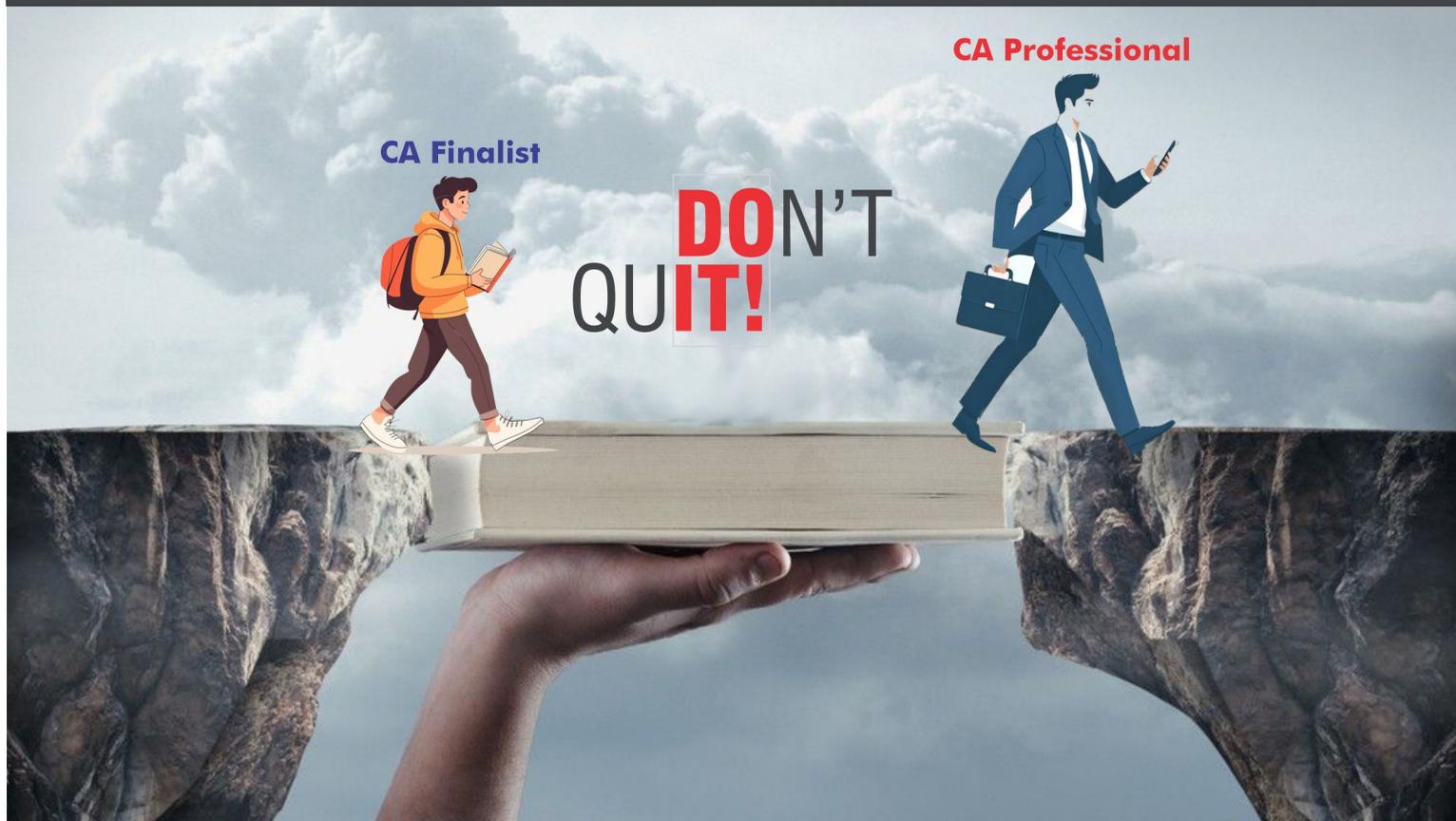


CA FINAL AUDIT

THEORY NOTES



**ADVANCED AUDITING, ASSURANCE
AND PROFESSIONAL ETHICS**

5TH EDITION

By India's Most Dynamic Faculty For Audit

CA AARTI LAHOTI

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MODES OF LEARNING : Pendrive / Google Drive / Face to Face / Livestream

CA FINAL

GROUP - I

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Right Concept. Right Practice. Right Result. — this simple philosophy forms the foundation of everything you will learn in this book.

Dear Students,

*It gives me immense pleasure to present **Module 1 – Theory Notes of Auditing for CA Final**, the first part of an integrated three-module learning system comprising*

Module I – Theory Notes,

Module II – Q & A Scanner, and

Module III – MCQ Compiler.

