objectively; results can be **projected** to the population; useful for large, homogeneous populations. **Non-statistical (judgemental)** – based on the auditor's judgement.

- **Sample selection methods: random** (random number tables/generators), **systematic** (constant interval from a random start – ensure the population is not structured to coincide with the interval), **monetary unit sampling** (value-weighted), **haphazard** (no conscious bias – not for statistical sampling), **block selection** (contiguous block – rarely appropriate, e.g. "first 150 accounts of last month" cannot be projected).
- **Stratification** – divide the population into sub-populations of similar characteristics (e.g. by value) to improve efficiency.

Factor	Effect on sample size
Increase in assessed RMM / desired assurance	Increase
Increase in **tolerable misstatement** (or tolerable rate of deviation)	**Decrease**
Increase in expected misstatement (or expected deviation rate)	Increase
Stratification of the population	Decrease
Number of sampling units in a large population	Negligible effect

- **Evaluating results:** investigate the nature and cause of deviations/misstatements; **project** misstatements to the population (an **anomaly** – proven not representative – may be excluded); evaluate whether the sample gives a reasonable basis for conclusions.

4.8 SA 550 – Related parties

- The auditor's responsibility: understand related-party relationships and transactions sufficient to recognise **fraud risk factors** and conclude whether the financial statements achieve fair presentation; obtain evidence on identification, accounting and disclosure as per the framework (AS 18 / Ind AS 24; s. 188 of the Companies Act).
- **Procedures:** inquire of management about the identity of related parties, nature of relationships and transactions; understand controls over authorisation and approval; remain alert while inspecting records (bank and legal confirmations, minutes, contracts); treat **significant transactions outside the normal course of business** as giving rise to significant risks. Transactions with **no exchange of consideration** (e.g. free use of assets, guarantees) also need to be identified and disclosed.

4.9 SA 610 – Using the work of internal auditors

- The external auditor has **sole responsibility** for the opinion; use of internal audit does not reduce it.
- **Evaluating the internal audit function:** its **objectivity** (organisational status, reporting line – to TCWG), **competence**, and whether it applies a **systematic and disciplined approach** including quality control.
- **Cannot use** the function's work if its status does not support objectivity, it lacks competence, or it does not apply a systematic approach. Use **less** of the work as more judgement is needed, RMM is higher, or objectivity and competence are lower.
- **Direct assistance** (internal auditors working under the external auditor's direction): not to be used for procedures involving significant judgements, higher assessed RMM, work the internal auditors were involved in, or decisions on the internal audit function. **Written agreements:** (i) from an authorised representative of the **entity** that internal auditors will be allowed to follow the external auditor's instructions and the entity will not intervene; (ii) from the **internal auditors** that they will keep confidential specific matters as instructed and inform the external auditor of any threat to their objectivity.

Chapter 5: Audit of Items of Financial Statements

NOTE The pattern for every item

For each item ICAI expects procedures by **assertion**: existence/occurrence, completeness, rights and obligations, valuation, cut-off and **presentation as per Schedule III**. Always end with "verify disclosure as per Schedule III (Division I/II)".

5.1 Income items

Item	Key procedures
Sales of products	Understand revenue recognition policy (AS 9 / Ind AS 115); vouch invoices with orders, **despatch documents** and gate passes; check **cut-off** (despatches near year-end); verify discounts, returns and credit notes after year-end; analytical review of monthly sales and gross margin; reconcile with GST returns
Sale of services	Contracts, stage of completion, time records, unbilled revenue, advance billing
Interest income	Recompute on deposits/loans (reasonableness test); TDS certificates (Form 26AS); accrued interest at year-end
Rental income	Rent agreements, register of properties let out, outstanding rent, TDS
Dividend income	Dividend warrants/bank credits; recognise when the **right to receive** is established (declared by the investee's GM)
Profit/loss on sale of investments	Broker's contract notes, board approval, cost method (FIFO/average)

5.2 Expense items

Item	Key procedures
Purchases	Purchase orders, GRNs, supplier invoices (**three-way match**); cut-off; purchase returns; related-party purchases; analytical review
Employee benefits	Payroll vs attendance and HR records; appointment letters; statutory deductions (PF, ESI, TDS) deposited on time; provision for gratuity/leave (actuarial valuation – AS 15); payroll analytics
Depreciation	Method and rates per Schedule II useful lives; residual value; component accounting; additions/deletions pro-rata
Interest expense	Loan agreements, recomputation, capitalisation under AS 16 for qualifying assets
Power and fuel	Bills, meter readings, consumption ratio to production
Rent; repairs to buildings and machinery	Agreements; distinguish **capital vs revenue** (enhancement of life or capacity → capitalise)
Insurance; rates and taxes; travelling; miscellaneous	Policies and premium receipts; tax challans; tour reports and approved claims; unusual items in miscellaneous

5.3 Liabilities

- **Share capital:** memorandum and articles (authorised capital), board and GM resolutions, return of allotment, bank statements for money received, share register; **shareholding of promoters** disclosure (Schedule III): promoter name, number of shares, % of total shares, **% change during the year**. **Sweat equity (s. 54):** special resolution; issued to directors or employees; for know-how, IPR or value additions; valuation by a registered valuer; the class of shares already issued; at least one year since commencement of business VERIFY.
- **Reserves and surplus:** movements authorised; **securities premium** used only as per s. 52 (bonus shares, preliminary expenses, issue expenses/discount, premium on redemption, buy-back); capital reserves not distributed as dividend.
- **Borrowings** (existence, completeness, obligations): loan agreements and board/s. 180 resolutions; **bank confirmations**; trace fresh borrowings and repayments to bank statements; covenants; **charges**

created/satisfied registered with ROC (Schedule III requires disclosure of charges or satisfaction not registered beyond the statutory period); classify long/short term; check for **defaults** in repayment (CARO clause ix).

