

PAPER
5

INTERMEDIATE COURSE
STUDY MATERIAL
GROUP-II
AUDITING & ETHICS
MODULE 1 OF 2



Board of Studies (Academic)
The Institute of Chartered
Accountants of India

(Set up by an Act of Parliament)



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BEFORE WE BEGIN...

At the Intermediate level, Auditing and Ethics as a subject is introduced for the first time. You would learn new jargon of auditing after reading contents of modules. The content has been developed in a student friendly manner to make you understand things through storyline, examples, situational case scenarios and application-based questions.

Story-telling is one of ancient Indian traditions. Do you remember *Panchtantra*? – an ancient Sanskrit treatise which taught principles of good governance to three princes of a king by telling them animal fables. They are a unique contribution of India to the world of Literature. We, at Board of Studies of ICAI, have made a small effort to assist you to gain overview of each chapter by telling a story. The story moves on along with your course content.

Auditing is an analytical subject requiring application of various skills. Apart from knowledge of subject, it requires understanding based learning, a knack for applying conceptual knowledge to practical situations and ability to write concisely. As Shakespeare wrote “*Brevity is the soul of wit*”. You have to develop ability to write what you intend to say. It would not only help you to come out of your exams with flying colours but would also groom you as versatile professional.

As you would be studying through the chapters step by step, you will learn the concepts of auditing, namely, meaning of audit, audit planning, audit strategy, audit risk, audit evidence, audit documentation, etc. Audit procedures as required to be followed in different auditing situations, have been explained point wise and also with the help of diagrams. This learning of yours would hone your auditing skills which will be put into practice when you undergo practical training.

Know your Syllabus

The study material deals with the conceptual theoretical framework in detail.

In each chapter, the topic has been covered in a step by step approach. The text has been explained, where appropriate, through illustrations, diagrams, tables, flowcharts, screenshots etc. You should go through the chapter carefully ensuring that you understand the topic and then can tackle the MCQs, Correct/Incorrect and other question.

The entire syllabus has been divided into Eleven chapters.

Chapter-1 discusses the basics of audit such as Origin, nature, scope, objectives, limitations etc. of audit. Meaning and Types of Assurance Engagements.

Chapter-2 is devoted to Audit Strategy; Audit planning and Audit programme;

Chapter-3 is devoted to Audit Risk, Identifying and Assessing the Risk of Material Misstatement, Risk Assessment procedures; Understanding the entity and its environment; Internal Control; Materiality.

Chapter-4 discusses about Audit evidence; Internal audit function; Audit Sampling; Audit Evidence - Specific Considerations for Selected Items; External Confirmations; Initial Audit Engagements-Opening Balances; Related Party Transactions; analytical procedures.

Chapter-5 is devoted to the Audit of Items of Financial Statements

Chapter-6 focusses on Audit Documentation.

Chapter-7 discusses about Completion and Review

Chapter-8 discusses about various aspects of Auditor's Report.

Chapter-9 extensively deals with the Audit Procedures in respect of different Category of Entities.

Chapter-10 deals with the Audit of Banks.

Chapter-11 deals with Ethics and Terms of Audit Engagements

Structure of the Study Material

The content for each chapter/unit at the Intermediate level has been structured in the following manner –

	Components of each Chapter	About the component
1.	Learning Outcomes	Learning outcomes which you need to demonstrate after learning each topic have been detailed in the first page of each chapter/unit. Demonstration of these learning outcomes would help you to achieve the desired level of technical competence.
2.	Chapter Overview	As the name suggests, this chart/table would give a

		broad outline of the contents covered in the chapter.
3.	Introduction	A brief introduction is given at the beginning of each chapter/unit which would help you get a feel of the topic.
4	Storyline	A story is given at the beginning of each chapter which will help to gain overview of the chapter and develop interest in the topics systematically.
5.	Content	The concepts and provisions of standards/law are explained in student-friendly manner with the aid of Story/Examples/illustrations/diagrams/ flow charts/ Case Studies. These value additions would help you develop conceptual clarity and get a good grasp of the topic. Diagrams and Flow charts would help you understand the concept/ provision in a better manner. Illustrations would help you understand the application of concepts/provisions.
6.	Test Your Understanding	Test Your Understanding would help you to check your knowledge after understanding the topic.
7.	Exercise Questions with Answers	The exercise questions and answers would help you to apply what you have learnt in problem solving. In effect, it would sharpen your application skills and test your understanding as well as your application of concepts/ provisions.
8.	Summary	A summary of the chapter is given at the end to help you revise what you have learnt. It would especially help you to revise the chapter quickly the day before the examination.
9.	Test Your Knowledge	This comprises of Multiple-Choice Questions, Correct/ incorrect and other questions which test the breadth and depth of your understanding of the topic.