*CA Final Auditing is a subject that demands **depth of understanding, conceptual clarity and professional judgment**. This module has been designed as a **comprehensive, structured and authoritative reference** covering the entire syllabus in a clear, logical and professional manner. Emphasis has been placed on **interlinking of standards, audit procedures and practical relevance**, while retaining the depth expected at the Final level.*

*This module forms the **conceptual backbone** of your preparation and should be used in conjunction with **Module II – Q & A Scanner** for developing professional answer-writing skills and **Module III – MCQ Compiler** for strengthening accuracy and application.*

Regular and cumulative revisions of these notes are essential to build confidence and command over the subject.

I had the privilege of securing All India Rank 24 in the CA Final Examination held in November 2008.

*Auditing defines your identity as a Chartered Accountant, yet it is often feared as one of the most theoretical subjects at the CA Final level. With a structured approach to concepts, writing and revision, countless students have transformed Audit from a feared paper into their **most favourite subject**. These books, along with Regular, Fast Track and Marathon video lectures and continuous revision support on the Aarti Lahoti YouTube channel, are designed to help you approach Audit with clarity, confidence and a scoring mindset.*

“Much like SA 200 sets out the overall objective of the independent auditor, the overarching objective of Aarti Lahoti’s notes and classes has always been to make Audit logical, relatable and scoring, not intimidating.”

Wishing you disciplined preparation and professional excellence.

Happy Auditing!

Warm Regards,

CA Aarti Lahoti

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CA Aarti Lahoti Classes



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LIST OF IMPORTANT ABBREVIATIONS

| | |
|----------------|--|
| AFRF (SA 200) | APPLICABLE FINANCIAL REPORTING FRAMEWORK |
| FRF | FINANCIAL REPORTING FRAMEWORK |
| GPF | GENERAL PURPOSE FRAMEWORK |
| SPF (SA 800) | SPECIAL PURPOSE FRAMEWORK |
| RMM (SA 200) | RISKS OF MATERIAL MISSTATEMENT |
| SAAE (SA 200) | SUFFICIENT APPROPRIATE AUDIT EVIDENCE |
| TCWG (SA 260) | THOSE CHARGED WITH GOVERNANCE |
| MGMT | MANAGEMENT |
| WR (SA 580) | WRITTEN REPRESENTATIONS |
| FI | FINANCIAL INFORMATION |
| HFI | HISTORICAL FINANCIAL INFORMATION |
| IFI (SRE 2410) | INTERIM FINANCIAL INFORMATION |

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|-----------------------|-----------------------------------|
| PFI (SAE 3400) | PROSPECTIVE FINANCIAL INFORMATION |
| PFFI (SAE 3420) | PRO FORMA FINANCIAL INFORMATION |
| FS | FINANCIAL STATEMENTS |
| AFS | AUDITED FINANCIAL STATEMENTS |
| CFS | CONSOLIDATED FINANCIAL STATEMENTS |
| SFS (SA 810) | SUMMARY FINANCIAL STATEMENTS |
| SGFS | SINGLE FINANCIAL STATEMENT |
| CG | CENTRAL GOVERNMENT |
| NTE | NATURE, TIMING & EXTENT |
| EP (SQC 1 & SA 220) | ENGAGEMENT PARTNER |
| EQCR (SQC 1 & SA 220) | ENGAGEMENT QUALITY CONTROL REVIEW |
| KAM (SA 701) | KEY AUDIT MATTERS |
| EOM (SA 706) | EMPHASIS OF MATTER |
| OM (SA 706) | OTHER MATTER |

3

IMPORTANT TERMS

| | | |
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| 1. | Historical financial information | <ul style="list-style-type: none"> Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past. |
| 2. | Financial Statements | <ul style="list-style-type: none"> A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies & other explanatory information. The term "financial statements" ordinarily refers to a complete set of FS as determined by the requirements of the AFRF, but can also refer to a single financial statement. |
| 3. | Applicable Financial Reporting Framework | <ul style="list-style-type: none"> The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation & presentation of the FS that is acceptable in view of the nature of the entity & the objective of the FS, or that is required by law or regulation. The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework &: <ul style="list-style-type: none"> (i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the FS, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or (ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the FS. Such departures are expected to be necessary only in extremely rare circumstances. The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above. |
| 4. | Auditor | <ul style="list-style-type: none"> "Auditor" is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. Where an SA expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "auditor" is used. "Engagement partner" & "firm" are to be read as referring to their public sector equivalents where relevant. |