- **Trade payables:** confirmations; supplier statements reconciliation; search for **unrecorded liabilities** (payments after year-end, unmatched GRNs); **ageing schedule** (Schedule III) and **MSME** dues with interest disclosure.
- **Provisions and contingent liabilities:** AS 29 criteria (present obligation, probable outflow, reliable estimate); legal letters; management representations; disclosure of contingent liabilities and commitments.

5.4 Assets

- **PPE (land, buildings, plant, furniture, vehicles, office equipment):** fixed asset register; title deeds (CARO 3(i)(c) – immovable properties not held in the company's name); additions vouched with invoices and capitalisation of **directly attributable costs** (site preparation, installation, **testing**, professional fees – but not administration overheads, training or abnormal costs); physical verification by management; revaluation; impairment (AS 28).
- **Intangibles (goodwill, brands, software):** AS 26 – recognise only if identifiable, controlled, future benefits and reliable cost; **research expenditure is expensed**; development cost capitalised only when the AS 26 criteria are met; internally generated goodwill and brands are **not** recognised; amortisation over useful life.
- **Inventories:** attendance at count (SA 501); valuation at **lower of cost and NRV** (AS 2); cut-off; slow-moving and obsolete stock; goods with third parties and consignment stock. **Schedule III disclosure:** raw materials, work-in-progress, finished goods, stock-in-trade, stores and spares, loose tools, others – with **goods-in-transit** shown separately under each head and the **mode of valuation** stated.
- **Trade receivables:** confirmations (SA 505); ageing (Schedule III – undisputed/disputed, considered good/doubtful/credit impaired); subsequent realisation; provision for doubtful debts; related-party receivables.
- **Cash and bank: surprise** physical count of cash (head office, branches, petty cash, **imprest**) – all counted simultaneously in the presence of the cashier; bank reconciliations and confirmations; fixed deposits and their lien; cheques in hand.
- **Loans and advances; other current assets:** agreements, approvals u/s 185/186, recoverability, confirmations.

Chapter 6: Audit Documentation

- **SA 230 – Audit documentation** (working papers): the record of audit procedures performed, relevant audit evidence obtained and conclusions reached.
- **Purpose:** evidence of the basis for the auditor's conclusion; evidence that the audit was planned and performed per SAs and law; assists planning, supervision, review and quality control; accountability; record of continuing significance for future audits; enables inspections.
- **Form, content and extent** – sufficient to enable an **experienced auditor, having no previous connection with the audit**, to understand: (a) the nature, timing and extent of procedures performed; (b) the results and evidence obtained; (c) **significant matters** arising, conclusions reached and significant professional judgements.
- **Identifying characteristics** of items tested, **who performed** the work and the date, **who reviewed** it and the date and extent of review. **Discussions of significant matters** with management and TCWG – nature of matters, when and with whom discussed. **Inconsistencies** with final conclusions – how they were resolved.
- **Examples of documentation:** audit programmes, analyses, issues memoranda, summaries of significant matters, letters of confirmation and representation, checklists, correspondence (including e-mails) on significant matters, extracts of important agreements. **Not required:** superseded drafts, notes reflecting incomplete thinking, duplicates.
- **Completion memorandum** – a summary of significant matters identified and how they were addressed.
- **Assembly of the final audit file:** administrative process, completed **within 60 days** after the date of the auditor's report (SQC 1). After assembly, no deletion or discarding before the end of the retention period; modifications or additions must be documented (who, when, why).
- **Retention:** at least **7 years** from the date of the auditor's report (or, if later, the group auditor's report) (SQC 1).
- **Ownership:** working papers are the **property of the auditor**. The auditor may, at discretion, make portions available to the client, provided it does not undermine the validity of the work or independence. The auditor is **not obliged** to provide them.
- **Permanent audit file** (constitution documents, long-term contracts, organisation chart, accounting manual) vs **current audit file** (current year's programmes, working papers, letters).

Chapter 7: Completion and Review

7.1 SA 560 – Subsequent events

- **Subsequent events** – events occurring between the date of the financial statements and the date of the auditor's report, and **facts that become known** to the auditor after the date of the auditor's report.

Period	Auditor's obligation
Date of FS → date of auditor's report	**Active duty** – perform procedures to identify events requiring adjustment or disclosure: understand management's procedures, inquire of management and TCWG, read minutes of meetings after year-end, read latest interim financial statements; obtain written representations (SA 580)
After report date but before FS issued	**No obligation to perform procedures**, but if a fact becomes known that might have caused the report to be amended: discuss with management/TCWG; determine whether FS need amendment. If amended – extend procedures and provide a **new auditor's report** dated not earlier than approval of the amended FS. If not amended and **report not yet provided** → modify the opinion; if **report already provided** → notify management and TCWG **not to issue** the FS to third parties; if issued anyway, take action to **prevent reliance**
After FS have been issued	If a fact known at report date would have caused amendment: discuss; determine need to amend; inquire how management will address it. If amended – audit the amendment, **review steps taken to inform** anyone who received the FS, and issue a **new report with an EOM/OM paragraph** referring to the note explaining the revision. If management takes no action – notify management and TCWG that the auditor will **seek to prevent future reliance**

- **Date the financial statements are issued** – the date that the auditor's report and audited financial statements are **made available to third parties**.
- **Adjusting events** (AS 4): conditions existing at the balance sheet date – e.g. insolvency of a debtor after year-end, settlement of a court case pending at year-end, sale of inventory below cost. **Non-adjusting:** conditions arising after the date (fire, merger, fall in market value) – disclose if material. **Dividends** proposed or declared after the balance sheet date are **not** a liability at year-end; disclosed in notes.