We hope that these student-friendly features in the Study Material would make your learning process more enjoyable, enrich your knowledge and sharpen your application skills.

Happy Reading and Best Wishes!

SYLLABUS

PAPER 5- AUDITING AND ETHICS (100 MARKS)

(One paper – Three hours – 100 Marks)

Objective:

- (a) To develop an understanding of the concepts in auditing and of the generally accepted auditing procedures, techniques and skills and acquire the ability to apply the same in audit and attestation engagements.
- (b) To understand and apply the concept of ethics while performing audit.

Contents:

1. Nature, Objective and Scope of Audit

Auditing Concepts: Origin of Auditing, Meaning and Nature of Audit, Need for audit (Benefits of an Audit), Objective of the audit, Scope of Audit, External Audit engagements, Qualities of Auditor. Inherent Limitations of an audit; Relationship of auditing with other disciplines. (SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing).

2. Audit Strategy, Audit Planning and Audit Program

(SA 300 Planning an Audit of Financial statements). Auditor's responsibility to plan an audit of financial statements. Benefits of audit planning. Planning is a continual and iterative process. Discussion of elements of planning with the entity's management. Involvement of Key Engagement Team Members in planning the audit. Preliminary engagement activities. The auditor's consideration of client continuance and ethical requirements. Planning activities. Establishing an overall audit strategy- Assistance for the auditor. Development of audit plan. Documenting the overall audit strategy and audit plan; Audit program. Development of Audit Plan and Program.

3. Risk Assessment and Internal Control

Audit Risk, Risk of Material Misstatement, Inherent Risk and Control Risk, Detection Risk. Sampling and Non-Sampling Risk. Concept of Materiality, Materiality in Planning and Performing an Audit. Auditor's responsibility to apply the concept of materiality. Auditor's determination of materiality is a matter of professional judgement.

Materiality and Audit Risk. Application of materiality in planning and performing the audit. Concept of Performance materiality. Determining materiality and performance materiality when planning the audit. Use of Benchmarks in determining materiality for the financial statements as a whole. Materiality level or levels for particular classes of transactions, account balances or disclosures. Revision in materiality as the audit progresses. Documenting the Materiality. (SA 320 Materiality in Planning and Performing an Audit).

Identifying and Assessing the Risk of Material Misstatement, Risk Assessment procedures. Understanding the entity and its environment; Internal control, Documenting the Risks; Evaluation of internal control system; Testing of Internal control; Internal Control and IT Environment (SA 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment).

Digital Audit: Key features of an automated environment, Impact of IT related Risks, Impact on Controls, Internal Financial Controls as per Regulatory requirements, Types of Controls, Audit approach, Understanding and documenting Automated environment, Testing methods, data analytics for audit, assessing and reporting audit findings. Overview and Introduction - The Auditor's Responses to Assessed Risks-SA 330.

4. Audit Evidence

Meaning of Audit Evidence. Relevance and Reliability of audit evidence; Sufficient appropriate audit evidence, Meaning of Assertions. Assertions contained in the Financial Statements. Source of audit evidence; Test of

controls. Substantive Procedures- Test of details and Substantive analytical procedures, Audit procedures for obtaining audit evidence. Evaluation of Audit Evidence (SA 500 Audit Evidence).

Audit Trail.

(Using the work of Internal Auditors – SA 610). Internal audit function. External Auditor's Responsibility for the audit, Evaluating the internal audit function.

Basics of Internal Financial Control and reporting requirements. Distinction between Internal Financial Control and Internal Control over Financial Reporting.

Audit Sampling: (SA 530 Audit Sampling). Meaning of Audit Sampling; Designing an audit sample; Types of Sampling (Approaches to Sampling); Sample Size and selection of items for testing; Sample selection method.

Obtaining evidence of existence of inventory; Audit procedure to identify litigation & claims, obtaining evidence regarding the presentation and disclosure of segment information (SA 501 Audit Evidence - Specific Considerations for Selected Items); External confirmation procedures; Management's refusal to allow the auditor to send a confirmation request; Negative Confirmations (SA 505 External Confirmations); Audit evidence about opening balances; Accounting policies relating to opening balances; Reporting with regard to opening balances (SA 510 Initial Audit Engagements-Opening Balances); Meaning of Related Party; Nature of Related Party Relationships & Transactions; Understanding the Entity's Related Party Relationships & Transactions (SA 550 Related Parties);

Analytical Procedures: Meaning, nature, purpose and timing of analytical procedures; Substantive analytical procedures, Designing and performing analytical procedures prior to Audit; Investigating the results of analytical procedures (SA 520 Analytical Procedures).