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| 5. | Management | <ul style="list-style-type: none"> ▶ The person(s) with executive responsibility for the conduct of the entity's operations. ▶ For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager. |
| 6. | Those Charged With Governance | <ul style="list-style-type: none"> ▶ The persons or organisations (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity & obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager. |
| 7. | Internal Control System | <ul style="list-style-type: none"> ▶ The process designed, implemented & maintained by TCWG, management & other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness & efficiency of operations, safeguarding of assets, & compliance with applicable laws & regulations. ▶ "Internal Control System" means all the policies & procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly & efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention & detection of fraud & error, the accuracy & completeness of the accounting records, & the timely preparation of reliable financial information. |
| 8. | Premise | <ul style="list-style-type: none"> ▶ Premise, relating to the responsibilities of management &, where appropriate, those charged with governance, on which an audit is conducted – That management &, where appropriate, TCWG have the following responsibilities that are fundamental to the conduct of an audit in accordance with SAs. That is, responsibility: <ul style="list-style-type: none"> (i) For the preparation & presentation of the FS in accordance with the AFRF; this includes the design, implementation & maintenance of internal control relevant to the preparation & presentation of FS that are free from material misstatement, whether due to fraud or error; & (ii) To provide the auditor with: <ul style="list-style-type: none"> (a) All information, such as records & documentation, & other matters that are relevant to the preparation & presentation of the FS; (b) Any additional information that the auditor may request from management &, where appropriate, TCWG; & (c) Unrestricted access to those within the entity from whom the auditor determines it necessary to obtain audit evidence. ▶ In the case of a fair presentation framework, the responsibility is for the preparation & fair presentation of the FS in accordance with the financial reporting framework; or the preparation of FS that give a true & fair view in accordance with the financial reporting framework. This applies to all references to "preparation & presentation of the FS" in the SAs. ▶ The "premise, relating to the responsibilities of management &, where appropriate, TCWG, on which an audit is conducted" may also be referred to as the "premise". |
| 9. | Overall Objectives of the Auditor | <ul style="list-style-type: none"> ▶ In conducting an audit of FS, the overall objectives of the auditor are: <ul style="list-style-type: none"> (a) To obtain reasonable assurance about whether the FS as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the FS are prepared, in all material respects, in accordance with an Applicable Financial Reporting Framework; & (b) To report on the FS, & communicate as required by the SAs, in accordance with the auditor's findings. |
| 10. | Reasonable assurance | <ul style="list-style-type: none"> ▶ In the context of an audit of financial statements, a high, but not absolute, level of assurance. |
| 11. | Professional judgment | <ul style="list-style-type: none"> ▶ The application of relevant training, knowledge & experience, within the context |

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| | | provided by auditing, accounting & ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement. |
| 12. | Professional skepticism | <ul style="list-style-type: none"> An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, & a critical assessment of audit evidence. |
| 13. | Assertions | <ul style="list-style-type: none"> Representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur. |
| 14. | Misstatement | <ul style="list-style-type: none"> A difference between the amount, classification, presentation, or disclosure of a reported financial statement item & the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the AFRF. Misstatements can arise from error or fraud. When the auditor expresses an opinion on whether the FS are presented fairly, in all material respects, or give a true & fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgment, are necessary for the FS to be presented fairly, in all material respects, or to give a true & fair view. |
| 15. | Business Risk | <ul style="list-style-type: none"> A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives & execute its strategies, or from the setting of inappropriate objectives & strategies. |
| 16. | Audit Risk | <ul style="list-style-type: none"> The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement & detection risk. |
| 17. | Risk of Material Misstatement | <ul style="list-style-type: none"> The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level: Inherent Risk & Control Risk. |
| 18. | Significant Risk | <ul style="list-style-type: none"> An identified & assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration. |
| 19. | Inherent Risk | <ul style="list-style-type: none"> The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls. |
| 20. | Control Risk | <ul style="list-style-type: none"> The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure & that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected & corrected, on a timely basis by the entity's internal control. |
| 21. | Detection Risk | <ul style="list-style-type: none"> The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists & that could be material, either individually or when aggregated with other misstatements. |
| 22. | Audit Evidence | <ul style="list-style-type: none"> Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the FS & other information. For purposes of the SAs: <ul style="list-style-type: none"> (i) Sufficiency of audit evidence is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement & also by the quality of such audit evidence. (ii) Appropriateness of audit evidence is the measure of the quality of audit evidence; that is, its relevance & its reliability in providing support for the conclusions on which the auditor's opinion is based. |
| 23. | 7 Methods of Obtaining Audit Evidence | Inspection <ul style="list-style-type: none"> Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. |
| | | External <ul style="list-style-type: none"> An external confirmation represents audit evidence obtained by |