7.2 SA 570 – Going concern

- **Auditor's responsibility:** obtain sufficient appropriate evidence on the appropriateness of management's use of the going concern basis and conclude whether a **material uncertainty** exists. The auditor cannot predict future events – the absence of reference to uncertainty is not a guarantee.

Financial events	Operating events	Other events
Net liability or net current liability position	Management intentions to liquidate or cease operations	Non-compliance with capital or other statutory requirements
Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; excessive reliance on short-term borrowings to finance long-term assets	Loss of key management without replacement	Pending legal proceedings that may result in claims the entity cannot meet
Indications of withdrawal of financial support by creditors	Loss of a major market, key customers, franchise, licence or principal suppliers	Changes in law or Government policy expected to adversely affect the entity
Negative operating cash flows; adverse key ratios; **substantial operating losses**	Labour difficulties	Uninsured or underinsured catastrophes
Arrears or discontinuance of dividends; inability to pay creditors on due dates; change from credit to **cash-on-delivery** by suppliers; inability to obtain financing	Shortages of important supplies; emergence of a highly successful competitor	

- **Procedures when events are identified:** request management to make an assessment if not done; evaluate **management's plans** for future actions and their feasibility; analyse cash-flow forecasts and underlying assumptions; consider additional facts after management's assessment; obtain **written representations** about plans.

Situation	Report
Going concern basis appropriate; material uncertainty **adequately disclosed**	Unmodified opinion + separate section **"Material Uncertainty Related to Going Concern"**
Material uncertainty **not adequately disclosed**	**Qualified or adverse** opinion; state in the Basis for Opinion that a material uncertainty exists and is not adequately disclosed
Going concern basis **inappropriate** but used	**Adverse** opinion
Management **unwilling** to make or extend its assessment	Consider implications – possibly qualified or disclaimer

7.3 SA 580 – Written representations

- Written statements by **management** (and TCWG where appropriate) with appropriate responsibilities and knowledge (e.g. CEO and CFO). They are **necessary evidence**, but **do not by themselves** provide sufficient appropriate evidence.
- **Required representations:** management has fulfilled its responsibility for **preparing the financial statements** as per the framework; it has provided all relevant **information and access**; and **all transactions** have been recorded and reflected. Others as required by other SAs (fraud – SA 240, laws – SA 250, uncorrected misstatements – SA 450, related parties – SA 550, subsequent events – SA 560, going concern – SA 570).
- **Date:** as near as practicable to, but **not after**, the date of the auditor's report; covers all periods referred to in the report.
- **Doubt about reliability or refusal:** discuss with management, re-evaluate integrity, take action including the effect on the opinion. If management **does not provide** the representations about its responsibilities (preparation of FS; information provided) or they are unreliable → **disclaimer of opinion**.

7.4 SA 450, SA 260 and SA 265 (overview)

- **SA 450 – Evaluation of misstatements:** accumulate misstatements other than those **clearly trivial**; types – **factual** (no doubt), **judgemental** (differences in estimates/policies), **projected** (from sampling). Communicate all accumulated misstatements to **management** on a timely basis and request **correction**. If management refuses, understand the reasons. Communicate **uncorrected** misstatements and their effect to **TCWG**, and obtain a **written representation** that uncorrected misstatements are immaterial. Reassess materiality before evaluating.
- **SA 260 – Communication with TCWG:** auditor's responsibilities; planned **scope and timing**; **significant findings** (difficulties, significant matters discussed, written representations requested, qualitative aspects of accounting practices); and, for listed entities, a statement on **independence**. Communication should be two-way and timely; in writing for significant findings where oral communication is inadequate.
- **SA 265** – see 3.4 (significant deficiencies to TCWG in writing).

Chapter 8: Audit Report

8.1 SA 700 – Forming an opinion and reporting

- **Forming the opinion:** whether reasonable assurance has been obtained; whether uncorrected misstatements are material; whether the financial statements are prepared in accordance with the framework (adequate disclosure of significant accounting policies, reasonable estimates, relevant/reliable/comparable/understandable information, appropriate terminology).
- **Elements of the auditor's report** (in order): title ("Independent Auditor's Report"); addressee; **Opinion** section (first); **Basis for Opinion** (immediately after the Opinion section); Going Concern (where applicable – SA 570); **Key Audit Matters** (listed entities – SA 701); Other Information (SA 720); Responsibilities of Management (and TCWG) for the FS; Auditor's Responsibilities for the audit of the FS; Report on Other Legal and Regulatory Requirements; signature with **membership number** and **UDIN**; place of signature; date.
- **Basis for Opinion section:** states that the audit was conducted **in accordance with the SAs**; refers to the auditor's responsibilities section; includes a statement that the auditor is **independent** in accordance with the ethical requirements (ICAI Code of Ethics) and has fulfilled other ethical responsibilities; states whether the auditor believes the evidence obtained is **sufficient and appropriate** to provide a basis for the opinion.
- **Date of the report** – not earlier than the date on which sufficient appropriate evidence has been obtained, including evidence that the FS have been prepared and **approved** by those with authority.