5. Audit of Items of Financial Statements:

Audit of sale of Products and Services; Audit of Interest Income, Rental Income, Dividend Income, Net gain/loss on sale of Investments etc.

Audit of Purchases, Employee benefits expenses, Depreciation, Interest expense, Expenditure on Power & Fuel, Rent, Repair to building, Repair to Machinery, Insurance, Taxes, Travelling Expenses, Miscellaneous Expenses etc. Audit of Share Capital, Reserve & Surplus, Long Term Borrowings, Trade Payables, Provisions, Short Term Borrowings & Other Current Liabilities. Audit of Land, Buildings, Plant & Equipment, Furniture & Fixtures, Vehicles, Office Equipment, Goodwill, Brand/Trademarks, Computer Software etc. Audit of Loan & Advances, Trade Receivable, Inventories, Cash & Cash Equivalent, Other Current Assets. Audit of Contingent Liabilities. (The list of items is illustrative only).

6. Audit Documentation

Concept of Audit Documentation. Nature & Purpose of Audit Documentation; Form, Content & Extent of Audit Documentation. Completion Memorandum; Ownership and custody of Audit Documentation (SA 230 Audit Documentation).

7. Completion and Review

Meaning of Subsequent Events. Auditor's obligations in different situations of subsequent events. Procedures for subsequent events. (SA 560 Subsequent Events). Responsibilities of the Auditor with regard to Going Concern Assumption; Objectives of the Auditor regarding Going Concern. Events or Conditions that may cast doubt about Going Concern Assumption. Audit Procedures when events or conditions are identified (SA 570 Going Concern). Overview and Introduction of Evaluations of Misstatements identified during the audit (SA 450). Written Representations as Audit Evidence. Objective of Auditor regarding Written Representation. Management from whom Written Representations may be requested. Written Representations about Management's Responsibilities (SA 580 Written Representations);

Overview and Introduction of SA 260: Communication with Those Charged with Governance.

Overview and Introduction of SA 265 Communicating Deficiencies in Internal Control to Those Charged with Governance and Management.

8. **Audit Report:**

Forming an opinion on the Financial Statements. Auditor's Report- basic elements (SA 700 Forming an Opinion and Reporting on Financial Statements). Communicating key Audit Matters in the Independent Auditor's Report (SA 701) Types of Modified Opinion, Circumstances When a Modification to the Auditor's Opinion is Required, Qualified, Adverse, Disclaimer of Opinion (SA 705 Modification to the Opinion in the Independent Auditor's Report). SA 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report. Nature of Comparative Information. Corresponding Figure; Comparative Financial Statements (SA 710 Comparative Information – Corresponding Figures and Comparative Financial Statements). Branch audit; Joint audit; Reporting requirements under the Companies Act, 2013 including CARO;

9. **Special Features of Audit of Different Type of Entities**

Appointment of Auditor, Audit Procedure and Audit Report in respect of different Category of Entities: Government; Local bodies; Not-for-profit organizations; Trust and Societies, Partnership Firms, Audit of different type of undertakings, i.e., educational institutions, Hotels, Clubs, Hospitals etc. Basics of Limited Liability Partnerships (LLPs) audit and Co-operative Societies Audit.

10. **Audit of Banks**

Understanding of accounting system in Banks, Audit Approach, Audit of Revenue items, Special Consideration in Bank Audit with emphasis on Advances and NPAs.

11. **Ethics and Terms of Audit Engagements**

Meaning of Ethics; Ethics is a State of Mind, Need for Professional Ethics; Principles based approach v Rules based approach (Ethical or Legal)

The fundamental principles of Professional Ethics: Integrity; Objectivity; Professional Competence and Due care; Confidentiality; Professional Behaviour. Independence of Auditors. Threats to Independence: Self Interest threats; Self Review threats; Advocacy threats; Familiarity threats; Intimidation threats. Safeguards to Independence; Professional Skepticism, Terms of Audit Engagements Preconditions for an audit; Audit

Engagement. Agreement on Audit Engagement Terms. Terms of Engagement in Recurring Audits (SA 210 Agreeing the Terms of Audit Engagements).

Overview and Introduction of SQC 1 Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Services Engagements.

Overview and Introduction of SA 220 - Quality Control for an Audit of Financial Statements).

Note:

- (i) The specific inclusions/exclusions, in any topic covered in the syllabus, will be effected every year by way of Study Guidelines.
- (ii) If new legislations/ Standards on Auditing/Guidance Notes/Statements are enacted in place of the existing legislations/ Standards on Auditing/Guidance Notes/Statements, the syllabus would include the corresponding provisions of such new legislations/ Standards on Auditing/Guidance Notes/Statements with effect from a date notified by the Institute. The changes in this regard would also form part of Study Guidelines.

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