8.2 SA 701 – Key audit matters

- **KAMs** – matters that, in the auditor's judgement, were of **most significance** in the audit of the current period; selected from matters **communicated with TCWG**. Required for **listed entities** (and when the auditor otherwise decides or law requires).
- **Determining KAMs – consider:** areas of **higher assessed RMM** or significant risks; significant auditor judgements relating to areas of significant **management judgement** (estimates with high estimation uncertainty); effect on the audit of **significant events or transactions** in the period.
- **Purpose:** enhance the **communicative value** of the report by providing greater transparency about the audit; give users a basis to engage further with management and TCWG.
- **Communicating KAMs is not:** a substitute for disclosure in the FS that the framework requires; a substitute for a **modified opinion** (SA 705); a substitute for reporting a **material uncertainty related to going concern** (SA 570); or a separate opinion on individual matters.
- A matter giving rise to a modified opinion or a material uncertainty on going concern is by nature a KAM, but is reported in those sections, with a reference in the KAM section.

8.3 SA 705 – Modified opinions

Nature of matter	Material but not pervasive	Material and pervasive
FS are **materially misstated**	**Qualified** opinion ("except for")	**Adverse** opinion ("do not give a true and fair view")
Inability to obtain sufficient appropriate evidence	**Qualified** opinion	**Disclaimer** of opinion ("we do not express an opinion")

- **Pervasive** – effects not confined to specific elements; or, if confined, represent a substantial portion of the FS; or, for disclosures, fundamental to users' understanding.
- **Management-imposed scope limitation** after accepting the engagement: request removal; if refused, communicate with TCWG, perform alternative procedures; if still unable – qualified, or disclaimer/withdraw where possible if possible effects are material and pervasive.
- The **Basis for Qualified/Adverse Opinion** paragraph describes the matter and quantifies the financial effects, if practicable.

8.4 SA 706 – Emphasis of Matter and Other Matter paragraphs

- **Emphasis of Matter (EOM)** – refers to a matter **appropriately presented or disclosed** in the FS that is **fundamental** to users' understanding of the FS. It does not modify the opinion. **Examples:** an uncertainty relating to the future outcome of **exceptional litigation or regulatory action**; a **significant subsequent event**; **early application** of a new accounting standard with a pervasive effect; a **major catastrophe** that has had a significant effect on the entity's financial position (e.g. a major fire after year-end disclosed in the notes).
- **EOM paragraph:** included in a separate section with the heading "Emphasis of Matter"; clear reference to the matter and the note where it is disclosed; states that the auditor's **opinion is not modified** in respect of the matter.
- **Other Matter (OM)** paragraph – refers to a matter **not presented or disclosed** in the FS that is relevant to users' understanding of the **audit, the auditor's responsibilities or the report** (e.g. restriction on distribution of the report; reporting on more than one set of FS; prior period audited by a predecessor – SA 710).

8.5 SA 710 – Comparative information

- **Corresponding figures** – prior-period amounts included as part of current FS, read only in relation to the current period; the opinion refers to the **current period only**. **Comparative financial statements** – prior-period amounts included for comparison; the opinion refers to **each period** presented.
- **Prior period audited by a predecessor auditor** (corresponding figures): if not prohibited, the auditor may state in an **Other Matter paragraph** (i) that the prior-period FS were audited by the predecessor auditor; (ii) the **type of opinion** expressed and, if modified, the reasons; (iii) the **date** of that report.
- **Prior period not audited:** state in an OM paragraph that the corresponding figures are **unaudited** (this does not relieve the auditor of obtaining evidence on opening balances).

8.6 Branch audit, joint audit and reporting under the Companies Act

- **Branch audit (s. 143(8)):** accounts of a branch office are audited by the company's auditor or another qualified person appointed u/s 139; the **branch auditor** prepares a report and sends it to the company's auditor, who deals with it in his report as he considers necessary.
- **Joint audit (SA 299):** division of work by joint auditors documented and communicated to the entity; each joint auditor is responsible for **work allocated** to him; **jointly and severally** responsible for work not divided and carried out jointly, for decisions on the nature, timing and extent of procedures communicated to all, and for examining that the FS comply with law. Each may report separately if they disagree.
- **s. 143(1) – matters the auditor must inquire into:** loans and advances properly secured and terms not prejudicial; transactions represented merely by **book entries** prejudicial to interest; investments (non-investment company) sold at less than cost; loans and advances shown as **deposits**; **personal expenses** charged to revenue; shares allotted for cash – whether cash actually received.
- **s. 143(3) – the report shall state:** information and explanations obtained; proper books of account kept; branch reports dealt with; agreement with books; compliance with **accounting standards**; observations having adverse effect; **director disqualification u/s 164(2)**; qualifications relating to maintenance of accounts; **adequacy and operating effectiveness of IFC**; and matters in **Rule 11** of the Audit and Auditors Rules, 2014 – pending litigations, material foreseeable losses on long-term contracts and derivatives, delay in transfer to **IEPF**, management representations on **funds advanced or received through intermediaries** (Rule 11(e)), compliance of **dividend** with s. 123, and use of accounting software with **audit trail (edit log)** feature (Rule 11(g)).
- **s. 143(12) – fraud reporting:** fraud involving **₹1 crore or above** – report to the Central Government (form ADT-4) after forwarding to the Board/Audit Committee within **2 days** and receiving the reply within **45 days**; forward to the Central Government within **15 days** of reply. Below ₹1 crore – report to the Audit Committee/Board within **2 days**, and the Board's report discloses it.

8.7 CARO 2020 – applicability and key clauses

REMEMBER CARO 2020 does not apply to

A banking company; insurance company; **s. 8 company**; **one person company**; **small company**; and a **private company** (not a holding or subsidiary of a public company) that satisfies **all three**: (i) paid-up capital + reserves and surplus **≤ ₹1 crore** as on the balance sheet date; (ii) total borrowings from any bank or financial institution **≤ ₹1 crore** at any time during the year; (iii) total revenue (including revenue from discontinuing operations) **≤ ₹10 crore** during the year. CARO also does not apply to the auditor's report on **consolidated** FS except clause 3(xxi).

Clause 3	Matter
(i)	PPE and intangibles – records, physical verification, **title deeds of immovable property**, revaluation, benami proceedings
(ii)	Inventory – physical verification (discrepancies ≥ 10% in aggregate for each class); working capital limits **> ₹5 crore** on security of current assets – agreement of quarterly returns with books
(iii)	Investments, guarantees, security and loans to companies, firms, LLPs or other parties
(iv)	Compliance with s. 185 and 186
(v)	Deposits and deemed deposits
(vi)	Cost records u/s 148(1)
(vii)	Statutory dues – regularity; dues not deposited on account of disputes
(viii)	Unrecorded income surrendered or disclosed in tax assessments
(ix)	Default in repayment of loans; wilful defaulter; term loans applied for purpose; short-term funds used for long-term purposes; funds raised for subsidiaries/associates
(x)	Money raised by IPO/FPO and preferential allotment/private placement
(xi)	Fraud and whistle-blower complaints; ADT-4 filed
(xii)	Nidhi company compliance
(xiii)	Related-party transactions – s. 177 and 188
(xiv)	Internal audit system and consideration of internal audit reports
(xv)	Non-cash transactions with directors – s. 192
(xvi)	Registration u/s 45-IA of the RBI Act; CICs
(xvii)	Cash losses in the current and immediately preceding year
(xviii)	Resignation of statutory auditors – issues raised by outgoing auditors
(xix)	Material uncertainty on meeting liabilities within one year (ratios, ageing, plans)
(xx)	CSR – unspent amounts transferred as per s. 135
(xxi)	Qualifications/adverse remarks in CARO reports of companies in the **consolidated** FS

Chapter 9: Special Features of Audit of Different Types of Entities

9.1 Companies – appointment, qualifications and removal (Companies Act, 2013)

Provision	Rule
First auditor – non-Government company (s. 139(6))	Board within **30 days** of registration; if it fails, members at an EGM within **90 days**; holds office till the conclusion of the **first AGM**
First auditor – Government company (s. 139(7))	**C&AG** within **60 days** of registration; if it fails, Board within 30 days; if Board fails, members at an EGM within 60 days
Subsequent auditor (s. 139(1))	Appointed at the first AGM to hold office till the conclusion of the **sixth AGM** (5 years); written consent and eligibility certificate; company files **ADT-1** within 15 days
Rotation (s. 139(2))	Listed companies and prescribed classes: individual – **one term of 5 years**; firm – **two terms of 5 consecutive years**; **cooling-off 5 years**. Prescribed classes: unlisted public companies with paid-up capital ≥ ₹10 crore; private companies with paid-up capital ≥ ₹50 crore; companies with public borrowings from FIs/banks or public deposits ≥ ₹50 crore (excluding OPCs and small companies)
Casual vacancy (s. 139(8))	Board within **30 days**; if caused by **resignation**, also approved by the company at a GM within **3 months**; Government company – C&AG within 30 days
Removal before expiry (s. 140(1))	**Special resolution** after obtaining **prior approval of the Central Government**; reasonable opportunity of being heard
Resignation (s. 140(2))	File **ADT-3** with the company and Registrar within **30 days** stating reasons (and with the C&AG for Government companies)
Remuneration (s. 142)	Fixed by the company in **general meeting** (first auditor – by the Board)

- **Disqualifications (s. 141(3)):** a body corporate (other than an LLP); an officer or employee of the company; a partner or employee of an officer/employee; a person who, or whose **relative or partner**, holds securities (a relative may hold up to **₹1 lakh** face value), is **indebted** to the company/its subsidiary/holding/associate **beyond ₹5 lakh**, or has given a **guarantee or security** beyond **₹1 lakh**; a person with a **business relationship** with the company; a person whose relative is a **director or KMP**; a person in full-time employment elsewhere or holding more than **20 company audits**; a person convicted of an offence involving **fraud** (for 10 years); a person who, directly or indirectly, renders **s. 144 services** to the company.
- **s. 144 – services an auditor cannot render** (to the company, its holding or subsidiary): accounting and book-keeping; **internal audit**; design and implementation of any financial information system; actuarial services; investment advisory; investment banking; rendering of outsourced financial services; management services.

9.2 Government audit (C&AG)

- The **C&AG** audits receipts and expenditure of the Union and States, Government companies (through appointed auditors and supplementary audit), and bodies substantially financed by Government.

Type	Meaning
Audit against provision of funds	Expenditure is within the grant/appropriation approved by the legislature
Audit of sanctions	Every item of expenditure is covered by a **sanction** of the competent authority
Audit against rules and orders	Expenditure conforms to the **rules, regulations and orders** framed by the executive (e.g. General Financial Rules); the auditor also checks whether the rules themselves are within the authority's power and are adequate
Propriety audit	Expenditure is not prima facie more than the occasion demands; no authority uses its sanctioning power for its own benefit; public money is not used for particular persons; the canon of **financial propriety** is observed
Performance audit	Programmes achieve their objectives with **economy, efficiency and effectiveness**

- **Inventory audit in Government departments:** check periodic physical verification, removal of damaged/obsolete items after condemnation by a competent authority, store records, accountability for losses.

9.3 Local bodies, NPOs, trusts and societies

- **Local bodies** (municipalities, panchayats): audit by the local fund auditor/Examiner of Local Fund Accounts or C&AG as per the State law; check budget provisions, sanctions, grants and their utilisation, octroi/tax collections, contracts and tenders.
- **NPOs (societies, trusts, NGOs):** check the **constitution** (trust deed/bye-laws) and objects; registration (Societies Registration Act, 1860 or State law; Indian Trusts Act/State public trusts acts; s. 12AB of the Income-tax Act); **receipts** – donations (receipt books, counterfoils, bank), **foreign contributions only into the designated FCRA bank account** (FCRA, 2010), grants and their conditions/utilisation certificates, membership fees and subscriptions (register of members, arrears), interest and rent; **expenditure** – sanctioned by the governing body, applied to the objects; fixed assets and investments; minutes.
- **Clubs:** members' register and subscriptions (arrears, entrance fees), bar/restaurant/catering **margins** (compare purchases, stock and sales of food and liquor), rent from rooms and halls, licences, the committee's minutes.
- **Hotels:** room sales – **guest register**, occupancy, room tariff cards, **hall bookings** and advance receipts, discounts authorised; food and beverage – KOTs (kitchen order tickets) matched with bills; inventory control of liquor and consumables; credit card settlements; complimentary services authorised.
- **Hospitals:** patients' register, bed occupancy, billing of room, pharmacy and diagnostics; free treatment to poor patients (charitable hospitals); fixed assets and medical equipment; drugs inventory.
- **Educational institutions:** fees – students' register, fee structure, concessions/scholarships authorised; grants and their conditions; hostel and transport fees; capitation fees not charged against law.

9.4 Partnership firms, LLPs and co-operative societies

- **Partnership firms:** audit is not compulsory under the Partnership Act but may be required by the deed, a tax law (s. 44AB), or banks. The auditor reads the **partnership deed** (capital, profit-sharing, interest, salaries, drawings) and obtains an **engagement letter** signed by all partners.
- **LLP (LLP Act, 2008 and LLP Rules):** accounts must be audited unless turnover does not exceed **₹40 lakh** and contribution does not exceed **₹25 lakh** in the year. Auditors are appointed by the **designated partners** (first auditor before the end of the first financial year; subsequent – at least 30 days before the end of the year). **Auditor's duty:** check compliance with the **LLP agreement** and the Act; verify the **Statement of Account and Solvency** (Form 8) and the annual return (Form 11); contributions and their valuation; profit sharing and partners' accounts; books maintained on a cash or accrual basis and **double-entry** system; true and fair view.
- **Co-operative societies:** audit under the State Co-operative Societies Act (or Multi-State Co-operative Societies Act, 2002) by an auditor from a panel approved by the Registrar/general body. Special features: verify compliance with the Act, rules and **bye-laws**; overdue debts classified in an **ageing schedule** (e.g. overdue for less than 6 months, 6 months–3 years, 3–5 years, more than 5 years VERIFY); loans to members within limits; audit classification of the society (A/B/C/D) VERIFY; the report covers irregularities and defalcations; where books are incomplete (e.g. only cash book and general ledger), report the non-maintenance of required registers.

Chapter 10: Audit of Banks

10.1 Accounting system and audit approach

- **Bank accounting:** voucher system, day book, **subsidiary ledgers** for each type of account, general ledger balanced daily, branch returns; heavily computerised (CBS – core banking solution).
- **Audit approach:** understand the bank and its environment (RBI regulations, Banking Regulation Act, 1949); assess IT controls in CBS; **materiality** and RMM; focus on **advances** (largest asset, highest risk); use of **Long Form Audit Report (LFAR)** questionnaire; **branch audits** with central statutory auditors consolidating.
- **Engagement letter and initial considerations:** declaration of indebtedness (the auditor and relatives must not be indebted to the bank beyond limits), letter to previous auditor, appointment under the Banking Regulation Act (by RBI-approved panels for PSBs; s. 30).
- **Revenue items:** interest on advances (recompute with rates, check **income recognition only on realisation for NPAs** – interest not recognised on accrual once an account becomes an NPA); commission, exchange, brokerage; interest on deposits (recompute, check accrual); discount on bills; locker rent.

10.2 Advances and NPAs – RBI prudential norms

- **Non-performing asset (NPA):** a loan or advance where (i) interest and/or instalment of principal remains **overdue for more than 90 days** in a **term loan**; (ii) the account remains **"out of order"** for an **overdraft/cash credit** – outstanding balance continuously in excess of the sanctioned limit/**drawing power** for 90 days, or no credits continuously for 90 days, or credits not enough to cover interest debited; (iii) a **bill** purchased/discounted remains overdue for more than 90 days; (iv) **agricultural advances** – instalment or interest overdue for **two crop seasons** (short-duration crops) or **one crop season** (long-duration crops).
- **SMA classification (pre-NPA): SMA-0** overdue 1–30 days; **SMA-1** 31–60 days; **SMA-2** 61–90 days (for non-revolving and revolving facilities).

Category	Meaning	Provision
Standard	Performing	General provision – e.g. 0.40% (agriculture and SME 0.25%; commercial real estate 1%; CRE-RH 0.75%)
Sub-standard	NPA for **≤ 12 months**	**15%** of outstanding; unsecured exposures **25%** (20% for certain infrastructure loans with escrow)
Doubtful	Sub-standard for **12 months**	100% of the **unsecured** portion + on the secured portion: **D1** (up to 1 year) 25%; **D2** (1–3 years) 40%; **D3** (more than 3 years) 100%
Loss	Loss identified by the bank, auditors or RBI but not written off	**100%**

- **Erosion in the value of security:** if the realisable value of security is **less than 50%** of the value assessed by the bank or accepted by RBI at the last inspection → classify straight as **doubtful**; if it is **less than 10% of the outstanding balance** → classify straight as a **loss asset** (e.g. outstanding ₹65 lakh with realisable security ₹6 lakh = 9.2% → loss asset, 100% provision).
- **Upgradation:** an NPA is upgraded to standard only when **all arrears** of interest and principal are paid.
- **Consortium advances:** each member bank classifies its share of the account based on **its own record of recovery** (in practice, banks may also be required to align classification across the consortium VERIFY).
- **Take-out finance:** a long-term lender (taking-out institution) agrees to **take over** the loan from the original lender (usually a bank) after a specified period or project milestone (e.g. completion of construction), so that banks can fund long-gestation **infrastructure** projects without asset–liability mismatch. **Objectives:** expand sources of finance for infrastructure; address **exposure** limits and **ALM mismatch** of banks; increase availability of **longer-tenor** debt. Income is recognised by the lending bank on the same NPA norms – if the account becomes an NPA before take-over, interest is recognised only on realisation.
- **Audit of advances:** sanction and documentation (loan agreements, hypothecation, mortgages, guarantees), **drawing power** computed from **stock statements** (less margin; excluding obsolete and old stock), **stock audit** reports for large working-capital accounts VERIFY, inspection reports, renewals, valuation of security, classification and provision, interest charged.

Chapter 11: Ethics and Terms of Audit Engagements

11.1 Ethics

- **Ethics** – the principles of conduct governing an individual or group; "ethics is a state of mind". The **need for professional ethics** – public trust in the profession, quality of service, credibility of the financial reports.
- **Principles-based vs rules-based approach:** a **rules-based** approach lists specific prohibitions and is easy to apply but cannot cover every situation, and invites "loophole" thinking. A **principles-based** approach (ICAI Code of Ethics follows this conceptual-framework approach) requires the professional to **identify, evaluate and address threats** to fundamental principles in any situation, using judgement.

Fundamental principle	Meaning
Integrity	Straightforward and honest in all professional and business relationships; not associated with materially false or misleading information
Objectivity	Not compromising professional judgement because of bias, conflict of interest or undue influence of others
Professional competence and due care	Maintaining knowledge and skill; acting diligently in accordance with technical and professional standards
Confidentiality	Respecting the confidentiality of information acquired; not disclosing without proper authority unless there is a legal or professional right or duty; not using it for personal advantage
Professional behaviour	Complying with laws and regulations and avoiding any action that discredits the profession

- **Independence** – **independence of mind** (state of mind that permits an opinion without being affected by influences) and **independence in appearance** (avoiding facts and circumstances that would lead a reasonable and informed third party to conclude that integrity or objectivity has been compromised).

Threat	Examples
Self-interest	Financial interest in the client; undue dependence on fees from one client; **loan from or to a client**; contingent fees; concern about losing a client; **significant gifts and hospitality**; close business relationship
Self-review	Auditing records the firm prepared (book-keeping); designing the financial information system and then auditing it; a team member recently being an employee/director of the client
Advocacy	Promoting the client's shares; acting as an **advocate** for the client in litigation or disputes with third parties
Familiarity	Long association of senior personnel with the client; a close or immediate family member being a director or employee in a position of influence; accepting gifts; former partner joining the client
Intimidation	Threat of dismissal or replacement over a disagreement; threat of litigation; pressure to reduce the extent of work to cut fees; pressure from a dominant client personality

- **Long association and rotation:** if the same firm continues indefinitely, a **familiarity threat** arises. Companies Act safeguards – **rotation of auditors** (s. 139(2)) with a **cooling-off period of 5 years**, and restrictions on non-audit services (s. 144). Situations: long association of senior personnel; immediate family in a position to influence; a former partner as director/officer of the client; gifts.
- **Safeguards:** created by the profession, legislation or regulation (education and training, professional standards, monitoring and disciplinary procedures, external review); within the firm (leadership stressing compliance, policies on independence, rotation of senior personnel, **engagement quality control review**, separate teams, discussion with TCWG, disclosure of fees).
- **Professional skepticism** – an attitude that includes a questioning mind, being alert to conditions that may indicate misstatement due to fraud or error, and a critical assessment of evidence.
- **Communication with the previous auditor:** under the Chartered Accountants Act, 1949 (First Schedule, Part I, Clause 8), a member must **communicate in writing** with the previous auditor before accepting an audit appointment. Failure to do so is professional misconduct. Clause 9 – accepting appointment as auditor of a company without ascertaining compliance with s. 139/140.

11.2 SA 210 – Terms of audit engagements

- **Preconditions for an audit:** (i) the financial reporting framework is **acceptable**; (ii) management **acknowledges and understands its responsibility** for preparing the FS in accordance with the framework, for **internal control** necessary for FS free from material misstatement, and to provide the auditor with access to all information, additional information requested and unrestricted access to persons. If the preconditions are not present, the auditor **shall not accept** the engagement unless law requires it.
- **Limitation of scope before acceptance:** if management imposes a limitation such that the auditor would disclaim an opinion, the auditor shall not accept the engagement (unless law requires).
- **Audit engagement letter** contents: objective and scope; responsibilities of the auditor; **responsibilities of management**; identification of the framework; expected form and content of reports; statement that a report may differ from expected form. It may also cover planning arrangements, written confirmations, fees and billing, involvement of other auditors/experts, restrictions on liability.
- **Recurring audits – factors for revising terms or reminding the entity:** any indication that the entity **misunderstands the objective and scope** of the audit; any **revised or special terms**; a recent **change of senior management**; a significant **change in ownership**; a significant change in the **nature or size** of the entity's business; a change in **legal or regulatory** requirements; a change in the **financial reporting framework**; a change in other reporting requirements.
- **Change in terms requested by the entity** (e.g. to a review or compilation): the auditor considers whether there is **reasonable justification** (change in circumstances or misunderstanding is reasonable; restriction on scope by management is not). If not justified and management does not permit continuing, the auditor **withdraws** (where possible) and considers reporting obligations to TCWG, owners or regulators.

11.3 SQC 1 and SA 220 (overview)

- **SQC 1 elements:** (a) **leadership** responsibilities for quality within the firm; (b) **relevant ethical requirements** (including independence – the firm obtains **written confirmation** of compliance with its independence policies from all personnel **at least annually**); (c) **acceptance and continuance** of client relationships; (d) **human resources**; (e) **engagement performance** (including consultation, differences of opinion, **engagement quality control review** – mandatory for audits of **listed entities**; for other engagements, based on criteria set by the firm); (f) **monitoring**.
- **Integrity of the client – matters to consider (acceptance):** identity and business reputation of the principal owners, key management and TCWG; the nature of operations including business practices; information about the attitude of owners and management towards **aggressive interpretation of accounting standards** and the internal control environment; whether the client is aggressively concerned with **keeping fees as low as possible**; indications of an inappropriate **limitation of scope**; indications of involvement in **money laundering or criminal activities**; reasons for the proposed appointment and **non-reappointment of the previous firm**; the identity and business reputation of related parties.
- **Monitoring** – an ongoing consideration and evaluation of the firm's system of quality control, including **periodic inspection** of a selection of completed engagements, to provide reasonable assurance that the system is relevant, adequate and operating effectively.
- **SA 220 – engagement partner** takes responsibility for the overall quality of each audit: direction, supervision and performance; compliance with ethical requirements (remaining alert for breaches of independence and taking action); acceptance and continuance; assignment of an engagement team with appropriate competence; review; consultation; and EQCR where applicable. On a **threat to independence** identified (e.g. a team member's close business relationship with a client executive), the engagement partner evaluates the threat, takes action to **eliminate it or reduce it to an acceptable level** (e.g. removing the member from the team), and reports to the firm if not resolved; documents conclusions.

Quick reference – numbers and time limits

Topic	Remember
SA 230	Assembly of final file within **60 days** of the report; retention **7 years**
SA 580	Dated as near as practicable to, but **not after**, the report date
SA 570	Look ahead at least **12 months** from the date of the FS (per framework)
Companies Act	First auditor: Board 30 days / EGM 90 days; Govt company: C&AG 60 days; term 5 years; rotation 5 / 10 years; cooling-off 5 years; casual vacancy 30 days (resignation – GM in 3 months); ADT-1 15 days; ADT-3 30 days; 20-company limit
s. 141 limits	Relative's securities ₹1 lakh; indebtedness ₹5 lakh; guarantee ₹1 lakh
s. 143(12)	≥ ₹1 crore to Central Government (2 days → 45 days → 15 days); < ₹1 crore to Audit Committee/Board
IFC exemption (pvt. co.)	Turnover < ₹50 crore **and** borrowings < ₹25 crore
CARO exemption (pvt. co.)	Capital + reserves ≤ ₹1 crore; borrowings ≤ ₹1 crore; revenue ≤ ₹10 crore – all three
LLP audit	Turnover > ₹40 lakh or contribution > ₹25 lakh
Bank NPA	90 days; 2 crop seasons / 1 crop season; sub-standard ≤ 12 months; D1/D2/D3 25% / 40% / 100%; sub-standard 15% (unsecured 25%); loss 100%; erosion < 50% → doubtful, < 10% → loss
SMA	SMA-0 1–30, SMA-1 31–60, SMA-2 61–90 days

Common mistakes in answers

1. Writing **general audit procedures** when the question asks for the **specific SA requirement** (e.g. inventory counted on a date other than year-end – write the roll-forward requirement).
2. Confusing **deficiency** with **significant deficiency** – the latter is defined by importance to TCWG, not by examples.
3. Treating a **KAM** as a substitute for a qualification or for going-concern disclosure.
4. Using an **EOM** paragraph for a matter not disclosed in the FS (that needs an OM paragraph or a modification).
5. For **CARO/IFC exemptions**, missing that the CARO conditions are **cumulative** and listing wrong thresholds.
6. Saying negative confirmations can be used whenever balances are small – **all four conditions** must be met.
7. Forgetting that the auditor's working papers are the **auditor's property**, and that the auditor is not obliged to give them to the client.
8. In bank questions, ignoring the **erosion of security** rule and the **unsecured portion** provisioning.
9. In ethics cases, naming the threat without giving the **reason** and a **safeguard**.
10. Not concluding: every case-study answer must end with "Conclusion: the auditor's view is correct/not correct because...".